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## Internationalization of the Korean Securities Market

Joon Park

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## INTRODUCTION

### A. Background

As the global economy has become increasingly interdependent and as technology in computers and telecommunications has progressed, there has been a parallel global trend of internationalization in securities and equities markets.<sup>1</sup> Increasing numbers of corporations are crossing their national boundaries to offer and sell their securities,<sup>2</sup> and investors are thus experiencing a significant increase in the availability of securities issued by foreign issuers.<sup>3</sup> Similarly, major securities offerors are no longer limiting themselves to

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† Member, Kim & Chang, Seoul, Korea; LL.M. Harvard Law School, 1988; L.L.B. Seoul National University, 1977. Mr. Park is currently participating in the Foreign Lawyers Program at Sullivan & Cromwell in New York City.

1. Although commentators have given different emphasis to a number of factors, reasons for the trend toward the internationalization or globalization of the securities markets include the following: the greater volatility of exchange rates, the high level of interest rates, the greater volatility of interest rates, the technological progress in computers and telecommunications, the institutionalization of the securities markets, the development of a wide variety of innovations in financial instruments, and the degree of regulation of securities transactions. See Debs, *The Development of International Equity Markets*, 4 B.U. INT'L L.J. 5, 5-7 (1986); Debs, *Globalization of Financial Markets: 'What is Happening and Why'*, 15 INT'L BUS. LAW. 198, 198-199 (1987); Shopkorn, *Global Trading: The Current and Future Impact on United States Markets and United States Portfolio Managers*, 4 B.U. INT'L. L.J. 25, 26 (1986); Gruson, *The Global Securities Market: Introductory Remarks*, COLUM. BUS. L. REV. 303, 304 (1987).

2. As of December 1986, securities of 512 foreign issuers were listed on the London Stock Exchange, 59 foreign companies were listed on the New York Stock Exchange, 52 foreign companies were listed on the Tokyo Stock Exchange, and 270 foreign securities including those in the form of American Depositary Receipts [hereinafter ADRs], were quoted in the NASDAQ. STAFF OF THE UNITED STATES SECURITIES AND EXCHANGE COMM'N, REPORT TO THE SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS AND THE HOUSE COMM. ON ENERGY AND COMMERCE ON THE INTERNATIONALIZATION OF THE SECURITIES MARKETS, II-64 to 65 (1987) [hereinafter SEC STAFF REPORT] (report on file in the offices of *International Tax & Business Lawyer*). American Depositary Receipts are documents which are usually created by a bank rather than by the company which originally issued the shares. The original shares remain with the bank, while the ADR's, not the share certificates, circulate as bearer documents. Becker, *Global Securities Markets*, 6 INT'L. TAX & BUS. LAW., 242, 244 n.2 (1988).

3. For example, U.S. purchases of foreign stocks has increased from \$1.7 billion in 1975 to \$51.7 billion in 1986. *Id.* at II-73.

transactions only within the capital market of their own countries, but are reaching toward financial centers around the world.<sup>4</sup>

This trend toward internationalization is viewed as a positive development, promoting the free flow of capital and efficiently allocating limited resources.<sup>5</sup> Whether such a trend will continue depends to a large extent upon the willingness of individual nations to share their resources and upon their perception of the benefits of internationalization.<sup>6</sup>

Until recently, the Korean government had not considered opening up its securities market, and foreign investors themselves paid little attention to the Korean securities market. However, a worldwide trend toward open-door economic policies was taking place, and the Korean government recognized the importance of opening its securities market in order to diversify foreign capital sources, and improve the functioning of the securities market in Korea's economy.<sup>7</sup> To this end, on January 14, 1981, the Korean government announced that it would gradually open up its securities market to foreigners through a four-step internationalization plan.<sup>8</sup>

The Korean government has successfully implemented the first two steps and part of the third step of the four-step plan.<sup>9</sup> Foreign investors are now permitted to make investments in the securities market of Korea through any of the following three channels: (i) seven investment trust funds established exclusively for foreign investors and are managed by Korean investment trust companies; (ii) two investment companies, one established in the United States (The Korea Fund) and the other in Europe (The Korea-Europe Fund); and (iii) convertible bonds currently issued by five Korean companies.<sup>10</sup> The resolute policy of the Korean government to internationalize its securities market,<sup>11</sup> combined with the outstanding growth of the Korean economy, accelerated participation by domestic as well as foreign investors in the Korean securities market. As a result, the Korean securities market has under-

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4. See Request for Comments on Issues Concerning Internationalization of the World Securities Markets, Securities Act Release No. 21,958, 50 Fed. Reg. 16,302, 16,304 (Apr. 18, 1985).

5. Thomas, *Extraterritoriality in an Era of Internationalization of the Securities Markets: The Need to Revisit Domestic Policies*, 5 RUTGERS L. REV. 453, 454 (1983) [hereinafter Thomas, *Extraterritoriality*]; see also Gruson, *supra* note 1, at 306. With respect to the benefits and risks to American investors from foreign companies entering the American securities market, see Thomas, *Internationalization of the Securities Markets: An Empirical Analysis*, 50 GEO. WASH. L. REV. 155, 167-174 (1982) [hereinafter Thomas, *Empirical Analysis*].

6. Thomas, *Extraterritoriality*, *supra* note 5, at 454.

7. See KOREAN SECURITIES AND EXCHANGE COMM'N, THE KOREAN SECURITIES MARKET AND ITS INTERNATIONALIZATION 17-18 (1987) [hereinafter KSEC, INTERNATIONALIZATION].

8. See *infra* Part II.B.1.

9. For a detailed description of the development of the internationalization of the Korean securities market, see *infra* notes 38-42 and accompanying text.

10. See *infra* notes 39-41 and accompanying text.

11. KSEC, INTERNATIONALIZATION, *supra* note 7, at 32.

gone very rapid growth over the past three years.<sup>12</sup>

### B. Purpose and Scope of Article

The securities market in Korea will continue its internationalization in sync with the internationalization and development of its economy. In the next stage, foreign investors will be allowed to make direct portfolio investments in the Korean securities market without restriction. In the fourth and final stage, the plan will allow the outflow of capital through portfolio investments by Korean investors in foreign securities.

The expanding internationalization of the Korean securities market will raise a number of legal issues which are insufficiently addressed under the current Korean laws. Most of the issues will arise in connection with foreign investment laws, securities regulations, corporate laws, and tax laws. Among those areas, this article will focus on the aspect of securities regulation. However, because issues governed by other areas of law require consistent attention, the securities regulation aspects of other legal areas will also be considered where necessary. In discussing the internationalization of the securities market, the focus will be on equity instruments rather than debt instruments.

Part I of this article briefly describes securities regulations in Korea and then reviews the four-step plan for the internationalization of its securities market and the status of that internationalization. It then examines the current laws and regulations of Korea with respect to international securities transactions and concludes that Korea needs to further develop its laws and regulations in order to cope with the internationalization of its securities market.

12. The following figures illustrate the rapid growth of the Korean stock market:

	'84	'85	'86	'87
Composite Stock Price Index (end of year)	142.46	163.37	272.61	525.11
Trading Volume (mil. shares)	4350.3	5563.8	9275.9	5942.9*
Market Capitalization (bil. Won)	5148.5	6570.4	11994.2	26172.1
(bil. dollars)	6.2	7.4	13.9	32.7
Sales Value (bil. Won)	3118.2	3620.6	9598.1	20493.9
(bil. US\$)	3.8	4.1	11.1	25.6

Source: KSEC, INTERNATIONALIZATION, *supra* note 7, at 11-12; KOREAN SECURITIES SUPERVISORY BOARD, MONTHLY REVIEW (Jan. 1988).

\*The volume of shares traded in 1987 was lower because an amendment to the Korean Commercial Code became effective on Sept. 1 of that year. This amendment raised the minimum par value of a share of stock from 500 Won to 5,000 Won, resulting in a large number of reverse stock splits, and fewer actual shares on the market. The ratio of shares traded in 1986 and 1987, when put into comparable terms, would be 993.3 to 1655.5. Commercial Code, Law No. 1000 of Jan. 20, 1962, as last amended by Law No. 3724 of Apr. 10, 1984, art. 329, para. 4, effective Sept. 1, 1987.

Part II examines the regulation of distribution of securities in Korea from the perspective of an internationalized securities market. Current regulations regarding registration procedure, disclosure requirements, and civil liabilities for the distribution of securities are then reviewed. Finally, it notes potential problems in the current laws and regulations and concludes that stricter rules are necessary for the protection of investors.

Part III examines the regulation of securities trading. The first two sections deal with the regulatory mechanism for the maintenance of market integrity through anti-fraud rules and insider trading regulations. Both the substantive and procedural aspects of these rules in Korea are reviewed. With respect to the international enforcement of such rules, the second section juxtaposes the expansion of the territorial reach of domestic regulations against the recent developments in international cooperation in this area. Noting the inadequacy of the substantive provisions of anti-fraud rules, the first two sections point out the necessity of international arrangements with major counterpart countries, as well as strengthening the investigative power of Korea's securities regulatory authority. The final section of Part III discusses the clearing and settlement regulations of Korea, and reviews the international clearing linkages.

Part IV reviews the current regulation of foreign broker-dealers and notes the problems in this area.

Part V begins with a discussion concerning a formation of basic policies in connection with the internationalization. This part emphasizes the fundamental objectives of securities laws in a global context, which are to protect investors and maintain the market integrity while pursuing the facilitation of internationalization. The part then offers proposals to cope with the problems discussed in Parts II, III, and IV.

## I.

### CURRENT REGULATORY MECHANISMS IN KOREA WITH RESPECT TO INTERNATIONAL SECURITIES TRANSACTIONS

#### A. *General Description of the Securities Regulations of Korea*

##### 1. *Governing Laws*

##### a. *Securities and Exchange Act*

The basic body of Korean securities law is contained in the Securities and Exchange Act [hereinafter KSEA],<sup>13</sup> in the Enforcement Decree,<sup>14</sup> and

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13. Securities and Exchange Act, Law No. 972 of Jan. 15, 1962, as last amended by Law No. 3945 of Nov. 28, 1987 [hereinafter KSEA].

14. Presidential Decree No. 618 of Mar. 30, 1962, as last amended by Presidential Decree No. 12352 of Dec. 31, 1987 [hereinafter KSEA Enforcement Decree].

in the Enforcement Regulation thereunder.<sup>15</sup> Although securities transactions have existed in Korea since the beginning of the twentieth century, Korea did not have its own securities law until 1962.<sup>16</sup> In 1962, the Korean government recognized the importance of a broader securities market as a means of mobilizing savings for productive investment. To strengthen the capital base of the Korean industry and to create a healthy investment climate, the KSEA was enacted.<sup>17</sup> It was influenced by the modern Japanese Securities Exchange Act, which in turn was based upon the federal securities laws of the United States.<sup>18</sup>

Responding to the development of the securities market and to the economy in general, the KSEA has been amended nine times since its inception.<sup>19</sup> The KSEA currently consists of twelve chapters. The first chapter defines the various terms used in the KSEA. Chapters 2 and 3 deal with the primary securities market and provide for the disclosure of relevant information and liabilities. Chapter 4 deals with tender offers. Chapters 5 and 5-2 deal with the regulation of securities companies and investment advisers, respectively. Chapter 6 regulates the Korean Stock Exchange [hereinafter KSE] and trading in securities, and deals with periodic disclosure requirements. Chapter 7 delineates the authority and responsibilities of the Securities and Exchange

15. Ministry of Finance Regulation No. 257 of May 30, 1962, as amended [hereinafter KSEA Enforcement Regulation].

16. The first securities transactions in Korea are believed to have taken place around 1906, and the first organized securities market came into being in 1911 during the Japanese occupation. In 1956, an independently organized securities market opened in Korea. See THE KOREAN STOCK EXCHANGE, THIRTY YEAR HISTORY OF THE KOREAN STOCK EXCHANGE (CHEUNGKwon GEORAESO SAMSIB-NYUN-SA) 8-19 (1986) [hereinafter KSE, HISTORY].

17. See Y. SHIN, SECURITIES REGULATIONS IN KOREA 15-17 (1983).

18. *Id.* at 16.

19. Of those amendments, the last three, which were made in 1976, 1982 and 1987, respectively, are noteworthy in connection with the internationalization of the securities market.

The 1976 amendments were designed to: (i) strengthen the securities market as an instrument of the mobilization of long-term financing, (ii) ensure fair dealing, (iii) strengthen the protection of investors through continuing control of the listed companies, and (iv) reorganize the regulatory structure. For such purposes, the KSEA was redrafted in its entirety by the 1976 amendments. The amendments included: (i) restrictions on ownership increases, tender offers and proxy solicitations, (ii) requirements for the registration of prospective issuers, (iii) restrictions on short-swing transactions, (iv) the establishment of the KSEC and the Korean Securities Advisory Board [hereinafter KSSB], and (v) the reorganization of the KSE.

The 1982 amendments were designed, among others, to reflect the government policy regarding the internationalization of the securities market as announced in 1981 and to prepare for the forthcoming internationalization of the securities market. The amendments included: (i) the insertion of new provisions regulating the business activities of foreign securities companies in Korea, see *infra* Parts I.B.2.a.ii., IV.B., and (ii) more detailed restrictions on acquisitions by foreign investors of securities in Korea, see *infra* Part I.B.2.a.i. The amendments also covered the provisions relating to the disclosure requirements, the regulation of insider trading and unfair transactions, and the appraisal rights of shareholders.

The KSEA was amended again on November 28, 1987, effective as of January 1, 1988, to promote the growth of the securities market and reflect the recent development in the internationalization of the securities market. The amendments included the insertion of new provisions regarding investment advisers, the strengthening of disclosure requirements, and the expansion of the scope of insider trading regulated by the KSEA. See *infra* Part III.A.2.

Commission [hereinafter KSEC] and the Securities Supervisory Board [hereinafter KSSB].<sup>20</sup> Chapter 8 regulates various securities related institutions such as the Korean Securities Finance Corporation [hereinafter KSFC], the Korean Securities Dealers Association [hereinafter KSDA], and the Korean Securities Clearing Corporation [hereinafter KSCC]. Chapter 9 addresses the regulation of listed companies. Chapter 10 regulates proxy solicitation, increases in shareholdings in general, and shareholding by foreigners. The last chapter deals with miscellaneous matters and criminal liabilities.

As briefly described above, the KSEA is designed to cover both the primary and secondary markets and almost all other legal issues relating to securities transactions.

*b. The Capital Market Promotion Act*

The Capital Market Promotion Act [hereinafter CMPA]<sup>21</sup> was enacted in 1968. Its purpose is to promote a sound capital market by creating an investment climate that encourages public offerings and the wide distribution of shares as well as public participation in enterprises and capital fund raising.<sup>22</sup> The CMPA authorizes the KSEC to recommend that companies which satisfy certain criteria go public.<sup>23</sup> The CMPA also grants incentives for going public. For example, the CMPA provides for a higher ceiling on the amount of debentures and the number of non-voting shares which may be issued under the Commercial Code.<sup>24</sup> To encourage a wide distribution of shares, the CMPA compels a listed company to grant its employees a right to subscribe up to ten percent (which has been raised to twenty percent by the 1987 amendments) of newly issued shares notwithstanding the statutory preemptive rights of existing shareholders.<sup>25</sup>

*c. Others*

Investment trust companies are regulated by a separate statute — the Securities Investment Trust Business Act.<sup>26</sup> Since a securities transaction is a commercial transaction under the Commercial Code, it is also governed by the Commercial Code,<sup>27</sup> particularly by the provisions regarding joint-stock companies. Finally, although it does not fall within the scope of securities laws, international securities transactions are also governed by the Foreign

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20. For further discussion of the KSEC and the KSSB, see Part I.A.2. below.

21. Capital Market Promotion Act, Law No. 2046 of Nov. 22, 1968, as amended [hereinafter CMPA].

22. *Id.* art. 1.

23. *Id.* art. 3.

24. *Id.* arts. 7-11, 22-24.

25. *Id.* art. 17. This is viewed in effect as a form of stock option plan. See Y. SHIN, *supra* note 17, at 46.

26. Securities Investment Trust Business Act, Law No. 2129 of Aug. 4, 1969, as amended.

27. Commercial Code, Law No. 1000 of Jan. 20, 1962, as amended.

Exchange Control Act [hereinafter FECA]<sup>28</sup> as a kind of cross-border transaction involving foreign exchange.

## 2. Governing Agencies and Related Institutions

Under the current KSEA, the Ministry of Finance [hereinafter MOF] has the highest authority to make policy decisions regarding the securities market and to supervise securities-related institutions. The MOF has the authority to supervise the KSEC, the KSSB, and the KSE.<sup>29</sup>

Although subject to the supervisory authority of the MOF, the KSEC has relatively broad authority to make policy decisions regarding the securities market and is responsible for the administration of the KSEA. Unlike the Securities and Exchange Commission of the United States [hereinafter SEC], however, the KSEC does not constitute an independent, quasi-judicial agency.<sup>30</sup> The KSSB functions as the executive body of the KSEC.<sup>31</sup> Based upon the above-described authority, the KSEC and the KSSB have issued various regulations and guidelines related to the securities market.

The KSE is a juridical entity established by the KSEA.<sup>32</sup> The KSE is the only stock exchange in Korea, with a single trading floor located in Seoul. The KSE is responsible for listings and trading on the exchange and for the control of its member firms.<sup>33</sup> Although, by virtue of the 1987 amendments to the KSEA, the KSE became an autonomous entity operated by its members, the MOF and the KSEC retained wide authority to supervise the KSE, and are thereby able to affect its policy and direction.<sup>34</sup>

28. Foreign Exchange Control Act, Law No. 933 of Dec. 31, 1961, as last amended by Law No. 1920 of Mar. 30, 1967 [hereinafter FECA].

