

November 2022

Recent updates on Korean Short Sale Rules

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As summarized in our previous newsletter ([click here](#)), the amendment to the Financial Investment Services and Capital Markets Act (the "FSCMA") aimed to strengthen short sale regulations became effective on April 6, 2021. Under the amended FSCMA which newly introduced criminal penalties and administrative fines for illegal short sale, any party which engages in, entrusts or accepts entrustment of short sale of listed securities in breach of applicable regulatory requirements may be subject to imprisonment of one year or longer period or a criminal fine equivalent to three to five times the amount of profit earned from the breach. In addition, the Financial Services Commission (the "FSC") may impose an administrative penalty ranging up to the amount of the relevant short sale order. The authorities are likely to seek to impose criminal penalties for intentional breaches while seeking to impose administrative penalties for breaches arising from negligence. In this regard, we note that the administrative penalty amount under the amended FSCMA, which may range up to the applicable short sale amount, may be significantly higher than the amount of administrative fine that could be imposed for short sale rule breaches under the prior law (*i.e.*, breaches occurring prior to April 6, 2021), which were capped at KRW 100 million per breach..

- With the introduction of FSCMA provisions for imposition of criminal penalties and administrative penalties for breaches of the short sale rules, the preexisting FSCMA provisions on the imposition of administrative fine for short sale breach have been removed. On November 1, 2022, the Securities and Futures Commission (the "SFC") reviewed and imposed administrative fines for certain short sale breach cases that occurred prior to April 6, 2021, pursuant to the FSCMA provisions in effect prior to that date. We understand that to date no disposition has been rendered for breaches of the short sale rules occurring on or after April 6, 2021, although the regulators continue to investigate breaches potentially subject to the strengthened penalties under the amended FSCMA. We therefore expect the SFC to deliberate and impose administrative penalties for short sale violations in the near future pursuant to the amended FSCMA provisions now in effect.

- The Short Sale Investigation Team at the Financial Supervisory Service (the "FSS") newly established this year is currently leading the FSS's efforts to investigate unfair trade practices relating to short sale, gathering information related to short sale, and closely examining those transactions involving local brokers and investors that participated in large volume short sale trades for potential regulatory breaches. It appears that the Short Sale Investigation Team at the FSS is looking not only into naked short sales but also unfair trade practices related to short sales as well as short sales linked to block trades (for example, short sale trades conducted during the book-building phase of block trades).
- The regulators have also indicated that they will consider publicly disclosing the names of the entities found to have engaged in illegal short sale.

Amendment to the Financial Investment Business Regulation Relating to Short Sale

On November 9, 2022, the proposed amendments to the provisions in the Financial Investment Business Regulation relating to short sale, which were previously announced as explained in our newsletters in July and October ([click here](#)), took effect.

- The purpose of the amendment is to set forth the necessary measures in accordance with the measures jointly announced by the relevant government agencies on July 28, 2022 to strengthen the detection and punishment of illegal short sales and to improve the short sale regime. The amendment stipulates (i) reduction of the collateral ratio for retail investors' short sale trades (from 140% to 120%), (ii) the obligation to report detailed information on relevant balance of stock lending and borrowing, and (iii) the obligation to file a report to the financial authorities regarding the long-term stock borrowing (over 90 days).

Based on the foregoing and in light of the strengthened short sale regulations, we anticipate that the regulatory agencies will maintain a restrictive view on short sale rule breaches and may try to impose significantly larger administrative penalties for short sale breaches going forward. Therefore, investors are advised to be fully aware of the recent amendments to the rules and regulations on short sales, and to enhance their compliance systems and controls to prevent the risk and occurrence of short sale violations.

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