29. The MOF may order the KSEC to take such action as it deems necessary for the public interest or investor protection. KSEA, *supra* note 13, art. 126(3). Upon adopting a resolution, the KSEC must report to the MOF. If the MOF deems a resolution of the KSEC to be illegal or extremely inappropriate in view of the public interest or investor protection, the MOF may revoke the resolution or suspend the enforcement thereof. *Id.* arts. 126(1)-(2). The MOF also has comprehensive power to order the KSSB to take necessary action in light of the activities or the financial status of the KSSB. *Id.* art. 142.

30. See Y. SHIN, *supra* note 17, at 97; M. AHN, SECURITIES REGULATIONS (CHEUNG-KWON GEORAE-BEOB CHE-GYE) 112 (1985).

31. KSEA, *supra* note 13, art. 130(1).

32. *Id.* art. 71(2). Prior to early 1988, the Korean government owned 68.1% of the shares issued by the KSE and the member firms owned the remaining 31.9%. Amendments to the KSEA made on December 31, 1987, required the government to sell its shares in the KSE to the twenty-five member firms by March 31, 1988.

33. *Id.* arts. 88(2)-(3), 74(1)-(2).

34. For example, KSEA Articles 74(2) and 78(2) require MOF approval to amend the Articles of Incorporation of the KSE, and to appoint the President of the KSE. Article 77(3) of the KSEA requires the KSE to report to the MOF the resolutions adopted by its general members' meeting. With certain exceptions, listing and delisting requires KSEC approval. KSEA, *supra* note 13, arts. 88(1), 89.

In addition to the above mentioned major agencies, the Korea Securities Dealers Association, the Korea Securities Finance Corporation, and the Korea Securities Clearing Corporation also play an important role in the securities market.

### B. Regulation of International Securities Transactions

#### 1. Four-Step Plan for Internationalization of the Korean Securities Market

Until 1980, international securities transactions involving securities in Korea or investors from Korea were virtually prohibited.<sup>35</sup> Then on January 14, 1981, the Korean government announced its plan to open up its securities market to foreign investors and issuers.

The plan was designed: (i) to effectively adapt to the worldwide trend toward an open-door economic system, (ii) to diversify the country's foreign capital sources, and (iii) to improve the function of Korea's securities market in its economy.<sup>36</sup>

The plan consists of four stages.<sup>37</sup> The first stage was intended to last until 1984. During that stage: (i) the restricted establishment of international trust funds would be permitted, (ii) the establishment of a representative office by foreign securities companies would be permitted, and (iii) personnel for securities institutions would be trained to prepare for the process of internationalization.

During the second stage, which was planned to take place around 1985, direct investment by foreign investors in the Korean securities market would be restrictively permitted.

The third stage was planned to take place during the latter half of the 1980's. During that stage, foreign investors would be permitted to invest directly in the Korean securities market without restriction, and domestic companies would be permitted to issue securities outside Korea.

During the fourth and final stage, which was planned to take place during the first half of the 1990's, capital outflow would be permitted, such that foreign issuers would be permitted to issue securities in the Korean securities market.

The Korean government has, for the most part, opened up its securities market in accordance with the above-described four-step plan.<sup>38</sup> The first

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35. An exception lies in those investments made by the establishment of a joint venture or of a subsidiary which is also subject to governmental approval.

36. See KSEC, INTERNATIONALIZATION, *supra* note 7, at 17-19; Lee, *Internationalization of the Korean Capital Market*, 9 U. PA. J. INT'L. BUS. L. 703, 703-04 (1987).

37. See KSEC, INTERNATIONALIZATION, *supra* note 7, at 19; Lee, *supra* note 36, at 709; Y. SHIN, *supra* note 17, at 425.

38. For a more detailed description, see KSEC, INTERNATIONALIZATION, *supra* note 7, at 20-28; Lee, *supra* note 36, at 704-08; Euh, *Internationalization of Korea's Capital Market*, 9 E. ASIAN EXECUTIVE REP. 16 (Aug. 1987).

two steps and part of the third step have been implemented in the following forms: (i) securities investment trusts managed by Korean securities investment companies exclusively for the purpose of investment by nonresident foreign investors in Korea's securities market;<sup>39</sup> (ii) investment companies incorporated outside Korea;<sup>40</sup> (iii) issuance by Korean companies of convertible bonds in the Eurodollar market;<sup>41</sup> and (iv) establishment by foreign securities firms of representative offices in Korea.<sup>42</sup>

At the present time, foreign investors are permitted to invest in the market only indirectly through mutual funds or convertible bonds, although foreign securities firms are permitted to establish representative offices in Korea.<sup>43</sup> The next stage will be characterized by unrestricted capital inflow through portfolio investment by foreign investors in Korea's securities market. Korean investors will finally be permitted to invest in foreign securities, and foreign issuers will be permitted to issue securities in Korea.

## 2. *Current Laws and Regulations Regarding International Securities Transactions*

International securities transactions involving Korean securities or investors are currently governed by the KSEA and the FECA.<sup>44</sup> The purpose of the KSEA in this regard is to eliminate or minimize the disruption of the

39. As the first step of the plan, two securities investment trusts were established by Korean securities investment trust companies in 1981 for nonresident foreign investors, each in the amount of \$15 million. (The amount of each fund was increased in 1983 by \$10 million.) In 1985 and 1986 three additional securities investment trusts and two venture capital funds managed by Korean domestic securities investment companies were authorized by the Korean government and raised a total of \$95 million. *Lee, supra* note 36, at 710.

40. In August 1984, The Korea Fund, Inc. was incorporated in the United States as an investment company and raised \$60 million mainly from U.S. residents for the purpose of investing in Korean securities. The amount raised by The Korea Fund, Inc. rose to \$100 million in 1986. In April 1987, the Korea-Europe Fund Limited was incorporated in Guernsey, England, and raised \$30 million, which increased to \$60 million in July, 1988. *Id.* at 705, 711.

41. Since December 1985, five private companies have been permitted by the Korean authorities to issue convertible bonds in the Eurodollar market in a total amount of \$140 million. Under the terms and conditions of the first four of these convertible bond issues, the bonds can be converted into shares from the later of: (i) the date eighteen months after the issuance (which is, in the case of the first convertible bond issue, October 19, 1987), or (ii) the date on which the Korean government permits the purchase, holding and transfer by foreign investors of shares of Korean companies. Since the Korean government has not yet permitted direct portfolio investment by foreign investors in Korean shares, the holders cannot exercise their conversion rights at the present time. On December 1, 1987, the Korean government announced that even before it takes an action to completely permit foreign investors to invest directly in the Korean securities market, it will permit the conversion of convertible bonds into shares pursuant to such terms and conditions of the bonds as will be amended by a negotiation between the relevant parties.

42. *See infra* note 56 and accompanying text.

43. *See infra* note 59 and accompanying text.

44. The investments by foreigners in Korea for the purpose of participation in management of the subject company are governed by the Foreign Capital Inducement Act, Law No. 3691 of Dec. 31, 1983 [hereinafter FCIA].

securities market which may take place due to foreign investment in and control of the securities market.<sup>45</sup> The purpose of the FECA is to regulate the inflow or outflow of foreign exchange.<sup>46</sup>

a. *Regulation under the KSEA*

The KSEA has two sets of special provisions with respect to international securities transactions. One is related to the acquisition by foreign investors of Korean securities,<sup>47</sup> while the other is related to the business activities by foreign securities companies in Korea.<sup>48</sup> Other than these two provisions, the KSEA does not treat foreign investors, foreign securities, or foreign securities companies differently than their Korean counterparts.

i. *Regulation of foreign acquisition of Korean securities*

Article 203(1) of the KSEA provides that “[a]cquisition of securities by foreigners or foreign juridical persons<sup>49</sup> may be restricted by the provisions of the Presidential Decree.”<sup>50</sup> A foreigner who has acquired a Korean security in violation of this provision may not exercise his voting rights, and the KSEC may issue an order to rectify the situation.<sup>51</sup>

This provision is explicated in Article 87-2 of the Enforcement Decree of the KSEA. Under that article, the KSEC is authorized to impose necessary restrictions on the types of securities which may be acquired by a foreigner and on the maximum amount of securities of a particular industry or issue which a foreigner may acquire. The article further provides that a sale or purchase by a foreigner of listed securities shall be made through the KSE unless otherwise approved by the KSEC. When a foreigner sells or purchases listed securities through the KSE, a securities company acting as his broker must report this to the KSEC.<sup>52</sup>

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45. See M. AHN, *supra* note 30, at 473.

46. FECA, *supra* note 28, art. 1.

47. KSEA, *supra* note 13, art. 203; KSEA Enforcement Decree, *supra* note 14, art. 87-2.

48. See KSEA, *supra* note 13, art. 28-2; KSEA Enforcement Decree, *supra* note 14, arts. 17-2, 18-3, 28-2.

49. “Foreigners or foreign juridical persons” include not only individuals who have foreign nationality and companies incorporated under the laws of a foreign country, but also companies incorporated under the laws of Korea if the majority of the outstanding shares are owned by, or it is otherwise controlled by, a foreigner(s) or a foreign juridical person(s). KSEA Enforcement Decree, *supra* note 14, art. 87-2(1).

50. The acquisition by foreigners of shares issued by certain key industry companies may be further restricted as provided in the Articles of Incorporation of the relevant company. KSEA, *supra* note 13, art. 203. This provision was inserted by the 1987 amendments and the scope of the key industry is determined by the MOF after consultation with other competent ministries. One of the criteria in becoming a key industry is thirty percent or higher ownership by the Korean government. KSEA, *supra* note 13, art. 199(2); KSEA Enforcement Decree, *supra* note 14, art. 85-2.

51. KSEA, *supra* note 13, art. 203.

52. KSEA Enforcement Decree, *supra* note 14, art. 87-2(3).

Based upon the above provisions of the KSEA and the Enforcement Decree thereunder, the KSEC issued two regulations. The first regulation is the Rules on Securities Transactions by Foreign Investment Companies of August 24, 1984, as amended, which is designed to regulate the investment by The Korea Fund, Inc.<sup>53</sup>

The second regulation is the Rules on Administration of the Issue of Overseas Securities by Listed Corporations of November 12, 1985, as amended [hereinafter KSEC Rule], which is designed to regulate the issuance by a Korean listed corporation of convertible bonds, depositary receipts, and other types of equity instruments in overseas markets.<sup>54</sup>

Aside from the two above-mentioned regulations, the KSEC has not issued any rule or guideline generally regulating securities transactions by foreigners. Generally speaking, this is because securities transactions by nonresident foreigners are not permitted under the FECA.<sup>55</sup>

## ii. Regulation of business activities of foreign securities firms in Korea

Under the KSEA, a license from the MOF is required to engage in the securities business in Korea.<sup>56</sup> In the same context, a foreign securities firm must obtain the approval of the MOF in order to establish a branch office for the purpose of engaging in the securities business.<sup>57</sup> As more extensively discussed in Part IV.A. below, once duly licensed, a foreign securities firm may engage in the business specified in the MOF license.<sup>58</sup>

On the other hand, in order to establish a representative office in Korea for the purpose of collecting information and data, in contrast to the operation of a securities business, a foreign securities firm is required to submit a report to the MOF.<sup>59</sup> Notwithstanding the difference of expression in the two above-mentioned provisions (approval and report), as a practical matter, the report to establish a representative office is not automatically accepted by the MOF. Thus, there is no significant difference between the report

53. These rules impose certain restrictions on transactions by a foreign investment company, such as the Korea Fund, Inc. or the Korea-Europe Fund Limited. For example, a foreign investment company may not acquire securities of an industry in excess of twenty-five percent of the total net worth of such investment company, nor acquire more than the limit approved by the MOF, which limit may not exceed five percent of the issued and outstanding shares of an issue. In addition, the total number of shares of an issue held by foreigners may not exceed ten percent of the issued and outstanding shares of such issue. With certain minor exceptions, unless otherwise approved by the KSEC, a foreign investment company must make their securities transactions only through the KSE and deposit the securities held by it to the KSCC.

54. See generally Note, *Liberalization of Korean Capital Market*, 14 INT'L BUS. LAW. 92 (1986); Lee, *Foreign Equity Ownership Closer with Recent Issues of Convertible Bonds*, 8 E. ASIAN EXECUTIVE REP. 21 (June 1986).

55. See *infra* Part I.B.2.b.

56. KSEA, *supra* note 13, art. 28.

57. *Id.* art. 28-2.

58. KSEA, *supra* note 13, art. 28-2(3) provides that any necessary matters regarding business activities of a foreign securities firm shall be specified in the Enforcement Decree, *supra* note 14. However, the Enforcement Decree has no such provision at the present time.

59. KSEA Enforcement Decree, *supra* note 14, art. 28-2.

requirement and the approval requirement. Based on the above provisions, seventeen foreign brokerage firms have been allowed to establish their representative offices in Seoul.<sup>60</sup>

*b. Regulation under the FECA*

Under the FECA and the Enforcement Decree<sup>61</sup> thereunder, unless otherwise approved by the MOF: (i) a nonresident must not purchase or sell securities in Korea,<sup>62</sup> (ii) a resident must not purchase or sell foreign securities,<sup>63</sup> (iii) a resident must not issue or offer securities outside Korea,<sup>64</sup> and (iv) a nonresident must not issue or offer foreign currency securities within Korea.<sup>65</sup> In sum, almost all international securities transactions are subject to MOF approval.

The Foreign Exchange Control Regulation [hereinafter FECA Enforcement Regulation]<sup>66</sup> sets forth the detailed enforcement regulation of the MOF under the FECA. Until 1981, with certain exceptions, the FECA Enforcement Regulation did not permit any international securities transactions. In 1981, the four-step internationalization plan was announced, and the MOF subsequently amended the FECA Enforcement Regulation several times. The MOF also issued a separate regulation to permit: (i) the issuance of beneficial certificates representing interest in a securities investment trust, (ii) the investment by a foreign investment company in Korean securities, and (iii) the overseas issuance by a Korean issuer of equity instruments such as convertible bonds, depositary receipts, and bonds with warrants.<sup>67</sup>

*3. Inadequacy of the Current Laws and Regulations*

As discussed above, both the securities laws (including the KSEA, the Enforcement Decree and rules thereunder) and the foreign exchange laws (including the FECA, the Enforcement Decree, the FECA Enforcement Regulation, and other MOF regulations thereunder) have been amended only to

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60. Of the seventeen, six are from Japan, two from the United States, seven from the United Kingdom, and two from Hong Kong.

61. Enforcement Decree of the Foreign Exchange Control Act, Cabinet Decree No. 382 of Jan. 19, 1962, as last amended by Presidential Decree No. 11843 of Jan. 9, 1986 [hereinafter FECA Enforcement Decree].

62. FECA, *supra* note 28, art. 24; FECA Enforcement Decree, *supra* note 61, art. 35.

63. FECA, *supra* note 28, art. 25; FECA Enforcement Decree, *supra* note 61, art. 35.

64. FECA, *supra* note 28, art. 26; FECA Enforcement Decree, *supra* note 61, art. 35.

65. FECA, *supra* note 28, art. 26; FECA Enforcement Decree, *supra* note 61, art. 35.

66. Ministry of Finance Notice No. 361 of Nov. 27, 1964, as amended [hereinafter FECA Enforcement Regulation]. As a purely theoretical matter, under the FECA and the Enforcement Decree thereunder, international securities transactions may be permitted by the MOF approval. See *supra* notes 62-65 and accompanying text. However, as a practical matter, unless the Federal Exchange Control Regulations [hereinafter FECA Enforcement Regulations] or other regulations of the MOF specify the criteria for the approval of the transactions, it would be extremely difficult, if not impossible, to obtain such an approval.

67. FECA Enforcement Regulations, *supra* note 66, arts. 14-18 through 14-34; Ministry of Finance, Regulation on Issuance of Foreign Currency Securities of Nov. 12, 1985 [hereinafter MOF Regulation].

the extent necessary to implement the then-current government policy with respect to the internationalization of the securities market. The laws and regulations now reflect only the current status of internationalization and do not envision the further development in the internationalization of Korea's securities market. Therefore, in order to facilitate internationalization, amendments to the current laws and regulations are needed in certain areas, and an emphasis placed on the improvement of international cooperation.

Furthermore, although the existing securities laws of Korea provide investors with some protection and contain a number of provisions to establish a fair and orderly securities market, the Korean government's policy with respect to the internationalization of the securities market has focused primarily on attracting foreign capital.<sup>68</sup> In preparing for the opening up of the Korean securities market, it will be necessary to reexamine the current securities regulations to ensure that the process of internationalization will not cause regulators to lose sight of the objectives of investor protection and the establishment of a fair and orderly market.

With such a framework, the following parts of this article analyze the problems which may result from the distribution and trading of securities and from the business activities of foreign securities firms in Korea once the Korean securities market is fully accessible to foreign investors, issuers, and securities firms.

## II.

### EXPECTED PROBLEMS RELATING TO DISTRIBUTION OF SECURITIES

#### A. Registration Procedure

##### 1. Current Regulation

Under the KSEA, with certain exceptions,<sup>69</sup> any public offering or secondary distribution of securities<sup>70</sup> is unlawful unless a registration statement

68. See *supra* note 36 and accompanying text.

69. The exceptions are limited to: (i) small offerings not exceeding 100 million Won (approximately \$133,000); (ii) capitalization of reserves; (iii) stock dividends; (iv) issuance of shares by exercise of warrants or conversion rights; (v) issuance of shares due to mergers; and (vi) stock splits or any other type of issuance of shares which does not require payment of consideration. KSEA, *supra* note 13, art. 8(1); KSEA Enforcement Decree, *supra* note 14, art. 5-2; KSEA Enforcement Regulation, *supra* note 15, art. 2.

70. Unlike the broad U.S. definition of the term "security" under Section 2(1) of the Securities Act of 1933, 15 U.S.C. 77b(1) (1982), the KSEA, adopting the limited enumeration approach, defines the term "securities" as: (i) national government bonds; (ii) local government bonds; (iii) bonds or notes issued by a statutory legal entity established by a special law; (iv) corporate bonds or debentures; (v) certificates of capital contribution issued by a statutory legal entity; (vi) share certificates or warrants; (vii) securities or certificates issued by a foreign country or a foreign juridical person, which have the nature of the securities or certificates listed in (i) through (vi), as designated by the MOF; and (viii) beneficial certificates issued by a trust company or a securities investment trust company. KSEA, *supra* note 13, art. 2(1); KSEA Enforcement Decree, *supra* note 14, art. 2-2. Such a limited definition may cause difficulties in adopting the

is filed with and accepted by the KSEC.<sup>71</sup> The term “public offering of new issues of securities” is defined as “a solicitation of an offer to acquire newly issued securities as against many unspecified persons under uniform terms and conditions.”<sup>72</sup> The term “public offering of outstanding securities” is defined as “an offer to sell, or a solicitation of an offer to buy outstanding securities as against many unspecified persons under uniform terms and conditions.”<sup>73</sup>

In general terms, once a registration statement is filed with and accepted by the KSEC, an offer to sell or a solicitation of an offer to buy may be made.<sup>74</sup> However, securities may not be sold until the registration statement becomes effective.<sup>75</sup> The registration statement becomes effective upon expiration of a waiting period.<sup>76</sup>

Article 8(1) of the KSEA further prohibits a listed company from issuing new shares unless a registration statement is filed and effective.<sup>77</sup> The article treats the issuance by a listed company<sup>78</sup> of new shares differently in two respects: (i) it is subject to the registration statement requirement irrespective of whether or not the issuance is made through a public offering; and (ii) the solicitation of an offer to buy such shares may not be made until the registration statement becomes effective.<sup>79</sup>

The KSEA requires an issuer to prepare a statutory prospectus<sup>80</sup> at the time of a public offering or of an issuance of new shares. This prospectus must be made available to the public at the issuer’s head office and branch offices. It must also be made available at the KSEC, at the KSE, and at the

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concept of “Korean depositary receipts” in connection with the distribution of foreign shares in Korea. See *infra* text accompanying note 257.

71. KSEA, *supra* note 13, art. 8(1).

72. *Id.* art. 2(3).

73. *Id.* art. 2(4).

74. *Id.* art. 8(1).

75. *Id.* art. 10. Before the 1987 amendments, it was unlawful to sell or offer to sell securities through a public offering (including the issuance by a listed company of new shares) until an additional cooling period of five days had elapsed after the registration statement became effective. The 1987 amendments were intended to facilitate public offerings by eliminating the additional cooling period. See *Official Gazette of Korea (Kwan-bo)* No. 10797 at 26 (Nov. 28, 1987).

76. The waiting period varies depending upon the types of issuance. In the case of rights issue to existing shareholders or the issuance of shares by exercise by a third party of his subscription privilege, seven days; in the case of public offering by a listed company of shares, ten days; in other types of public offering of shares, twenty days; and in the case of debentures, fifteen days. KSEA Enforcement Regulation, *supra* note 15, art. 3(1).

77. The exceptions listed in note 69 above are also applicable to the registration statement requirement for the issuance by a listed company of new shares.

78. The term “listed company” means an issuer of securities listed on the KSE. KSEA, *supra* note 13, arts. 2(12), 3(3).

79. *Id.* art. 8(1).

80. The statutory prospectus consists of a “preliminary prospectus,” which is to be used for a public offering or a secondary distribution of securities before the registration statement becomes effective, and a “main prospectus,” which is to be used after the registration statement becomes effective. Korean Security and Exchange Commission Regulation on Filing of Registration Statement, art. 7.

office of securities companies dealing with the subscription.<sup>81</sup> However, the prospectus for the securities specified in the effective registration statement must be delivered to a potential investor only upon the request of the investor.<sup>82</sup> The KSEA requires that any such prospectus must satisfy KSEC requirements.<sup>83</sup>

Finally, as a substantive requirement with respect to a distribution of shares, the CMPA provides that employees of a company making a public offering or secondary distribution of shares have the right to subscribe to up to twenty percent of such offered shares.<sup>84</sup> With certain exceptions,<sup>85</sup> the CMPA further grants employees of a listed company the right to subscribe to up to twenty percent of the shares issued through a rights offering.<sup>86</sup> These CMPA provisions are designed to encourage employees to participate in the securities market, thereby distributing shares widely among the Korean general public.<sup>87</sup> However, these provisions are silent on the treatment of foreign issuers.

## 2. Problems

### a. Inappropriate Provisions

Some provisions of the KSEA and the CMPA need to be clarified and improved with respect to cross-border offerings. First, as discussed above, Article 8(1) of the KSEA requires a listed company to file a registration statement for the issuance of new shares.<sup>88</sup> On its face, the above provision does not require the new shares to be issued through a public offering or to be issued within Korea. There is no court precedent, no interpretative ruling, nor any established commentator's view as to the interpretation of this provision. Only one report by the KSSB raises this issue,<sup>89</sup> and it provides two possible views with respect to the manner of offerings.

81. KSEA, *supra* note 13, art. 12(1); KSEA Enforcement Regulation, *supra* note 15, art. 4.

82. KSEA, *supra* note 13, art. 13(1). Article 13(1) provides:

When any person who intends to acquire securities which are specified in a registration statement then in effect requests a delivery of a prospectus prepared, no one shall have such person acquire, or shall sell such securities prior to the delivery of the prospectus in accordance with the provision of Article 12.

83. *Id.* art. 13(2).

84. CMPA, *supra* note 21, art. 17(1); *see also supra* note 25.

85. The exceptions are limited to: (i) issuance by certain foreign invested companies under the FCIA, *supra* note 44, (ii) issuance by exercise of warrants or conversion rights, or (iii) stock dividends. CMPA, *supra* note 21, art. 17(2); Capital Market Promotion Act Enforcement Decree, art. 17 [hereinafter CMPA Enforcement Decree].

86. In order to exercise said subscription privilege, employees must organize an "employee share ownership cooperative" pursuant to the CMPA. CMPA, *supra* note 21, art. 2(5); CMPA Enforcement Decree, *supra* note 85, art. 2.

87. CMPA, *supra* note 21, art. 1.

88. *See supra* text accompanying notes 69-76.

89. Korean Securities Supervisory Board, *Issuance of Securities in Overseas Capital Market (Hae-oi Chabon Seechang Eh-seo-eui Cheungkwon Balhaeng)* 246-47 (Feb. 1985) [hereinafter KSSB Report].

One view is that the issuance by a listed company of new shares is specifically referred to in Article 8(1) to make it clear that a rights offering to existing shareholders falls within the category of a public offering and that even in the absence of specific language, the issuance through a private placement is not subject to the registration statement requirement.

The other view is the literal interpretation. The language of the provision specifically refers to the issuance by "a listed company" of new "shares," separately from the reference to public offerings and secondary distributions in general.<sup>90</sup> The provision also uses the term "issuance of new shares" rather than "rights offering of new shares."<sup>91</sup> Focusing on the above language, the literal view argues that insofar as new shares are issued by a listed company, it is regulated by Article 8(1) irrespective of whether it is issued through a public offering or a private placement.

The latter view appears more faithful to the language of Article 8(1). However, in light of the purpose of the provision, to protect potential investors by ensuring the disclosure of material information relating to the distribution of securities, the more reasonable interpretation would be that the said provision applies only to the issuance of new shares by means of a public offering. In this regard, to issue shares to a depositary, thereby making a public offering of the depositary receipts which represent such shares, could arguably be considered a variant of a public offering of shares, even if the shares are issued to a single purchaser.<sup>92</sup>

The question of whether such an issuance is subject to Article 8(1) should be dealt with in terms of the jurisdictional reach of the provision rather than in terms of the manner of offering itself. The above mentioned report of the KSSB does not discuss the territorial issue, apparently assuming that issuance outside Korea by Korean issuers is regulated by Article 8(1).<sup>93</sup> This position as to the territorial issue is presumably based on the literal interpretation of the provision and on the necessity of protecting Korean investors holding securities issued by the listed company concerned.

Such an interpretation, however, would create an obstacle to a cross-border offering by a Korean issuer as well as an obstacle to an offering by a foreign issuer in Korea. According to this interpretation, in order to make an overseas offering, a Korean issuer would be required to file a registration statement. However, except for the timing problem which may arise due to the regulatory disparities, this registration statement requirement may not be so onerous to Korean issuers. They are already required to file a similar

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90. KSEA, *supra* note 13, art. 8(1).

91. *Id.*

92. The first view as described in the report of the KSSB will reach the same conclusion due to the twenty percent distribution to employees in Korea pursuant to the CMPA. See text accompanying *supra* notes 84-86 and *infra* notes 102-05.

93. KSSB Report, *supra* note 89, at 247.

statement with the KSEC and the MOF under the KSEC Rule and the MOF Regulation.<sup>94</sup>

In contrast, the impact of this provision would be more serious when a foreign issuer has its shares listed on the KSE. In such a situation, if Article 8(1) is literally enforced, the foreign company will be required to file a registration statement at the time of issuance of new shares even if the shares are issued outside Korea.<sup>95</sup> However, application of this provision to such a situation was not envisioned at the time of legislation of the KSEA, nor is it desirable for the achievement of the eventual objectives of the KSEA (i.e., contribution to the national economy through smooth circulation of securities and protection of investors).<sup>96</sup>

Therefore, with respect to the issuance of new shares by a listed company, it should be clarified that Article 8(1) of the KSEA is applicable only where the Korean securities market or Korean investors are involved in the issuing process. If the shares are issued outside of Korea and to foreign investors only, without an intent to redistribute such shares within Korea, such an issuance should be regulated by the continuing disclosure requirements rather than a provision concerning distribution of securities.

In connection with offerings by a U.S. corporation of securities outside of the United States, the SEC has taken the position that Section 5 of the Securities Act of 1933 is primarily intended to protect American investors.<sup>97</sup> The SEC will not take any enforcement action for failure to register the securities if the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.<sup>98</sup> This no action position is not affected by the fact that the offering originates from within the United States, that U.S. broker-dealers are involved, or that the actual distribution mechanism is effected in the United States.<sup>99</sup> However, if the securities are purchased by a foreign investor for redistribution in the United States, the registration statement requirement would be applicable.

The SEC takes two precautions to assure that redistribution of equity securities is not made. The SEC staff requires: (i) an absolute ninety-day lock-up, and (ii) a mechanism designed to assure that the securities may be resold in the United States or to U.S. nationals only if there is an exemption available for resale after the expiration of the ninety-day period.<sup>100</sup> However, demarcation of the appropriate reach of the registration statement provision

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94. KSEC Rules, arts. 7, 9; MOF Regulation, *supra* note 67, arts. 6-8.

95. KSEA, *supra* note 13, art. 8(1).

96. *Id.* art. 1.

97. Securities Act Release No. 4708, 29 Fed. Reg. 9,828 (July 9, 1964).

98. *Id.*

99. *Id.*

100. See 3C H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW 15-96 (1983).

has not yet been definitely determined in the United States.<sup>101</sup> Nevertheless, the SEC's position as to overseas offerings could be referred to by the Korean securities authorities in order to determine the territorial reach of Article 8(1) of the KSEA.

Second, Article 17 of the CMPA could raise a problem in cross-border offerings. Article 17 grants a subscription privilege to employees of an issuer with respect to publicly offered shares or newly issued shares.<sup>102</sup> This provision does not treat an issuance of shares in a foreign market differently from that made in the domestic market. Therefore, when a Korean company issues new shares in a foreign securities market, whether in the form of ADRs or ordinary shares, it must distribute up to twenty percent of the shares to its employees if they subscribe for such shares.<sup>103</sup> Such a distribution will constitute a public offering in Korea and thus, in whatever way the provision concerning "the issuance by a listed company of new shares" is interpreted, it will be subject to the provisions regulating a public offering.

On the face of the CMPA, all companies listed on the KSE are subject to Article 17, with no exceptions made for foreign companies. However, since the purpose of the CMPA provisions is to widely distribute shares by mobilizing an employee shareholding system, and since a domestic social policy granting incentives to employees underlies these provisions, they should be interpreted as being inapplicable to foreign companies listed on the KSE which do not have a place of business in Korea.

On the other hand, what is the result for a foreign corporation which has a place of business in Korea and which hires employees in Korea? Can the employees in Korea argue that they have a subscription privilege with respect to the shares publicly offered by the foreign corporation in Korea or the shares newly issued after the corporation is listed on the KSE? Would the conclusion be different if the offering were made internationally to investors of various countries including Korea rather than exclusively in the Korean securities market? A series of questions will arise as to the scope of application of Article 17 to foreign issuers which the CMPA in its current form has not anticipated.

On the face of Article 17, it may be argued that employees of a foreign corporation who work at its place of business within Korea are granted a subscription privilege.<sup>104</sup> It would be more inappropriate if the provision was applied to a rights offering by a foreign corporation listed on the KSE or an

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101. See SEC STAFF REPORT, *supra* note 2, at III-313. In this regard, the SEC recently proposed the adoption of Regulation S to clarify the extraterritorial application of registration requirements. See Securities Act Release No. 33-6773, 53 Fed. Reg. 22,661 (June 10, 1988).

102. See *supra* notes 84-86 and accompanying text.

103. *Id.*

104. As mentioned above in note 86, employees must first organize an "employee share ownership cooperative." In order to become a legally recognized cooperative, it must allow all employees of the issuer to participate in the cooperative. CMPA Enforcement Decree, *supra* note 85, art 2(1)(i). If a position is taken that Article 17 of the CMPA is applicable to the employees within Korea, the term "all employees" in the Enforcement Decree provision could

international offering made to investors in various countries including Korea. In addition, the issue of whether and to whom a subscription privilege should be granted is a matter of corporate governance, rather than of securities regulation, and thus should be governed by the laws of the jurisdiction under which the corporation is incorporated, unless a compelling reason exists to preempt this principle.

In this regard, an additional factor should be taken into account in determining the scope of the application of Article 17. While the primary purpose of Article 17 is to widely distribute shares through an employee shareholding system, it also serves in effect as an employee stock option plan.<sup>105</sup> From the perspective of social policy rather than that of regulation of the securities market or corporate governance, it may be necessary to grant the subscription privilege to employees within Korea whether they are employed by a domestic corporation or by a foreign corporation. Even in such a case, in order to minimize the conflicts with the laws of the jurisdiction of incorporation, the subscription privilege of employees of a foreign corporation should be limited to the offerings made within Korea. If an offering is made internationally, however, a problem would persist in attempts to draw a line between those offerings made within Korea and those made outside of Korea.

Since Article 17 deals with substantive rights of employees rather than a regulatory matter, the issues discussed above cannot be resolved by a mere ruling of the KSEC or the MOF, but rather should be resolved through entirely new legislation.

*b. Inadequacies of investor protection*

In order to promote the growth of the securities market, the Korean government has granted a number of incentives to encourage close corporations to go public.<sup>106</sup> Issuers, underwriters, and dealers in Korea have not yet found it necessary to make significant efforts to sell equity securities at the time of public offering because of an excess of subscriptions. Therefore, the importance of providing procedural protection of investors during the course of securities distribution has not been fully recognized.<sup>107</sup> However, as the Korean securities market grows and foreign issuers start to sell their securities in the Korean securities market, the protection of investors will require that attention should be paid to the following loopholes and drawbacks in the KSEA provisions concerning the distribution of securities.

First, the definition of the terms "public offering" and "secondary distribution" are so vague that it is very difficult to distinguish a private placement

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mean all employees of the issuer working within Korea. However, in light of the above-mentioned purpose of Article 17, it appears inappropriate to apply the provision to foreign corporations simply because they have employees within Korea.

105. See *supra* note 25.

106. See *supra* note 24 and accompanying text.

107. See Y. SHIN, *supra* note 17, at 146 n.94.

and a public offering. Standards for private placement exemptions, such as those used in Regulation D safe harbor provisions of the U.S. Securities Act,<sup>108</sup> should be provided.

Second, on the face of the amended Article 8(1) of the KSEA, except for new shares issued by a listed company, a security may be publicly offered as soon as the registration statement is filed, even before the registration statement becomes effective.<sup>109</sup> This provision appears to expedite public offerings or secondary distributions of securities. In such situations, the issuer is not required to provide a statutory prospectus to potential investors, and no other safeguard has been established for the adequate dissemination of material information to potential investors. Therefore, such a provision may fall short of true investor protection. In addition, there seems to be no persuasive reason to treat the issuance of new shares by listed companies differently than other types of public offerings.

Third, the prospectus provisions have some drawbacks in terms of investor protection. The prospectus must be delivered "only when it is asked for" by potential investors.<sup>110</sup> Furthermore, pursuant to a literal interpretation of Article 13(1) of the KSEA, the issuer is not required to deliver a preliminary prospectus to a potential investor *even* when it solicits offers to buy a security from such potential investor.<sup>111</sup> The latter problem was apparently caused by an inadvertent mistake in the 1987 amendment to the KSEA. Since a public offering or a secondary distribution (other than the issuance by a listed company of new shares) may be made upon the filing of a registration statement, Article 13(1) of the KSEA should also have been amended to expand its coverage to such a public offering and secondary distribution during the waiting period.

### B. Disclosure Requirements

Disclosure requirements at the time of distribution of securities in the Korean securities market are set forth in a form prescribed by the KSEC.<sup>112</sup> The form consists of three parts. Information required to be specified in the registration statement includes the following:

#### Part I

(1) Brief description of the issuer, including the purpose, history, and changes in capital; types, class, and number of shares; and matters concerning the declaration of dividends during the past five fiscal years.

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108. 17 C.F.R. § 230.501-.506 (1933).

109. The term "listed company" is defined as an issuer of securities listed on the KSE. KSEA, *supra* note 13, arts. 2(12), 3(3). Therefore, the initial public offering by foreign issuers of their shares will not fall within "the issuance of new shares by listed companies".

110. KSEA, *supra* note 13, art. 13(1).

111. *See supra* note 82.

112. KSEA, *supra* note 13, art. 8(2); "Regulation on Filing of Registration Statements" of the KSEC.

- (2) Description of public offering or secondary distribution, including the description of the securities to be offered, terms and conditions of the offering, and information about underwriting.
- (3) Use of proceeds.
- (4) Description of the business operation and facilities, including principal products in the respective fields; productive capacity and actual production of each plant during the past three fiscal years; sales volumes; sales methods; orders received and production plan for the next six months; and information about material contracts.
- (5) Description of financial affairs, including financial statements during the past five fiscal years.
- (6) Opinion of an outside auditor (certified public accountant).
- (7) Covenants regarding distribution of dividends and capitalization of reserves to be accumulated by the offering.
- (8) Brief analysis by the underwriters of the securities to be offered.

## Part II

- (1) Description of production, sales and management facilities of each place of business, and the project plan for the expansion of such facilities.
- (2) Financial statements prior to and after a merger, if made during the past three years.
- (3) Description of price fluctuations for major products and materials necessary for their production.
- (4) Brief description of affiliated companies.

## Part III

- (1) Information on shares and shareholders, including description of shareholding of each type of institutional investor and the controlling shareholder, pre-emptive rights of shareholders, and share prices during the past six months.
- (2) Information on officers, including class and number of shares held by each officer.
- (3) Average remuneration of officers and that of four classified groups of employees.

As shown above, a wide range of information is required to be disclosed in a registration statement. However, Korea's textual requirements do not include many of the significant American disclosure requirements as found in Form 20-F<sup>113</sup> under the Securities Exchange Act of 1934 and Form F-1<sup>114</sup> under the Securities Act of 1933. For example, a Korean registration statement need not contain risk factors,<sup>115</sup> legal proceedings,<sup>116</sup> management discussion and analysis of financial condition and results of operation,<sup>117</sup> interests of management in certain transactions,<sup>118</sup> and relationships with senior securities.<sup>119</sup>

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113. 4 Fed. Sec. L. Rep. (CCH) ¶ 29,701 (June 8, 1988).

114. 2 Fed. Sec. L. Rep. (CCH) ¶¶ 6,951-53 (May 11, 1988).

115. See Securities Act Release No. 6,437, 47 Fed. Reg. 5,764 (Dec. 6, 1982), Form F-1, Item 2.

116. See Exchange Act Release No. 16,371, 44 Fed. Reg. 70,132 (Nov. 29, 1979), Form 20-F, Item 3.

117. *Id.* Item 9.

118. *Id.* Item 13.

119. *Id.* Items 15-16.

These stricter requirements in the U.S. market, together with the inherent liabilities which may arise therein may find Korean issuers hesitant to sell their securities in the U.S. market. Korean issuers may prefer the Euromarket, which has less strict regulations. However, in preparing for the fourth stage during which foreign issuers will be permitted to sell their securities in the Korean securities market, the above differences could provide a starting point for discussion as to whether the current disclosure requirements are adequate for the protection of investors and, if not, how more stringent requirements should be imposed.

In addition, Korean regulatory authorities should also take into consideration the adoption of additional disclosure requirements for foreign issuers as required under Form 20-F in the United States, such as exchange controls and other limitations affecting security holders,<sup>120</sup> taxation,<sup>121</sup> and the nature of the principal trading market.<sup>122</sup>

### C. Civil Liabilities

Commentators view the strict liability standards under the securities laws of the United States as one of the primary reasons that foreign companies are not interested in offering their securities in the United States.<sup>123</sup> In comparison, the liability provisions of the KSEA fail to adequately ensure the full disclosure of material information to potential investors or to protect investors from fraudulent offerings or misrepresentations made in connection with these offerings.

The KSEA has only two provisions, Articles 14 and 197, which provide the legal basis for civil liability relating to the distribution of securities. Article 14 imposes civil liability for false or misleading statements in a registration statement or a prospectus.<sup>124</sup> Article 197 creates, by reference to Articles 17(2)-(4) of the Act Concerning External Audit of Joint Stock Corporation,<sup>125</sup> civil liability for an independent certified public accountant who

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120. *Id.* Item 6.

121. *Id.* Item 7.

122. *Id.* Item 5.

123. *E.g.*, Spencer, *The Reaction of the Securities and Exchange Commission to the Internationalization of the Securities Markets: Three Concept Releases*, 4 B.U. INT'L L.J. 111, 115 (1986); *see also generally*, Note, *Barriers to the International Flow of Capital: The Facilitation of Multinational Securities Offerings*, 20 VAND. J. TRANSNAT'L L. 81, 107-111 (1987).

124. KSEA, *supra* note 13, art. 14. Article 14 provides:

If any issuer has injured any purchaser of securities by including any untrue statement or omitting to state any material fact in a registration statement or a prospectus referred to in Article 12, the registrant, the directors of the corporation concerned at the time of filing the registration statement, (promoters, in case such registration statement is filed prior to incorporation) and any person who has prepared or delivered the prospectus shall be liable for any loss or damage; provided, however, that the foregoing shall not apply, if such person who may be liable proves that he could not have known such untruth or omission at the time with his exercise of due diligence, or that the purchaser of such securities knew of the fact at the time he made an offer to purchase them.

125. Law No. 3297 of Dec. 31, 1980, *as last amended* by Law No. 3724 of Apr. 10, 1984.

has made false or misleading statements in auditing statements included in a registration statement or a prospectus.<sup>126</sup>

The civil liability provisions of the KSEA have several deficiencies when compared to those of the U.S. Securities Act of 1933.<sup>127</sup> First, the scope of the persons subject to liability is limited to: (i) the registrant-issuer who has filed a registration statement or prepared the prospectus,<sup>128</sup> (ii) all directors and promoters of the issuer at the time of filing of the registration statement, (iii) an underwriter or dealer who actually delivered the prospectus, and (iv) an independent certified public accountant who prepared the audit report. Unlike Section 11(a) of the U.S. Securities Act of 1933, principal executive officers, accounting officers, and experts (other than the accountant) who certify the preparation of a registration statement in Korea are not subject to liability. Those persons making a secondary distribution are not specifically included, nor does the KSEA have any provision similar to Section 15 of the Securities Act of 1933 regarding the liability of a controlling person of the issuing corporation.<sup>129</sup> The KSEA is also silent on the liability of aiders and abettors.<sup>130</sup>

Second, the civil liability provisions of the KSEA have limited coverage. Due to the lack of a provision similar to Sections 12(1)-(2) of the Securities Act of 1933, liability does not arise even when the issuer or an underwriter makes an improper offer to a potential purchaser in the pre-filing period,<sup>131</sup>

126. KSEA, *supra* note 13, art. 197(1)-(2). Article 197(1)-(2) provides:

(1) The provisions in paragraphs 2 to 4 of Article 17 of the Act Concerning External Audit of Joint Stock Corporations shall apply *mutatis mutandis* to the civil liabilities of [outside independent] auditors to *bona fide* investors.

(2) The provisions in Article 15 of the KSEA shall apply *mutatis mutandis* to the calculation of the amount to be compensated referred to in Paragraph 1 of this article.

Articles 17(2) and (3) of the Act Concerning External Audit of Joint Stock Corporations provide:

(2) If any [outside, independent] auditor has caused damages to third party due to having omitted or made a false statement about important matter in the auditing report, such auditor shall be jointly and severally liable in damages to the third party. However, this provision shall not apply in cases where the auditor has proved that there had been no negligence of duties on his part.

(3) If, in cases where the [outside, independent] auditor is liable in damages to corporation or to third party, a director or an [inhouse] auditor [under the Commercial Code] is also liable, such auditor, director and inspector are jointly and severally liable in damages.

Article 17(4) provides for the statute of limitation.

127. For general discussion on the problems of Articles 14 and 197 of the KSEA, see Y. SHIN, *supra* note 17, at 156-160.

128. Even in the case of a secondary distribution by a person other than the issuer, it is the issuer that is required to make the registration statement. KSEA, *supra* note 13, art. 8(1).

129. Y. SHIN, *supra* note 17, at 156-57.

130. One conceivable way to impose civil liability upon aiders and abettors is to resort to general tort theory. There is, however, no commentary or court precedent on this issue.

131. Nevertheless, such an act is subject to a criminal sanction of up to two years imprisonment or a 10 million Won fine. KSEA, *supra* note 13, arts. 8, 209(1).

or when the issuer or underwriter effects a distribution by means of misleading statements, or when an underwriter or dealer uses an invalid prospectus.<sup>132</sup>

Third, the reasonable care defense and the plaintiff's knowledge defense are applicable to all defendants including the issuer. As mentioned above, because of excessive subscriptions, issuers, underwriters, and dealers in Korea have not yet found it necessary to make significant attempts to sell equity securities at the time of public offering, and purchasers of publicly offered shares have not raised any issue in connection with the compliance of the distribution provisions.<sup>133</sup> However, when foreign issuers start to tap the Korean securities market in order to distribute their securities to Korean investors, the role of civil liability as a sanction to ensure the full disclosure of material information and the protection of investors should be recognized. If the existing provisions of the KSEA are maintained, investors in the Korean securities market will be provided with less information and protection than the investors in the United States with respect to the same offering made by an American issuer.

In this regard, it may be argued that the strengthening of civil liability provisions will present a pressing concern for potential issuers and thus may create an impediment to the development of the Korean securities market. On the other hand, it must be noted that the general public's distrust of the mechanism of the securities market has been one of the major obstacles to its development in Korea. Although this distrust has been created for the most part by manipulations in the secondary market,<sup>134</sup> in order to encourage the general public to participate in the securities market more actively, the mechanism of the primary market should also be improved to ensure investor protection. To ensure the full disclosure of necessary information and investor protection from fraudulent offerings, it may be more efficient to rely on enforcement by the securities supervisory authority such as the KSEC or the KSSB rather than private civil actions. Although the KSEC and the KSSB should obviously take a major role in the prevention of any fraudulent offering and should police the disclosure of necessary information in advance of an offering, civil liability provisions should also be strengthened as post-offering remedies.

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132. Two additional provisions are relevant to the situation described in the text. First, any person who uses a prospectus for a public offering of securities or any other type of transaction in violation of the statutory prospectus requirement is subject to criminal sanctions of up to one year imprisonment or five million Won fine. KSEA, *supra* note 13, arts. 13, 210(2). Second, a question may arise as to the applicability of Article 105(4) of the KSEA, a general anti-fraud provision, to the situations described above. Although there is no court precedent or any commentators' view on this point, in light of the location of Article 105 in a subchapter titled "sales and purchases on a stock exchange," Korean courts would be unlikely to expand the applicability of this provision to the distribution of securities.

133. See *supra* note 107 and accompanying text.

134. See Y. SHIN, *supra* note 17, at 15, 56-60, 422.

## III.

EXPECTED PROBLEMS RELATING TO INTERNATIONAL  
TRADING*A. Maintaining the Integrity of the Securities Market — Substantive Aspects of Anti-Fraud Provisions and Insider Trading Regulation*

As the development of the international securities market progresses, insider trading, fraud, and manipulation in multiple-listed securities may adversely affect the market for such securities for those jurisdictions in which they are traded. Fraud or manipulation conducted in one country may have its effect in another. Inside information obtained in one jurisdiction may be used for trading on an exchange in another jurisdiction. In such cases, the laws of one jurisdiction will inevitably come into conflict with the laws of another jurisdiction.<sup>135</sup>

These problems will certainly arise as the Korean securities market is opened up to foreign investors and issuers. For example, during the third stage of internationalization, when securities issued by Korean companies will be traded by foreign investors, the enforcement of Korean securities regulations against foreign investors will become a major issue. It is also expected that during the third stage, Korean securities will be listed on a stock exchange outside of Korea.<sup>136</sup> If such a multiple listing occurs, the opposite issue will arise: whether and how to enforce the securities regulations of a foreign country in Korea. These issues will become even more important during the fourth stage, when all international securities transactions will be liberalized.

Since the Korean securities market has not yet fully developed, the significance of anti-fraud provisions and insider trading regulations has not been adequately recognized. However, as Korea opens up its securities market to foreign issuers and investors, the regulatory authorities in Korea will need to utilize these provisions in order to establish a fair and orderly market. Therefore, in spite of international enforcement problems, the substantive anti-fraud provisions and insider trading regulations are in need of reassessment.

Part III.A. analyzes the substance of the anti-fraud rules and insider trading regulations of Korea. Part III.B. discusses procedures for the enforcement of such anti-fraud provisions in the international context.

*1. Regulation of Manipulative or Deceptive Practices*

Article 105 of the KSEA prohibits manipulative or deceptive practices.<sup>137</sup> Specifically, Article 105(1) prohibits "matched sales," "wash sales," and the entrusting of an offer to effect such sales "for the purpose of creating

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135. See generally Kubler, *Problems of Enforcement in the Multinational Securities Market Round Table*, 9 U. PA. J. INT'L BUS. L. 315 (1987).

136. See *supra* note 37 and accompanying text.

137. KSEA, *supra* note 13, art. 105.

a misleading appearance of active trading or causing others to make a misled judgment with respect to a listed security.”<sup>138</sup> Article 105(2) prohibits the operation of “pool manipulation,” the circulation or dissemination of rumors and willful misrepresentation of a material fact “for the purpose of inducing the purchase or sale of any security on the exchange.”<sup>139</sup>

Article 105(3) regulates the stabilization of security prices.<sup>140</sup> Article 105(4), which appears to be the most important anti-fraud provision applicable to the secondary market, prohibits: (i) willful circulation or dissemination of false quotations, untrue facts or rumors, or use of deception to gain unjust benefits; (ii) acquisition of money or other benefits by inducing misunderstanding of others by false representation of material facts or by the use of a written document omitting or falsifying material facts; and (iii) certain forms of insider trading,<sup>141</sup> which will be discussed below in Part III.A.2.b.

Violations of Article 105 result in civil liability as well as criminal sanctions.<sup>142</sup> Violators of Article 105 are liable for compensatory damages to anyone who has purchased or sold securities at an unfair price as a result of such violation in connection with the purchasing and selling of securities.<sup>143</sup>

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138. KSEA, *supra* note 13, art. 105(1). Article 105(1) provides:

No person shall engage in the following activities for the purpose of creating a false or misleading appearance of active transaction or causing any other person to make a false judgment with respect to the transaction of a listed security:

- (i) To make a sale with prior agreement with another person that the purchase of the security concerned will be made by such person at the same period and at the same price with the sale;
- (ii) To make a purchase with prior agreement with another person that a sale of the security concerned will be made by such person at the same period and at the same price with the sale;
- (iii) To effect any false transaction in a security without intending to transfer ownership thereof;
- (iv) To entrust or to be entrusted with such acts as described in subparagraphs (i)-(iii).

139. KSEA, *supra* note 13, art. 105(2). Article 105(2) provides:

No person shall engage in any of the following activities for the purpose of inducing purchases or sales of any security on the securities market:

- (i) To effect, to entrust or to be entrusted with, alone or in conspiracy with other persons, transactions in a security creating a false or misleading appearance of active trading or making the price of such security fluctuate;
- (ii) To circulate a rumor to the effect that the price of any security will fluctuate by market manipulation by himself or by other persons;
- (iii) To willfully make the representation which is false or misleading with respect to any material fact in a purchase or sale of the security concerned.

140. KSEA, *supra* note 13, art. 105(3). Article 105(3) provides: “No person shall effect, entrust or be entrusted with, independently or jointly, transactions on the securities market for the purpose of pegging or stabilizing the price of any security in violation of the Presidential Decree.”

141. KSEA, *supra* note 13, art. 105(4).

142. The maximum criminal sanction for violation of Article 105 is three years imprisonment or a 20 million Won fine. KSEA, *supra* note 13, art. 208(3).

143. KSEA, *supra* note 13, art. 106(1).

However, the criminal and civil penalties of the article have never been invoked by a regulatory authority or by an injured party.<sup>144</sup> This lack of enforcement is attributable to some deficiencies in the above provisions as contrasted to their counterparts in the securities laws of the United States.

First, the fraudulent or manipulative devices prohibited by Article 105 are narrowly defined. The KSEA does not have an analogous provision to Section 10(b) of the Securities Exchange Act of 1934 which broadly prohibits the use of any manipulative or deceptive device in connection with the purchase or sale of any security both on the exchange or in the over-the-counter market.<sup>145</sup> Nor does it have any provision similar to Section 15(c) of the Securities Exchange Act of 1934 which regulates the use of such devices in the over-the-counter market.<sup>146</sup>

Second, the prohibitions of Article 105 as described above are little more than a reiteration of the general fraud rule under the civil law and criminal law.<sup>147</sup> The requirement of "illegal statutory purpose"<sup>148</sup> particularly hinders the effective enforcement of the anti-fraud rules.

Third, the KSEC as yet lacks sufficient investigative power to enforce the antifraud rules as discussed below in Part III.B.3.

## 2. Insider Trading Regulation

Two provisions of the KSEA, Articles 105(4)(iii) and 188(2), regulate insider trading.<sup>149</sup> Until the 1987 amendment was made, effective as of the beginning of 1988,<sup>150</sup> the KSEA contained only one provision regulating short-swing profits, Article 188(2).<sup>151</sup> Article 188(2) regulates six-month short-swing transactions performed by an officer, employee or a major shareholder (defined as a person who owns ten percent or more of the total outstanding shares for his account, whether held in his name or in the name of others) of an issuer.<sup>152</sup>

144. Y. SHIN, *supra* note 17, at 218.

145. Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982).

146. *Id.* § 78o(c) (1982).

147. Y. SHIN, *supra* note 17, at 217.

148. *See supra* notes 138-39.

149. *See supra* note 14.

150. Amendment to the KSEA, Law No. 3945 of Nov. 28, 1987, Addendum art. 1(1).

151. KSEA, *supra* note 13, art. 188(2). Article 188(2) provides:

In the case where any officer, employee, or major shareholder [who owns 10% or more of the total outstanding shares for his account irrespective of whether held in his name or in the names of others] of a listed or a registered corporation has realized profits from any purchase and sale or any sale and purchase of equity securities of the corporation within a six month period, the corporation or the KSEC may bring a suit to have such profits returned to the corporation; *provided*, however, that this shall not apply if such person proves that the profits were not realized through the use of non-public information obtained in the performance of his duty or by reason of his relationship to the corporation.

152. *Id.*; *see generally* Y. SHIN, *supra* note 17, at 367-79.

In order to regulate insider trading more strictly, the 1987 amendments inserted a new provision in Article 105(4);<sup>153</sup> the article prohibits any person who has obtained non-public information concerning a particular security, either in the performance of his duty or by reason of his relationship to the corporation, from using such information or letting any other person use such information in connection with a purchase, sale, or any other transaction in the security.<sup>154</sup>

This provision appears sufficiently broad to cover various types of insider trading. However, the KSEA is not specific as to the measurement of damages.<sup>155</sup> The KSEA also requires the plaintiff to have purchased or sold securities at a price formed "as a result of" a violation such as insider trading.<sup>156</sup> As a practical matter, it is very difficult to determine when a market price is formed as a result of insider trading. Compounding these substantive legal difficulties, the class action suit does not exist in Korean civil procedure.<sup>157</sup> In light of such deficiencies, injured parties can hardly be expected to bring suit against inside traders to recover their damages.

The above barriers to private plaintiff suits leave the regulatory authorities, particularly the KSEC, primarily responsible for the effective enforcement of this provision. However, the KSEA does not have a civil penalty provision such as the Insider Trading Sanctions Act of 1984<sup>158</sup> and furthermore, the maximum fine for insider trading is fixed, regardless of the amount of profits made by the insider.<sup>159</sup> For more effective regulation of insider trading through monetary sanctions, the maximum amount of the fine should be linked to the amount of profits made by an insider. The KSEA has no special provision with respect to insider trading or other manipulative or deceptive practices in international trading. The enforcement of these provisions or of similar foreign provisions in international trading deserves separate and scrupulous treatment, considering the recent legal developments in this area.

*B. Maintaining the Integrity of the Securities Market —Procedural Aspects — Enforcement of Anti-Fraud Provisions and Insider Trading Regulations*

The two principal means available to Korea to enforce anti-fraud rules and regulate insider trading in the international context are: (i) the expansion

153. Law No. 3945, *supra* note 150, art. 105(4); *Official Gazette of Korea*, *supra* note 75, at 21.

154. KSEA, *supra* note 13, art. 105(4).

155. Article 106 of the KSEA merely provides for the compensation of damages incurred in connection with certain purchases and sales but does not make it clear whether an insider should be liable for damages in excess of his profit. *See supra* note 143 and accompanying text.

156. KSEA, *supra* note 13, art. 106.

157. *See S. LEE, CIVIL PROCEDURE (Minsa-sosong-beob)* 188 (1984).

158. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (codified at 15 U.S.C. 78a note, 78c, 78o, 78t, 78u, 78ff (1984)).

159. *See supra* note 142.

of the territorial reach of national regulations, and (ii) the utilization of recent developments in international cooperation. A discussion of the current methods of enforcement under the KSEA regulations follows. Finally, the necessity of strengthening the KSEC's investigative power and of developing international cooperation in the form of a bilateral arrangements with major foreign markets will be examined.

### 1. *Extraterritorial Application of Domestic Regulations*

A country which has very strict securities regulations will often try to protect its national policies by expanding the territorial reach of its regulation.<sup>160</sup> The typical example, and the one which best serves to illustrate the possible techniques and limits of this type of expansion, is the United States.

There are indications in the Securities Act of 1933 and the Securities Exchange Act of 1934 that U.S. securities laws may be applied to any international securities transaction that has some connection with the United States.<sup>161</sup> Most U.S. courts have determined that the Congress intended the above two acts to apply extraterritorially to protect U.S. investors from the effects of fraudulent activity abroad.<sup>162</sup>

In order to establish subject matter jurisdiction in international fraud cases,<sup>163</sup> U.S. courts have applied "conduct" and "effects" tests.<sup>164</sup> Under the conduct test, subject matter jurisdiction is found where fraudulent conduct or conduct in preparation of a fraud occurred within the United States.<sup>165</sup> Under the effects test, subject matter jurisdiction is found where a

160. See Kubler, *Regulatory Problems in Internationalizing Trading Markets*, 9 U. PA. J. INT'L. BUS. L. 107, 115 (1987).

161. For example, Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) (1982), suggests the application of the provision to any international securities transaction which has even a minimal connection to the United States. Section 10(b) provides that it is unlawful for any person, "by the use of any means or instrumentality of interstate commerce . . . to use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention . . ." of rules promulgated by the SEC. Section 3(a)(17) of the Securities Exchange Act defines "interstate commerce" to encompass "trade, commerce, transportation or communication between any foreign country and any State." 15 U.S.C. 78(c)(a)(17) (1982). Thus, the language of the statute apparently indicates that any minimum contact with the United States in connection with a foreign securities transaction may bring the transaction within the jurisdictional scope of the Securities Exchange Act. See also Thomas, *Extraterritoriality*, *supra* note 5, at 455 n.4.

162. See Thomas, *Extraterritoriality*, *supra* note 5, at 455; Larose, *Conflicts, Contacts, and Cooperation: Extraterritorial Application of the United States Securities Laws*, 12 SEC. REG. L.J. 99, 102 (1984).

163. Most of the cases which have dealt with the extraterritorial application of U.S. securities regulations have focused on the application of Rule 10b-5. Thomas, *Extraterritoriality*, *supra* note 5, at 455.

164. Recently, a controversy has arisen among commentators with respect to the appropriateness of the conduct and effects tests in the extraterritorial application of the securities laws of the United States. See generally Thomas, *Extraterritoriality*, *supra* note 5; Larose, *supra* note 162.

165. *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975), *cert. denied sub nom.*, *Bersch v. Arthur Anderson & Co.*, 423 U.S. 1018 (1975).

foreign securities transaction caused a substantial and foreseeable injury in the United States even though no actionable conduct occurred in the United States.<sup>166</sup>

The territorial reach of U.S. securities laws has been expanded through private lawsuits. This same trend is also found in the field of extra-territorial investigation by the SEC. The U.S. courts have held that the SEC's power to subpoena witnesses and documents is not limited to witnesses and documents located within the United States and that the "obligation to respond applies even though the person served may find it necessary to go to some other place within or without the United States in order to obtain the documents required to be produced."<sup>167</sup>

Recently, in *SEC v. Banca Della Svizzera Italiana*,<sup>168</sup> a Swiss bank refused to respond to a request for information by the SEC about its customers, suspected of insider trading. The bank raised a defense based upon the Swiss secrecy laws.<sup>169</sup> However, the court ordered the bank to answer the SEC's interrogatories and to reveal the identity of its customers notwithstanding the existence of the Swiss secrecy laws.<sup>170</sup>

The strengthened effort to expand the territorial reach of the U.S. securities laws was also reflected in the use of the "waiver by conduct" approach by the SEC.<sup>171</sup> Under the "waiver by conduct" approach, anyone who trades in the United States is presumed to have submitted himself to be bound by U.S. law and to have waived the protection of domestic secrecy laws.<sup>172</sup> "Waiver by conduct" constitutes a unilateral measure and thus would seem to be efficient from the perspective of the United States. This approach, however, was severely criticized both within the United States and abroad and was eventually abandoned.<sup>173</sup>

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166. *Schoenbaum v. Firstbrook*, 405 F.2d 200, *rev'd on other grounds*, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom.*, *Manley v. Schoenbaum*, 395 U.S. 1215 (1969).

167. *See SEC v. Minas de Artemisa, S.A.*, 150 F.2d 215, 218 (9th Cir. 1945).

168. 92 F.R.D. 111 (S.D.N.Y. 1981).

169. *Id.* at 117.

170. *Id.* at 119.

171. *See* Concept Release Requesting Comments Concerning a Concept to Improve The Commission's Ability to Investigate and Prosecute Persons Who Purchase or Sell Securities in the U.S. Markets from Other Countries, Exchange Act Release No. 21,186, 49 Fed. Reg. 31,300 (Aug. 6, 1984); Fedders, Wade, Mann & Beizer, *Waiver by Conduct—A Possible Response to the Internationalization of the Securities Markets*, 6 J. COMP. BUS. & CAP. MARKET L. 1 (1984) [hereinafter Fedders & Beizer]; Fedders, *Policing Trans-border Fraud in the United States Securities Markets: The "Waiver by Conduct" Concept - A Possible Alternative or A Starting Point for Discussions?*, 11 BROOKLYN J. INT'L L. 477 (1985).

172. Exchange Act Release No. 21,186, *supra* note 171.

173. Bornstein & Dugger, *International Regulation of Insider Trading*, COL. BUS. L. REV. 375, 411 (1987); *see generally* Liftin, *Our Playing Field, Our Rules: An Analysis of the SEC's Waiver by Conduct Approach*, 11 BROOKLYN INT'L L. 525 (1985); Bschorr, "Waiver by Conduct": Another View, 6 J. COMP. BUS. & CAP. MARKET L. 307 (1984); Boyle & Thau, *The Newest Configuration of the Ugly American: A Response to Mr. Fedders*, 6 J. COMP. BUS. & CAP. MARKET L. 323 (1984); Wymeersch, *Response to Fedders' "Waiver by Conduct"*, 6 J. COMP.

The expansion of the territorial reach of investigative power is, to a certain extent, justified by the necessity of maintaining the integrity of the domestic securities market. The problem with this approach is balancing the different interests of the countries concerned. Such a purely national approach could aggravate conflict of laws problems.<sup>174</sup> These problems are illustrated by the fact that the extraterritorial application of U.S. substantive law and the use of U.S. discovery procedures has been viewed by other countries as coercive.<sup>175</sup>

As a response to this perceived extraterritorial coercion, some countries have considered the adoption of blocking laws.<sup>176</sup> Blocking laws are designed to either: (i) foreclose discovery in certain areas which are the focus of undesirable foreign litigation or investigation, or (ii) require foreign parties to comply with the procedural rules of the home country.<sup>177</sup> The enactment of blocking laws would make the conflict of laws problem even more complicated if each country tried to enforce its own national laws in the international context. Obviously, the necessity of international cooperation in this respect has become vitally important.

## 2. International Cooperation — Bilateral Arrangements<sup>178</sup>

In order to promote cooperation in enforcing securities regulations, four types of memoranda of understanding [hereinafter MOU] have been signed by the United States, and they serve as illuminating examples of the types of

BUS. & CAP. MARKET L. 339 (1984); Singer, *The Internationalized Securities Market & International Law — A Reply to John M. Fedders*, 6 J. COMP. BUS. & CAP. MARKET L. 345 (1984); Kubler, *supra* note 160, at 116-117; Spencer, *supra* note 123, at 113.

174. Fedders & Beizer, *supra* note 171, at 25-28.

175. See Note, *Summary, Problems of Enforcement in the Multinational Securities Market Roundtable*, 9 U. PA. J. INT'L BUS. L. 315, 321 (1987).

176. For example, the Foreign Extraterritorial Measures Act of Canada and the Protection of Trading Interest Act of the United Kingdom. See generally Pitt, Hardison & Shapiro, *Problems of Enforcement in the Multinational Securities Market* 9 U. PA. J. INT'L BUS. L. 375, 412 (1987) [hereinafter Pitt & Shapiro].

177. *Id.* at 412.

178. In addition to memoranda of understanding, bilateral arrangements have also been made in the form of treaties for mutual legal assistance in criminal matters. See, e.g., Treaty Concerning The Cayman Islands and Mutual Legal Assistance in Criminal Matters, July 3, 1986, United States-United Kingdom, — U.S.T. —, T.I.A.S. No. —, reprinted in 26 I.L.M. 536 (1987). With respect to the international agreements for obtaining assistance in discovery of securities regulation violators, see generally Goelzer, Mills, Gresham & Sullivan, *The Role of the U.S. Securities & Exchange Commission in Transnational Acquisitions*, 22 INT'L. LAW. 615, 635-641 (1988) [hereinafter Goelzer & Sullivan]. Also, efforts to undertake a multilateral arrangement have been made by several international securities organizations such as the Committee on International Investment & Multinational Enterprises of the Organization for Economic Cooperation & Development, International Organization of Securities Commissions, and Group of Securities Regulators. However, none of these organizations is believed to be able to offer in the near future a framework for international coordination which will be satisfactory to all the participants. Kubler, *supra* note 160, at 117; Hawes, *Internationalization Spreads to Securities Regulators*, 9 U. PA. J. INT'L. BUS. L. 257 (1987); SEC STAFF REPORT, *supra* note 2, at VII-75 to 77.

agreements which could be utilized by Korea to overcome the problems of international enforcement of Korean securities regulations.

On August 31, 1982, an MOU was signed between Switzerland and the United States concerning the investigation of insider trading [hereinafter U.S.-Switzerland MOU].<sup>179</sup> Before the signing of the MOU, the SEC faced a problem in obtaining assistance from Switzerland for the investigation of insider trading. Under the 1977 Treaty for Mutual Assistance in Criminal Matters between Switzerland and the United States, assistance could be given only in cases of dual criminality<sup>180</sup> — and insider trading was not a criminal act in Switzerland.<sup>181</sup> The U.S.-Switzerland MOU remedied this situation by recognizing the necessity of cooperation concerning insider trading litigation and investigations.<sup>182</sup>

In keeping with the purpose of the U.S.-Switzerland MOU, a private agreement among those members of the Swiss Bankers' Association who trade on the U.S. securities markets was entered into whereby a signatory bank, working through the Swiss Federal Office for Police Matters,<sup>183</sup> may disclose information about its customers to the SEC.

On November 10, 1987, the United States and Switzerland exchanged diplomatic notes agreeing that the SEC will be able to use the 1977 Treaty to obtain information from Switzerland for insider trading investigations.<sup>184</sup> New Swiss legislation which makes insider trading a criminal act took effect on July 1, 1988, making the U.S.-Switzerland MOU obsolete.<sup>185</sup> Since the U.S.-Switzerland MOU covers only insider trading and was signed to supplement the 1977 Treaty, it is viewed by commentators as too limited to serve as a model for future enforcement arrangements.<sup>186</sup>

A second type of MOU is typified by the agreement signed between the SEC, the Commodity Futures Trading Commission of the United States, and the Department of Trade and Industry of the United Kingdom on September

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179. United States-Switzerland: Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Law Enforcement Cooperation in the Field of Insider Trading, *reprinted in* 22 I.L.M. 1 (1983) [hereinafter U.S.-Switzerland MOU].

180. Treaty on Mutual Assistance on Criminal Matters, May 25, 1973, United States-Switzerland, 27 U.S.T. 2019, T.I.A.S. 8302, art. 4(2)(a).

181. U.S.-Switzerland MOU, *supra* note 179, art. I.2.

182. *Id.* arts. I.5, II.3, II.4, III.1.

183. See Agreement XVI of the Swiss Bankers' Association, *reprinted in* 22 I.L.M. 7, 8-10 (1983), arts. 3-5.

184. *U.S., Switzerland Strengthen Insider Trading Access Agreement*, 19 Sec. Reg. & L. Rep. (BNA) 1729 (Nov. 13, 1987); Goelzer & Sullivan, *supra* note 178, at 640; M. MANN & J. MARI, CURRENT ISSUES IN INTERNATIONAL SECURITIES LAW ENFORCEMENT, SECURITIES ENFORCEMENT INSTITUTE 1988 (PLI CORPORATE COURSE HANDBOOK No. 604) 68-69 (1988).

185. *July 1 is Effective Date for New Insider Trading Law*, 20 Sec. Reg. & L. Rep. (BNA) 878, 878-79 (June 10, 1988).

186. See Summary, *supra* note 175, at 323; see generally Salisbury, *International Agreements: United States-Switzerland Investigation of Insider Trading through Swiss Banks—Memorandum of Understanding*, 23 HARV. INT'L L.J. 437 (1983).

23, 1986 [hereinafter U.S.-U.K. MOU].<sup>187</sup> This MOU provides for reciprocal assistance in obtaining records that are in the hands of the other party or that can be obtained through the best efforts of the parties.<sup>188</sup> The U.S.-U.K. MOU covers a broad range of matters relating to the regulation of investment businesses including insider trading, fraudulent securities dealing, and market manipulation.<sup>189</sup>

To ensure that assistance is properly invoked, the U.S.-U.K. MOU outlines the proper form for a request for information,<sup>190</sup> and gives proper grounds for the refusal of a request.<sup>191</sup> The request must specify the identity of the subject person, the purpose for which information is sought, and the behavior that has caused concern.<sup>192</sup> Each party may refuse to comply with a request on grounds of domestic public interest.<sup>193</sup> The U.S.-U.K. MOU is an interim arrangement which is to terminate upon entry into force of a treaty between the two countries governing mutual cooperation in securities regulations.<sup>194</sup>

A third type of MOU is typified by the agreement signed between the SEC and the Securities Bureau of the Japanese Ministry of Finance on May 23, 1986.<sup>195</sup> This MOU simply states that the parties thereto agree to facilitate each agency's respective requests for surveillance and investigatory information on a case-by-case basis.<sup>196</sup>

Finally, two of the most comprehensive MOU's were signed between the SEC and the Canadian provincial securities regulators on January 7, 1988 [hereinafter U.S.-Canada MOU]<sup>197</sup> and between the SEC and the Brazilian securities authorities on July 1, 1988 [hereinafter U.S.-Brazil MOU].<sup>198</sup> The

187. Memorandum of Understanding on Exchange of Information Between the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission and the United Kingdom Departures of Trade and Industry in Matters Relating to Securities and Futures, reprinted in 25 I.L.M. 1431 (1986) [hereinafter U.S.-U.K. MOU]; see generally Note, *The British-U.S. Memorandum of Understanding of 1986: Implications After Warner*, 11 FORDHAM INT'L L.J. 110 (1987); Deal, *Policing Securities and Commodities Markets*, 6 INT'L FIN. L. REV. 21 (1987).

188. U.S.-U.K. MOU, *supra* note 187, paras. 2-6.

189. *Id.* para. 1(h)(i)(A).

190. *Id.* para. 7(b).

191. *Id.* paras. 5-6.

192. *Id.* para. 7(b)(ii)-(iv).

193. *Id.* para. 5.

194. *Id.* para. 17.

195. Memorandum of the U.S. Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information, reprinted in 25 I.L.M. 1429 (1986).

196. *Id.*

197. Memorandum of Understanding: U.S. Securities and Exchange Commission, the Ontario Securities Commission, Commission Des Valeurs Mobilières Du Québec, and British Columbia Securities Commission, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,210, at 88,945; 20 Sec. Reg. & L. Rep. (BNA) 17 (Jan. 8, 1988) [hereinafter U.S.-Canada MOU].

198. Memorandum of Understanding: United States Securities and Exchange Commission and Comissão de Valores Mobiliários (Brazil), [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,246, at 89,204; 20 Sec. Reg. & L. Rep. (BNA) 1059 (July 8, 1988) [hereinafter U.S.-Brazil MOU].

most significant development made in these MOU's is that the parties agree to assist each other by investigating violations of certain laws and regulations of the requesting country even without allegation that the laws of the reciprocating country have been violated.<sup>199</sup> Certain parties to these MOU's, including the SEC, lack the statutory authority to conduct investigations on behalf of a foreign government; however, the parties have agreed to use all reasonable efforts to obtain necessary authorization to provide assistance under the MOU.<sup>200</sup>

Assistance under these MOU's will be available for cases involving disclosure and reporting requirements as well as for those cases covered by the U.S.-U.K. MOU, such as insider trading, misrepresentation, or fraudulent securities practices.<sup>201</sup> Available assistance includes providing access to information, taking testimony, and obtaining documents.<sup>202</sup> These agreements will also improve the enforcement of requests. A representative of the requesting party may be present while testimony is being taken, and subject to the discretion of the requested party, may conduct an interrogation.<sup>203</sup>

### 3. *Investigative Powers of the KSEC*

Under the KSEA, the KSEC has the authority to investigate anyone involved when: (i) it believes that there is a violation of the KSEA, of any order issued thereunder, or of any regulation or order issued by the KSEC, or (ii) it deems such an investigation necessary in the public interest or for the protection of investors.<sup>204</sup> For this investigation, the KSEC may: (i) require that the person concerned submit written statements or other documents or materials regarding the matter at issue, or (ii) demand the appearance of any witness.<sup>205</sup> The KSEC may also order the KSSB staff to investigate such a person and may request the assistance of any administrative agency or other

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199. U.S.-Canada MOU, *supra* note 197, art. 1; U.S.-Brazil MOU, *supra* note 198, art. 1.

200. U.S.-Canada MOU, *supra* note 197, art. 2(3); U.S.-Brazil MOU, *supra* note 198, art. 2(3). To fulfill the commitment made by the SEC under the MOU's, legislation entitled the "International Securities Enforcement Cooperation Act of 1988" was proposed as § .2544. One of the provisions of the bill amends Section 21 of the Securities Exchange Act to enable the SEC, at the request of its counterpart of a foreign country, to conduct investigations in connection with a potential violation of the foreign country's securities laws. See 134 Cong. Rec. S8318 (June 21, 1988); [Transfer Binder 1987-88] Fed. Sec. L. Rep. (CCH) ¶ 84,240. The Insider Trading and Securities Enforcement Act of 1988, which was signed by the President on November 19, 1988, also contains such an amendment. See Fed. Sec. L. Rep. No. 1304 (Sept. 21, 1988), No. 1309 (Oct. 26, 1988), No. 1313 (Nov. 23, 1988).

201. U.S.-Canada MOU, *supra* note 197, art. 1(h); U.S.-Brazil MOU, *supra* note 198, art. 1(1)(h).

202. U.S.-Canada MOU, *supra* note 197, art. 2(2); U.S.-Brazil MOU, *supra* note 198, art. 2(2). In addition to the categories mentioned in the text, the U.S.-Brazil MOU lists "conducting compliance inspections or examinations of investment businesses" as a separate category of assistance. U.S.-Brazil MOU, *supra* note 198, art. 2(2).

203. U.S.-Canada MOU, *supra* note 197, arts. 5(5)-(6); U.S.-Brazil MOU, *supra* note 198, art. 5(5)-(7).

204. KSEA, *supra* note 13, art. 128(1).

205. *Id.* art. 128(2).

related institution.<sup>206</sup> However, the KSEC's investigative power has some limitations.

First, although failure to comply with a KSEC investigation is subject to criminal sanction,<sup>207</sup> the KSEC does not have any power to otherwise compel the persons concerned to comply with its investigation.<sup>208</sup> In addition, while one of the primary purposes of regulatory power is the detection and prevention of manipulations and deceptions at their inception, the KSEA is silent on whether the KSEC may invoke the assistance of the courts, especially in the form of an injunction.<sup>209</sup>

Furthermore, the KSEC cannot resort to a general injunction under the Code of Civil Procedure.<sup>210</sup> Under Korean civil procedure, the existence of underlying private rights of action is one of the criteria for the issuance of an injunction.<sup>211</sup> Except for an action to disgorge short-swing profits under Article 188 of the KSEA, the KSEC grants no private rights of action against those who have violated an anti-fraud provision and therefore cannot satisfy the above criterion. Even if the KSEA were amended to provide special injunctive relief against fraudulent or deceptive practices, due to the absence of contempt of court penalties for non-compliance with court orders or decisions, such an injunction would not be effective unless sanctions for non-compliance were also specified.

Second, at least one commentator, a high ranking staff member of the KSSB, states that the KSEC's investigative power is further limited as follows:<sup>212</sup>

(i) Since the KSEC was established to review and resolve such matters as provided in the KSEA,<sup>213</sup> its investigative power should be construed as supplementary and thus may be exercised only to the extent necessary to supplement the power of its administrative body, the KSSB,<sup>214</sup> such as the inspection of issuers of publicly offered securities or securities companies.

(ii) The authority granted to the KSEC with respect to securities trading on the KSE is limited to the review of the internal regulations of the KSE, and the approval of the listing and delisting of securities. Therefore, the KSEC may not raise the issue as to whether a listed company has made a necessary disclosure to the KSE.<sup>215</sup>

206. *Id.* art. 129(1).

207. *Id.* art. 208(iv).

208. See Y. SHIN, *supra* note 17, at 223.

209. See *id.* at 221 n.168 and accompanying text.

210. Code of Civil Procedure, Law No. 547 of Apr. 4, 1960, as amended.

211. *Id.* art. 714.

212. See M. AHN, *supra* note 30, at 123.

213. KSEA, *supra* note 13, art. 118(1).

214. See M. AHN, *supra* note 30, at 123.

215. This issue was raised in connection with Kong-Young Construction Co., Ltd. Newspapers reported that its promissory notes with aggregate value of over 8 billion Won were dishonored by its prime trading bank and that the company became "de facto" bankrupt as of April 29, 1982. Despite this publication, on April 30, 1982 the company denied that there was any truth to

However, the above view appears overly conservative, and Article 128 of the KSEA could be interpreted to grant the KSEC a separate investigatory power in addition to its other authorities and powers. Also, although the power of the KSEC to supervise the KSE is limited to reviewing the internal regulations of the KSE and approving listing and delisting, the investigation of manipulative or deceptive practices is a separate matter, and thus the better interpretation would be that the KSEC can investigate activities within the KSE if it believes such activities violate the KSEA or other relevant regulations. In any event, if the KSEC interprets its investigative power so narrowly, it cannot be expected to exercise its power actively.

The KSEA makes no provision for transnational enforcement or investigation. Nor has Korea entered into a treaty or a memorandum of understanding with any foreign country to better enforce its securities regulations. Major policy decisions will, therefore, have to be made as to the best means to protect the Korean securities market from foreign traders in transactions based upon fraud or inside information.

#### 4. *Special Problems of Inbound Enforcement of Foreign Securities Regulations — Secrecy Laws of Korea*

There are three laws in Korea which require securities companies or banks to maintain the confidentiality of information regarding customers or their transactions.

First, Article 59 of the KSEA prohibits the officers or employees of securities companies from disclosing information about customers' accounts or transactions without the written request or consent of the customer. This provision is believed to induce greater participation by the Korean public in the securities market.<sup>216</sup> Waiver of this secrecy provision occurs when: (i) a court issues an injunction to submit such information, or a court judge issues a warrant, or when showing a document issued by a public prosecutor;<sup>217</sup> (ii) a supervisory agency inspects the securities company;<sup>218</sup> (iii) the KSSB, the KSE or the KSFC orders the release of information;<sup>219</sup> or (iv) a particular written request is made by the tax offices.<sup>220</sup>

Second, the Law Concerning Real Name Financial Transactions<sup>221</sup> has a very similar secrecy provision. The major difference between this statute

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the report in response to the KSE's inquiry. At that time, the issue was raised as to whether the KSEC had the authority to investigate the truth of the report and the company's response. See M. AHN, *supra* note 30, at 123; Y. SHIN, *supra* note 17, at 380 n.235a.

216. See Y. SHIN, *supra* note 17, at 256.

217. KSEA, *supra* note 13, art. 60(1); KSEA Enforcement Decree, *supra* note 14, art. 38(7).

218. KSEA, *supra* note 13, art. 59.

219. *Id.* art. 60(1); KSEA Enforcement Decree, *supra* note 14, art. 38(iv)-(vi).

220. KSEA, *supra* note 13, art. 60(1); KSEA Enforcement Decree, *supra* note 14, art. 38(i)-(iii).

221. Law Concerning Real Name Financial Transactions, Law No. 3607 of Dec. 31, 1982.

and the KSEA provisions is that this statute applies to all financial institutions including securities companies as well as banking institutions and almost all kinds of financial transactions.<sup>222</sup> The exceptions to this prohibition are very similar to those under the KSEA.<sup>223</sup>

Third, the FECA Enforcement Regulation has a similar secrecy provision, which applies to foreign exchange transactions.<sup>224</sup> Since a foreign exchange transaction will always be involved in transnational securities trading, this regulation may be triggered in the context of international securities transactions.

All three of these laws are secrecy rather than blocking laws. Nevertheless, since the violation of the above provisions will subject the violator to criminal sanctions, a Korean bank or securities company will not voluntarily cooperate with a request by a foreign regulatory agency to disclose information about its customers. There is, as yet, no clear arrangement for dealing with the impact that these laws could have on an internationalized Korean securities market.

##### 5. *The Necessity of Strengthening KSEC's Investigative Power and Cooperation with Major Foreign Securities Markets*

As the Korean securities market further develops and foreign investors participate in the market, illegal activities will become more sophisticated. In order to cope with such a situation, the Korean government should seriously consider strengthening the investigative power of the KSEC. In particular, the KSEC should be authorized to compel persons under investigation to comply with its investigative measures. Furthermore, injunctive relief and effective sanctions against non-compliance with an injunction should be specifically provided for in the KSEA to suspend illegal activities at their inception.

In the international context, Korea has not entered into a treaty or a memorandum of understanding with a foreign country to better enforce their respective securities regulations, nor is Korea a party to the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters.<sup>225</sup> Korea has not found it necessary to enter into such an arrangement because the Korean securities market has not taken a major role in the Korean economy and has been closed to foreign investors and issuers.

However, as the Korean securities market opens up, the problems as to the enforcement of Korean securities regulations against transnational securities transactions and as to the enforcement of foreign securities regulations against Korean entities will increase. As discussed above, there may be two

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222. *Id.* arts. 2(1)-(3).

223. *Id.* art. 5(1).

224. FECA Enforcement Regulations, *supra* note 67, art. 2-7.

225. Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, Mar. 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231.

different approaches: (i) to expand the territorial reach of national laws, or (ii) to develop international cooperation through such means as MOU's and treaties.

In order to maintain market integrity, it will be necessary for the KSEC to obtain documents and testimony from witnesses located outside of Korea and to investigate broker-dealers and foreigners suspected of participating in illegal activities. The problem in this regard will be to maintain market integrity by expanding the KSEC's extraterritorial reach without damaging the interests of foreign countries.

Since the internationalization of the Korean securities market is still in its infancy, it would be premature to introduce a detailed policy with respect to these issues at the present time. However, given the potential conflicts caused by unilateral extraterritorial expansion of national securities laws and the non-existence of a multilateral arrangement in this area, Korea should make greater efforts to pursue international cooperation through bilateral arrangements.<sup>226</sup> In particular, these arrangements should be sought with foreign counterparts such as the United States, the United Kingdom, and Japan, which will presumably be preeminent originators of transactions in the Korean securities markets. By such arrangements, detailed procedures governing the investigation of fraudulent dealings or other specific areas of concern can be established as they were in the U.S.-U.K. MOU<sup>227</sup> or the U.S.-Canada MOU.<sup>228</sup>

### C. Securities Processing—Clearing and Settlement

As the cross-border listing and trading of securities increases, international clearing and settlement becomes an important issue among participants in the international securities markets.<sup>229</sup> Problems in clearing arise due to: (i) the lack of international clearance and settlement links to facilitate cross-border settlements, and (ii) the existence of widely varying clearance and settlement systems among the world's capital markets.<sup>230</sup> Clearing will therefore be an issue in the international trading of Korean-issued securities, particularly when the shares are listed on a foreign exchange in their ordinary form rather than in the form of depositary receipts. Part III.C. discusses the

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226. The bilateral arrangement may take the form of a treaty or an MOU. However, an MOU has an advantage in that it need not be formally ratified by the congress of each country. See Pitt & Shapiro, *supra* note 176, at 435.

227. See *supra* note 187 and accompanying text.

228. See *supra* note 197 and accompanying text.

229. A commentator enumerates the obstacles as follows: (i) conflict of laws — as the parties from different countries are involved, the laws of one jurisdiction may conflict with those of another; (ii) credit risks as to the brokers' or the other party's insolvency; (iii) currency risks during the period between trade and settlement; (iv) custom, practice, and regulatory differences; (v) sovereign risk; and (vi) taxes. See Bernard, *International Linkages Between Securities Markets: "A Ring of Dinosaurs Joining Hands and Dancing Together,"* COLUM. BUS. L. REV. 321, 325-27 (1987).

230. See SEC STAFF REPORT, *supra* note 2, at V-61.

current clearing and settlement system of Korea, analyzes the possible problems which may arise in the international context, and then reviews recent developments in international cooperation in this area.

### 1. *Current Clearing and Settlement System of Korea*

#### a. *Background*

In order to avoid the inconvenience of delivering certificates<sup>231</sup> and thus facilitate the clearing and settlement of transactions on the KSE, the KSEA recently revised the legal framework of the Korean clearing system.<sup>232</sup> Until the 1987 amendments became effective,<sup>233</sup> the KSEA had only six provisions (Articles 173 through 178) for securities clearing. These provisions failed to adequately set forth the rights and obligations of the participants in the clearing system and the responsibilities of the clearing corporation.<sup>234</sup> Thus, the clearing system operated in accordance with the custom and practice of the industry. Commentators have quickly responded by pointing out the inadequacy of the KSEA provisions.<sup>235</sup> The 1987 amendments, effective as of January 1, 1988, amended the provisions of the KSEA regarding the clearing system almost in their entirety.<sup>236</sup> A brief discussion on the current KSEA provisions regarding the clearing system follows.

#### b. *Regulation of clearing corporations*

In order to engage in a clearing business, a license must be obtained from the MOF.<sup>237</sup> A clearing corporation may, with MOF approval, also engage in securities custody, deposit business, transfer agency, or other securities related businesses.<sup>238</sup> The KSCC, a wholly owned subsidiary of the KSE, is currently the only licensed securities clearing corporation in Korea.

#### c. *Clearing procedures*

Any person who wishes to deposit securities with the KSCC must open an account with them.<sup>239</sup> Although the KSEA does not limit the scope of eligible persons who may open an account with the KSCC, the KSCC's internal regulations require that the depositor obtain the KSCC's consent.<sup>240</sup> The depositor may deposit with the KSCC both its own securities and those of its

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231. For example, under the Commercial Code of Korea, which is the basic law governing commercial transactions, in order to transfer a share, the share certificate representing the share must be delivered. Commercial Code, *supra* note 27, art. 336(1).

232. KSEA, *supra* note 13, arts. 173, 174, 174-2 through -9, 175, 176, 178.

233. *See supra* note 19.

234. *See M. AHN, supra* note 30, at 455-66.

235. *Id.*

236. Law No. 3945; *Official Gazette of Korea, supra* note 75.

237. KSEA, *supra* note 13, art. 173(1).

238. *Id.* art. 173(2).

239. *Id.* art. 174(1).

240. Securities Clearing Business Regulation, art. 2(1).

consenting customers.<sup>241</sup> The KSCC must enter in its books the depositors' own securities and its customers' securities separately. However, the KSCC may physically comingle the securities with those of the same kind deposited by other depositors.<sup>242</sup> A broker which takes deposits of securities from its customers must keep a separate securities deposit book for each of its customers and, immediately upon entering a transaction in such book, must deposit with the KSCC the securities deposited by the customer.<sup>243</sup> Entry of a transaction in the broker's books and in the KSCC's books is deemed to be physical delivery of the securities for the purposes of a transfer or pledge.<sup>244</sup>

*d. Rights and obligations of the parties involved*

A person whose name is entered in the books of the KSCC or of a broker is deemed to possess the securities and to hold the ownership interest of such securities shares, which are kept by the KSCC. Therefore, a customer may demand from the broker the withdrawal of securities corresponding to his share interest in the company.<sup>245</sup> In turn, the broker (and any depositor who has deposited his own securities) may demand the withdrawal of these securities from the KSCC.<sup>246</sup>

If the KSCC is short of the deposited securities, the KSCC and the depositing broker will be jointly and severally liable.<sup>247</sup> The KSCC may register "shares" with the issuers in its own name even if the customer has not so requested.<sup>248</sup> The KSCC must notify the relevant issuer (or its transfer agent) of the name and other relevant information of the beneficial owner (i.e., the depositor or its customer, as the case may be) of the security as of the recording date.<sup>249</sup> The issuer must prepare a Beneficial Shareholders Registry incorporating such information for the distribution of dividends or the exercise of voting rights.<sup>250</sup> The beneficial owners of the shares exercise their rights based upon such registry.<sup>251</sup>

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241. KSEA, *supra* note 13, art. 174(2).

242. *Id.* art. 174(3)-(4).

243. *Id.* arts. 174-2(1), 174-2(2).

244. *Id.* art. 174-3(2).

245. *Id.* arts. 174-3(1), 174-4.

246. *Id.*

247. *Id.* art. 174-5(1). No special fund is established to guarantee the performance of such liabilities. However, in order to ensure the compensation of damages caused by the failure of a KSE member to perform a sale/purchase transaction, a compensation fund has been established. The fund consists of contributions by members of the KSE of 1/100,000 of the amount equivalent to the value of each transaction on the KSE. KSEA, *supra* note 13, arts. 95, 97; KSEA Enforcement Decree, *supra* note 14, arts. 48-56.

248. *Id.* art s. 174-6(2), 174-6(3).

249. *Id.* art. 174-7.

250. *Id.* art. 174-8.

251. *Id.*

*e. Possible clearing problems in the international context*

The KSEA is silent on the clearing of international trading. Therefore, in order to effect a transfer of shares between foreign investors or a foreign investor and a domestic investor pursuant to the laws of Korea, the following alternatives are available: (i) to actually deliver the share certificates from the seller to the purchaser, (ii) to open an account at the KSCC and use the clearing service of the KSCC, or (iii) to become a customer of a domestic broker and use the account of the domestic broker at the KSCC.

If transactions involving one or more foreign investors are executed on the KSE, the normal clearing procedures (either (ii) or (iii) above) applicable to domestic transactions can be used. However, if the Korean securities, particularly ordinary shares, are listed on an exchange outside Korea, clearing will not be so simple. In such a case, alternative (i) will be impractical due to inconvenience, cost, and safety problems. Alternative (iii) may cause additional cost to the foreign investors (e.g., fees to the brokers of the investor's home country and fees to domestic Korean securities companies). It is not certain whether the second alternative will be practically feasible for trading Korean securities on a foreign exchange.

As an additional complication, foreign shares will be listed on the KSE during the fourth stage of internationalization.<sup>252</sup> The classic solution to this problem is the adoption of the depositary receipts concept.<sup>253</sup> Under the depositary receipts arrangement, the underlying shares are kept by a custodian located in the jurisdiction of the issuer and separate securities (depositary receipts) are traded in the target country, avoiding most clearing and settlement issues.<sup>254</sup> However, the depositary receipt mechanism may not be used under the current laws of Korea for the following reasons:

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252. See *supra* note 37 and accompanying text.

253. For example, ADRs are negotiable receipts issued by a depositary in the United States (a U.S. bank or trust company) to evidence the depositary shares. Depositary shares represent a foreign security or a multiple of or fraction thereof deposited with the depositary's office or agent in the foreign country. Typically, the depositary establishes a foreign custodian that accepts foreign securities. The depositary then sells ADRs, representing a beneficial interest in the foreign securities deposited abroad, to American investors and performs certain services for the ADR holders, such as converting dividends into dollars and transmitting information concerning rights offerings. The use of ADRs has grown for several reasons such as the cost saving, convenience and safety of the ADR arrangement as compared to trading in foreign securities directly. See generally Moxley, *The ADR: An Instrument of International Finance and a Tool of Arbitrage*, 8 VILL. L. REV. 19, 22 (1962); Royston, *The Regulation of the American Depositary Receipts: Americanization of the International Capital Markets*, 10 N.C.J. INT'L L. & COM. REG. 87, 87 (1985); Tomilson, *Federal Regulation of Secondary Trading in Foreign Securities*, 32 BUS. LAW. 463, 464-467 (1977); Note, *SEC Regulation of American Depositary Receipts: Disclosure, Ltd.*, 65 YALE L. J. 861 (1956); L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION*, 229-230 (2d ed. 1987).

254. See Bernard, *supra* note 229, at 328. With respect to the advantages and disadvantages of ADRs, see Tomilson, *supra* note 253, at 464-67.

(i) Since the current laws and regulations of Korea are silent on the concept of depositary shares or depositary receipts,<sup>255</sup> and the business operation of banks and securities clearing corporations are tightly regulated by statute,<sup>256</sup> it is questionable whether a bank or a clearing corporation in Korea has the authority to issue depositary receipts. Even if such an institution is found to have such authority, it is not clear whether depositary receipts can be regarded as negotiable instruments due to the lack of any statutory basis for them.

(ii) The KSEA has adopted a limited enumeration approach in defining the term "securities."<sup>257</sup> Depositary receipts do not fall within any of the eight categories of securities regulated by the KSEA.

In light of the foregoing, unless the relevant laws are changed to accommodate the concept of Korean depositary receipts, Korea will require international institutional cooperation in order to clear securities.

## 2. Clearing of Foreign Issuers' Stocks — Japanese Example

A typical system for the clearing of foreign securities can be found in the Japanese model for clearing shares of foreign companies listed on the Tokyo Stock Exchange.<sup>258</sup> The Tokyo Stock Exchange, which is responsible for the account transfer and the clearing, actually delegates this business to the Japan Stock Clearing Corporation [hereinafter JSCC].<sup>259</sup> All share certificates representing a foreign company's listings on the Tokyo Stock Exchange are kept in the name of the JSCC by a custodian (a bank or a domestic clearing agency) located in the jurisdiction of the issuer.<sup>260</sup>

Transactions effected between members of the Tokyo Stock Exchange are entered in a registry kept by the JSCC.<sup>261</sup> When the JSCC enters the transactions, the broker enters the transaction in its own registry and delivers a depositary receipt to the customer.<sup>262</sup> However, the receipts issued by the broker are not negotiable.<sup>263</sup> A member of the Tokyo Stock Exchange who

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255. Neither the KSEA nor the Commercial Code of Korea has any provision for a depositary share or depositary receipt representing securities issued by a foreign issuer.

256. Banking Act, Law No. 139 of May 5, 1950, as amended, arts. 18-21; KSEA, *supra* note 13, art. 173.

257. *See supra* note 70.

258. The description of the Japanese system derives principally from Takahashi & Kitahara, *On Listing of Foreign Shares (Kaikoku Kabushiki No Zyozyo Ni Tsuite) (2) — Explanation of Foreign Shares Listing Guideline*, 638 SHOJI HOMU 146 (1973), and the Guideline on Foreign Shares Clearing System attached thereto as material no. 2. *See also* Kitagawa, *infra* note 308, at 75.

259. *See* Takahashi & Kitahara, *supra* note 258, at 148.

260. *Id.* at 149.

261. *Id.*

262. *Id.*

263. *Id.*

has deposited foreign shares with the JSCC may also withdraw the share certificates.<sup>264</sup> Since the shares are registered in the name of the JSCC, the beneficial shareholders may not exercise their rights directly. They receive dividends through a fiscal agent and a paying agent in Japan and exercise voting rights through the fiscal agent.<sup>265</sup> With respect to rights offerings, initially the preemptive rights are sold in the jurisdiction of the issuer and the proceeds are distributed to the investors.<sup>266</sup>

This system was designed to solve the potential problems in clearing and trading multinationally-listed shares by locating the foreign shares in their home country and registering them only in the name of the JSCC. Due to the location and registration of the shares, however, there are drawbacks to this system. Japanese commentators have pointed out that where the share certificates are kept in custody in the home country of the issuer and registered in the name of the JSCC, the depositors or their customers are not able to provide foreign shares as debtor security to a bank.<sup>267</sup>

If a foreign counterpart has this type of clearing system, another problem may arise in enforcing the KSEA's restrictions of individual shareholding by foreign investors. Article 203 of the KSEA authorizes the KSEC to set a limit on the total number of shares held by foreign investors as well as on the number of shares which may be held in an individual company.<sup>268</sup> Pursuant to this provision, the KSEC set a limit on the number of shares a foreigner may hold through the conversion of convertible bonds or withdrawal of underlying shares of depositary receipts.<sup>269</sup> At the present time, any foreign holder of convertible bonds or depositary receipts may not convert or withdraw in excess of three percent of the outstanding shares of a single issuer.<sup>270</sup> In order to effectively enforce this rule (or any variant thereof limiting the maximum foreign shareholding), a mechanism should be established for the KSEC to identify beneficial shareholders rather than to simply register the shares in the name of a foreign clearing agency.

### 3. *Recent Developments in International Cooperation in Clearing*

Increased international trading of securities has encouraged the stock exchanges of some countries to make efforts to create cross-border clearing and settlement linkage. Since 1980, several U.S. clearing agencies have pursued clearance and settlement linkage with their foreign counterparts.<sup>271</sup> The majority of the clearing linkages developed by the U.S. clearing agencies to date provide foreign broker-dealers and institutional investors with indirect

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264. *Id.*

265. *Id.* at 150.

266. *Id.*

267. *Id.* at 149.

268. *See supra* Part I.B.2.a.i.

269. KSEC Rule, *supra* note 94, art. 4(3).

270. *Id.*

271. *See* SEC STAFF REPORT, *supra* note 2, at V-64.

access to U.S. clearing agencies through their domestic clearing agencies.<sup>272</sup> In general, the foreign clearing agency either becomes a full member of the U.S. clearing agency or agrees to be bound to most of the U.S. clearing agency's rules, including financial standards and safeguards.<sup>273</sup> Although the first clearing linkage was formed by the Depository Trust Company and the Bankers Trust Company,<sup>274</sup> the first international linkage which provided a foreign clearing agency with direct access to a U.S. clearing agency was formed between the National Securities Clearing Corporation [hereinafter NSCC] and the Canadian Depository for Securities Limited [hereinafter CDS].<sup>275</sup>

This linkage was established to support trading between the Boston Stock Exchange and the Montreal Stock Exchange<sup>276</sup> and also trading between the American Stock Exchange [hereinafter AMEX] and the Toronto Stock Exchange [hereinafter TSE].<sup>277</sup> Under this arrangement, the NSCC has expanded its links with the CDS. The CDS acts as the clearing representative for certain Canadian broker-dealers.<sup>278</sup> Similar links have been created between the Midwest Clearing Corporation and the CDS to support the linkage between the Midwest Stock Exchange and the TSE.<sup>279</sup>

These arrangements expand the role of each clearing agency from its original function (i.e., holding domestic securities) to one that enables its participants to hold securities in foreign clearing agencies through an omnibus account.<sup>280</sup> The securities are held in a depository located in the jurisdiction of the issuer.<sup>281</sup> In the case of the Midwest Clearing Corporation-CDS linkage, the Illinois Commercial Code makes it clear that book-entry transfers by the Midwest Securities Trust Company of securities physically held by the CDS are legally effective.<sup>282</sup> Concerning regulation of a foreign clearing

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272. *Id.*

273. *Id.*

274. *Id.*

275. *Id.* at V-66.

276. See generally Exchange Act Release No. 21,449, 49 Fed. Reg. 44,575 (Nov. 7, 1984); Exchange Act Release No. 21,925, 50 Fed. Reg. 14,480 (Apr. 12, 1985).

277. See Exchange Act Release No. 22,442, 50 Fed. Reg. 39,201 (Sept. 27, 1985); Exchange Act Release No. 24,016, 52 Fed. Reg. 3,070 (Jan. 30, 1987). In this type of trading linkage, orders received by one exchange for dually-listed stocks can be flown to another exchange. Prices and quotes for the dually-listed stocks are displayed on each exchange floor in both U.S. dollars and Canadian dollars. Orders are forwarded between the exchanges using their automated routing systems. Orders received by each exchange are executed in the exchange's home currency. All transactions made through the linkage are cleared and settled through the omnibus account of the CDS at the NSCC.

278. See Exchange Act Release No. 21,449, *supra* note 277, at 759 n.5.

279. See Exchange Act Release No. 23,075, 51 Fed. Reg. 11,854 (Apr. 7, 1986); Exchange Act Release No. 22,738, 51 Fed. Reg. 143 (Jan. 2, 1986).

280. See Bernard, *Case Studies in International Market Structure Issues: Market and Clearing Linkages* Part 2.IV.A. (Feb. 14, 1987); Broker-Dealer Institute 1986 (Practicing Law Institute, B 539) 93, 118.

281. *Id.*

282. See *id.*; see also Exchange Act Release No. 22,738, *supra* note 279, at 1045.

agency, the SEC staff took a "no action" position upon CDS's failure to register as a clearing corporation under the Securities Exchange Act of 1934.<sup>283</sup>

In 1986, the NSCC established a wholly owned subsidiary, the International Securities Clearing Corporation.<sup>284</sup> This corporation is intended to enter into agreements with foreign stock exchanges or clearing agencies, permitting U.S. broker-dealers to clear and settle transactions executed on foreign exchanges.<sup>285</sup>

In reviewing a trading linkage, which usually includes a clearing and settlement linkage, the SEC has focused on: (i) whether adequate provision is made for the sharing of enforcement and surveillance information; (ii) whether the home country of the linked foreign market has enacted a "blocking statute"; (iii) whether there exists any inter-governmental information sharing arrangement between the SEC and the home country of the linked foreign market; (iv) whether the linked foreign exchange has the ability to discipline its members for violation of its trading rules; (v) whether the linked markets have similar rules and regulatory structures; (vi) whether the linkage contains a "trade through protection provision" whereby best efforts should be made to see that no trade is effected at an inferior price.<sup>286</sup> This practice of the SEC appears to be designed to prevent any serious conflict between the linked markets and to maintain the integrity of the markets. It could serve as a useful model for the Korean regulatory authorities when a market linkage is formed between the KSE and a foreign exchange.

#### IV.

#### REGULATION OF FOREIGN SECURITIES FIRMS

Multinational financial corporations are seeking increased opportunities to participate in the growth of the global equity market. Their businesses were originally designed chiefly to capture the price differentials in equity securities (or ADRs) between their home markets and foreign markets. Now, their businesses have evolved into more general dealer, agency, and research operations. However, their primary focus has been on the equity securities of their home countries and on agency services in foreign securities for the customers in their home countries.<sup>287</sup>

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283. See Exchange Act Release 21,449, *supra* note 276, at 759 n.5; NSCC/CDS Letter (Nov. 26, 1984), [1984-85] Fed. Sec. L. Rep. (CCH) ¶ 77,880.

284. SEC STAFF REPORT, *supra* note 2, at V-68.

285. *Id.*

286. See *id.* at V-56 to 57.

287. See *id.* at V-31 to 32.

## A. Current Regulations in Korea

### 1. Licensing

As mentioned above,<sup>288</sup> after the Korean government announced its plan to internationalize the securities market, a new provision, Article 28-2, was inserted in the KSEA and corresponding amendments were made to the Enforcement Decree of the KSEA in 1982. Article 28-2 of the KSEA and the Enforcement Decree thereunder deal for the most part with the licensing of foreign broker-dealers and underwriters.

A foreign securities firm is required to obtain a license from the MOF for the establishment of a branch in Korea and for each type of business of dealing, brokerage or underwriting in which it intends to engage.<sup>289</sup> A notable regulation of the business activities of securities companies is Article 51 of the KSEA which requires MOF approval for a securities company to engage in any business other than the securities business.<sup>290</sup>

In reviewing an application by a foreign securities firm for the establishment of a branch in Korea, the MOF is required to apply the following standards:

(i) The home country of the applicant must allow the establishment of a branch office or any other business office of a Korean securities company.<sup>291</sup>

(ii) The applicant must have an international reputation in terms of financial condition and business activities.<sup>292</sup>

(iii) The business funds of the applicant's branch in Korea must be sufficient to conduct the type of business for which the application is made.<sup>293</sup>

(iv) It must be necessary to establish a branch of the applicant in Korea in view of securities trading in the region concerned, of the number of securities companies and branch offices thereof, of the number of branch offices of foreign securities firms, and of other economic factors in the region.<sup>294</sup>

### 2. Business Activities

The branch office of a foreign securities firm in Korea, once duly licensed by the MOF, is treated in the same manner as a domestic securities company except for certain provisions such as the minimum capital requirements and the rule concerning the engagement in securities business outside Korea.<sup>295</sup> A representative of a branch is treated in the same manner as an officer of a

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288. See *supra* Part I.B.2.a.ii.

289. KSEA, *supra* note 13, art. 28-2(1); KSEA Enforcement Decree, *supra* note 14, art. 17-2(1).

290. KSEA, *supra* note 13, art. 51.

291. KSEA Enforcement Decree, *supra* note 14, art. 17-2(2)(i).

292. *Id.* art. 17-2(2)(ii).

293. *Id.* art. 17-2(2)(iii). The term "business funds" means the funds in Korean currency obtained from the central bank of Korea in exchange for foreign currency by the foreign applicant establishing and operating a branch in Korea. *Id.*

294. KSEA Enforcement Decree, *supra* note 14, art. 17-2(2)(iv).

295. KSEA, *supra* note 13, art. 28-2(2).

domestic securities company.<sup>296</sup> Although the KSEA provides that the Enforcement Decree shall specify any necessary matters regarding business activities by a foreign securities firm,<sup>297</sup> no provisions on these matters have been included in the Enforcement Decree. This is because the Korean government has not yet opened up its market to foreign securities firms.

### 3. Financial Requirements

Under current laws and regulations, the branch office of a foreign securities firm in Korea will be subject to the same regulations and financial requirements (except for the minimum capital requirement) as domestic securities companies.<sup>298</sup>

Minimum net working capital must be maintained as follows: (i) for those which engage in any one of three types of securities business (i.e., dealing, brokerage and underwriting), 150 million Won (approximately \$220,000)<sup>299</sup>; (ii) for those which engage in any two of three types of securities business, 500 million Won (approximately \$740,000); and (iii) for those which engage in all three types of securities business, 600 million Won (approximately \$890,000).<sup>300</sup> The amount of net working capital is calculated by deducting the total amount of liabilities and fixed assets from the total amount of assets.<sup>301</sup> Firms must also maintain net capital at no less than ten percent of total liabilities.<sup>302</sup>

A foreign securities firm is additionally required to set aside: (i) a reserve for liabilities in the amount of 0.02% of the total amount of trading made during a fiscal year, and (ii) a reserve for sales loss in the amount of 70% (or if approved by the KSEC, 50%) of the net capital gains made during such fiscal years.<sup>303</sup> Unless otherwise approved by the KSEC, the reserve for liabilities may be used only to compensate for damages suffered by its customers due to the negligence of the firm's officers or employees, and the reserves for sales losses may be used only to replenish sales losses during the fiscal year.<sup>304</sup>

### 4. Admission to the KSE

The KSEA provides that members of the KSE shall be securities companies<sup>305</sup> which satisfy the conditions under the Articles of Incorporation of the

296. KSEA Enforcement Decree, *supra* note 14, art. 18-3(1).

297. KSEA, *supra* note 13, art. 28-2(3).

298. See *supra* note 295 and accompanying text.

299. Based on a foreign exchange rate of 673 Won to the U.S. dollar. Wall St. J., Mar. 3, 1989, at C10, col. 4.

300. KSEA Enforcement Decree, *supra* note 14, art. 32.

301. KSEA Enforcement Regulation, *supra* note 15, art. 11.

302. KSEA, *supra* note 13, art. 39; KSEA Enforcement Decree, *supra* note 14, art. 33.

303. KSEA, *supra* note 13, art. 40(1); KSEA Enforcement Decree, *supra* note 14, art. 34(1).

304. KSEA, *supra* note 13, art. 40(2); KSEA Enforcement Decree, *supra* note 14, art. 34-3.

305. The term "securities company" is defined as "a person engaged in securities business pursuant to the KSEA." KSEA, *supra* note 13, art. 2(9).

KSE.<sup>306</sup> Under the current Articles of Incorporation of the KSE, foreign securities firms are not qualified to be members of the KSE even if they are licensed to engage in the securities business pursuant to Article 28-2 of the KSEA.

### B. Deficiencies in the Current Regulations

A primary purpose of regulating the business activities of a foreign securities firm should be to ensure the financial integrity of such a firm.<sup>307</sup> Currently, the KSEA simply applies the general domestic financial requirements to foreign securities firms and does not provide any special safeguards for such a purpose.

In an illuminating approach, the Japanese Law on Foreign Securities Firms has three safeguards to ensure such financial integrity: (i) the requirement to deposit a performance bond as a condition to the commencement of business;<sup>308</sup> (ii) the requirement to accumulate (in addition to reserves for sales loss and reserves for liabilities) an amount equivalent to a certain percentage of the profits earned from a branch's business at each closing of accounts at the branch in Japan as a reserve against loss;<sup>309</sup> and (iii) the requirement to hold assets in Japan equivalent to the aggregate sum of (a) the amount set aside as reserves for sales loss, reserves for liabilities, and reserves against loss, and (b) the amount equivalent to certain debt of the branch.<sup>310</sup>

The above-described safeguard provisions can be criticized as an obstacle to foreign securities firms' access to the Japanese market. However, given that the Korean securities market is not yet fully developed in comparison to the securities markets of major developed countries, Korea will need to give more weight to investor protection and to the sound growth of the securities market. Based on this reasoning, the safeguards adopted in Japan could provide a useful model to Korea.

The next problem in the current laws and regulations is whether the existing financial requirements for minimum working capital, for minimum net capital, and for the accumulation of reserves are to be applied to a foreign securities firm as a whole or only to its branch in Korea. Since Article 28-

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306. KSEA, *supra* note 13, art. 76-2. Prior to the 1987 amendments, a trading member's qualification for membership on the KSE was dictated by Article 84(1) of the KSEA, and by the Trading Member Regulation of the KSE. Under the 1987 amendments, the KSE became an autonomous organization and can now prescribe the terms of membership qualification in its Articles of Incorporation.

307. See SEC STAFF REPORT, *supra* note 2, at V-37.

308. Japanese Law on Foreign Securities Firms, Law No. 5 of 1971, as amended to June 9, 1981, art. 8; see also Kitagawa, *International Securities Transactions* in L. LOSS, M. YAZAWA & B. BANOFF, JAPANESE SECURITIES REGULATION 77-78 (1983).

309. Japanese Law on Foreign Securities Firms, *supra* note 308, art. 24; see also Kitagawa, *supra* note 308, at 78.

310. Japanese Law on Foreign Securities Firms, *supra* note 308, art. 25; see also Kitagawa, *supra* note 308, at 78.

2(2) of the KSEA provides that, with some exceptions, "a branch [of a foreign securities firm in Korea] duly licensed [by the MOF] shall be deemed a securities company under [the KSEA]," a literal interpretation of such provision would be that the requirements are applicable on a "branch" basis rather than a "whole legal entity" basis. With respect to minimum working capital or accumulation of reserves, this view is persuasive because such requirements are primarily related to the business activities of a branch in Korea. However, it could be argued that the minimum net capital requirement (i.e., debt-to-equity ratio) is designed to assure the financial stability and integrity of the securities firm as a whole and that therefore the requirement should apply to the firm as a whole rather than only to its branch in Korea. This should be clarified before foreign securities firms are permitted to establish a branch office in Korea.

Finally, the legal separation of the securities business and the banking business would become a problematic issue if a financial institution, engaged in both businesses under the universal banking system as in European countries, applies for the establishment of a branch in Korea as a securities firm. The KSEA has no provision directly applicable to this issue. As a general provision, Article 51 of the KSEA, which is applicable to foreign securities firms' branches in Korea as well as Korean domestic securities companies, prohibits a securities company from engaging in a business other than the securities business unless otherwise approved by the MOF. Another general provision, Article 29 of the KSEA, requires banks or other types of financial institutions to obtain approval from the MOF in order to engage in the securities business.<sup>311</sup>

Under the current KSEA, as a theoretical matter, a European bank engaged in both securities and banking in the jurisdiction of its incorporation can establish two separate branches in Korea, one as a banking branch and the other as a securities branch, or even one unified branch which conducts both securities and banking, after an approval of the MOF is obtained.<sup>312</sup> However, engagement by one financial institution in both securities and banking using either one or two separate branches would run counter to the fundamental structure of financial institutions in Korea as envisaged by the KSEA and the Bank Act.<sup>313</sup> Therefore, so long as the separation of the securities business from the banking business is maintained, a mechanism should be

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311. KSEA, *supra* note 13, art. 29. Based upon MOF approval, Korean domestic banks and some foreign bank branches in Korea are permitted to engage in limited bond underwriting and bond repossession. Article 25(1) of the Banking Act, *supra* note 256, also provides that in order to engage in a business other than banking, a bank shall obtain approval from the Monetary Board, the highest banking regulatory authority. Strangely, however, the banking authorities take the position that the securities business is incidental to the banking business and that no approval under the Banking Act is required for a bank to engage in securities business.

312. See KSEA, *supra* note 13, arts. 28-2(1), 51; Banking Act, *supra* note 256, art. 25.

313. See KSEA, *supra* note 13, art. 51; Banking Act, *supra* note 256, art. 25.

devised that ensures that a financial institution incorporated under the universal banking system will be permitted to establish only one type of branch (i.e., either a commercial banking branch or a securities branch), and that in order to engage in both businesses a subsidiary having a separate legal entity should be used.

## V.

### RECOMMENDATIONS FOR REFORM AND IMPROVEMENTS

#### A. *Formation of Fundamental Policies*

The internationalization of the securities market will obviously provide Korea with certain benefits. By opening up its securities market, Korea, whose economy depends heavily on foreign trade, will be able to mitigate the pressure from its trading counterparts for the elimination of various trade and non-trade barriers and foster a closer relationship with them. The internationalization of the securities market will also provide Korea with diversified means of raising foreign capital necessary for the further development of its economy, and eventually will provide Korea with diversified objects of investment. The above-mentioned benefits constituted the impetus behind the Korean government's policy to open up the securities market. All of the foregoing factors seem to call for a rapid facilitation of internationalization.

It should be noted, however, that the Korean securities market has not reached the maturity of the U.S., the British, or the Japanese market. The Korean securities market still plays a relatively small role in corporate financing in Korea,<sup>314</sup> and only a small number of Korean investors participate in the securities market.<sup>315</sup> The relative underdevelopment of the Korean securities market as compared with the growth of Korean economy can, for the most part, be attributed to the distrust of the general public in the mechanisms of the securities market. This perception was caused by several stock market crashes in Korea which occurred through manipulation of the market by groups of securities companies and through poor market administration. These crashes resulted in significant damages to innocent public investors.<sup>316</sup>

In order to digest the impact from internationalization, the Korean securities market must grow and develop, both in terms of size and trading practice. Most importantly, investor protection must be insured and the integrity of market maintained. If the Korean securities market is internationalized under the current securities laws, problems in the current regulatory mechanism could be unveiled which previously went unrecognized due to the

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314. The ratio of stock issuances to total corporate financing was 2.0% in 1985 and 5.4% in 1986. The ratio of market capitalization to Korean GNP was 9.0% in 1985 and 14.3% in 1986. See KSEC, INTERNATIONALIZATION, *supra* note 7, at 14.

315. As of June 1987, the number of individual stock investors only totaled 2.3 million, less than six percent of the total population. Korean Securities Exchange, Stock 87 (Jan. 1988).

316. For information about stock market crashes in Korea, see generally KSE, HISTORY, *supra* note 16, at 29-32, 46-51, 93-96.

market's immature and sheltered condition. Such a phenomenon would not allow Korea to fully enjoy the benefits of internationalization. The emphasis upon better protection of investors and the integrity of market is also consistent with the legislative intent of the KSEA.<sup>317</sup>

In sum, to expand the Korean economy through international trade and to diversify both sources of capitalization and objects of investment, it will be necessary to take steps to facilitate the internationalization of the Korean securities market. However, in taking such steps, policy makers should first insure investor protection and market integrity. Securities laws and regulations should be improved to guarantee these two vital domestic values, whether or not the laws in question are directly related to internationalization.

### *B. Recommendations for Reform and Improvements*

#### *1. Distribution of Securities*

In order to facilitate internationalization, the issuance by a listed company of new shares outside Korea to foreign investors without an intent to redistribute such shares within Korea should not be subject to a registration statement requirement and other provisions regulating the distribution of securities. Instead, such issuance should be dealt with in the context of a continuing disclosure requirement.

It should be clarified whether and to what extent Article 17 of the CMPA is applicable to foreign corporations which make a public offering of shares or are listed on the KSE. Article 17 should not be applicable to foreign issuers which do not have a place of business or an employee in Korea. It may be necessary to apply this provision to a certain extent to those foreign corporations which have such a place of business or employees in Korea. However, even in such a case, it would be appropriate to limit application of the provision to situations where the offering is made exclusively or primarily in the Korean securities market.

The regulatory mechanism in Korea for the distribution of shares should also be improved to give better investor protection. The concepts of "public offering" and "secondary distribution" should be clarified by providing standards for private placement exemptions. Public offerings or secondary distributions of securities (other than the issuance of new shares) should be treated in the same manner as an issuance by a listed company of new shares.

The required delivery of prospectuses to potential investors should be emphasized. The information to be disclosed in a registration statement should be reexamined and foreign issuers should be required to disclose additional information peculiar to themselves.

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317. Article 1 of the KSEA provides: "The purpose of this Act is to contribute to the development of the national economy by attaining wide and orderly circulation of securities, and by protecting investors through fair issuance, purchase, sale or other security transactions."

Civil liability provisions should expand the scope of persons subject to liability to include principal officers and those making secondary distributions. The acts subject to civil liability should be expanded to include improper offers during the pre-filing period and to include distribution by means of misleading statements. The reasonable care defense for issuers should be eliminated.

## 2. *Trading of Securities*

In order to maintain the integrity of the securities market, the substantive provisions of the anti-fraud rules and insider trading regulations are in need of improvement and the investigative power of the KSEC should be strengthened. The anti-fraud provisions should be improved by expanding their coverage and by removing the burden of proof needed to establish the existence of certain illegal statutory purposes.

The insider trading remedy provisions should be improved by clarifying the measurement of damages, the standing requirements, and the reliance requirements. The KSEC should be granted more effective investigative power with regard to fraudulent activities in securities. For the prevention of fraudulent acts at their inception, the KSEA should specify special injunctive relief to which the KSEC can resort and effective sanctions for non-compliance with an injunction. The criminal sanctions for violation of insider trading rules, particularly the maximum fine, should be strengthened by linking them to the profits made by the violator concerned.

For cross-border enforcement of securities laws without serious foreign conflicts, Korea should enter into international information sharing arrangements with the securities regulatory authorities in such countries as the United States, the United Kingdom, and Japan, with which Korea will presumably create close relationships in securities transactions. The U.S.-U.K. MOU or the U.S.-Canada MOU serve as a useful model.

In order to facilitate international securities trading, a new mechanism for clearing and settling international securities transactions and a linkage with foreign clearing agencies should be established by means demonstrated by the precedents of other developed countries.

## 3. *Regulation of Foreign Securities Firms*

Safeguards contained in the KSEA for the financial integrity of foreign broker-dealers are in need of improvement. Following the Japanese approach, such safeguards should include the deposition of a performance bond, the maintenance of a specified amount of assets within Korea, and the accumulation of specified reserves. The KSEA should also be clarified as to whether the existing financial requirements are applicable on a branch basis or a "whole legal entity" basis and should include the necessary regulations dealing with the opening of a business office by a foreign financial institution engaged in universal banking in its home country.

Finally, other areas such as the FECA, the FECA Enforcement Regulation, the FCIA and the tax laws should also be brought into line with the above described reforms and improvements to achieve a smooth and balanced regulation of Korea's internationalized securities market.

#### CONCLUSION

Korea has achieved remarkable economic growth during the past two decades. The economic growth has been attributable to a large extent to foreign trade and capital. The securities market, however, has not played a major role in the development of the Korean economy. The Korean government has recently taken actions to develop and gradually open up its securities market to foreign investors and issuers. This development will increase the role of the securities market in the Korean economy of the future.

The internationalization of the securities market will, however, raise various issues, among them, international cooperation in securities offerings, cross-border clearing and settlement, and enforcement of anti-fraud rules and insider trading regulations. It will also provide an opportunity to reexamine the adequacy of the current securities laws to protect investors and to maintain the integrity of the securities market. In order to enjoy the benefits of internationalization, priority should be given first to investor protection and maintenance of market integrity, and then to the facilitation of international offerings and trading.

**ABBREVIATIONS**

- AMEX:** The American Stock Exchange; *See* note 277.
- ADR:** American Depositary Receipts. *See* note 2.
- CCP:** Code of Civil Procedure. *See* note 210.
- CDS:** The Canadian Depositary for Securities Ltd.. *See* text accompanying note 184.
- CMPA:** Capital Market Promotion Act. *See* text accompanying note 21.
- FCIA:** Foreign Capital Inducement Act. *See* note 44.
- FECA:** Foreign Exchange Control Act. *See* note 23.
- JSCC:** Japan Stock Clearing Corporation. *See* Part IV.C.3.
- KSCC:** Korean Securities Clearing Corporation. *See* Part II.A.1.a.
- KSDA:** Korean Securities Dealers Association. *See* Part II.A.1.a.
- KSE:** The Korean Stock Exchange. *See* Part II.A.1.a.
- KSEC:** The Securities and Exchange Commission of Korea. *See* note 15.
- KSFC:** Korean Securities Finance Corporation. *See* Part II.A.1.a.
- KSSB:** Securities Supervisory Board of Korea. *See* note 20.
- MOF:** Ministry of Finance of Korea. *See* Part II.A.2.
- MOU:** Memorandum of Understanding. *See* Part IV.B.3.
- NSCC:** National Securities Clearing Corporation. *See* Part IV.C.4.
- KSEA:** Korean Securities and Exchange Act. *See* note 13.
- SEC:** Securities and Exchange Commission of the United States. *See* Part II.A.2.
- TSE:** The Toronto Stock Exchange. *See* note 277.