

October 27, 2022

## FINANCIAL REGULATORY AUTHORITIES TO STRENGTHEN INVESTIGATION, EXAMINATION AND PUNISHMENT OF ILLEGAL SHORT SELLING ACTIVITIES

It is essential for international securities companies and offshore investors to review your own records for any known or unknown potential violations. Please contact us to discuss your particular facts. Please note that, in addition to naked short selling, certain covered short selling may be in violation of the Korean regulations.

### I. Background

- A. On 27 July 2022, President Yoon ordered the implementation of preventive measures against short selling violations. As a result, the Financial Services Commission ("**FSC**"), the Supreme Public Prosecutors' Office ("**PPO**"), the Financial Supervisory Service ("**FSS**") and the Korea Exchange ("**KRX**") held a joint meeting on July 28, 2022, and announced measures to improve the stock short selling system and strengthen the detection and punishment of short selling violations. FSS' recent activities including audits, examinations, and investigations are aligned with such measures. A brief outline of such proposed new measures is set forth below for your reference.
- B. In the past, the KRX was primarily responsible for monitoring and detecting short selling violations, and the FSS generally initiated investigation only after KRX notified it of the suspicious trading cases. Now, the regulators (FSC and FSS) and KRX along with PPO are working in collaboration so that the FSS, FSC, and PPO will be alerted in real time of suspected short selling violations.
- C. The FSS also established a short sell investigation task force ("**Task Force**") within the FSS. The Task Force aims to significantly strengthen oversight on short selling violations along with related market manipulation, market disruption and insider trading activities. The Task Force aims to launch an investigation immediately upon detection of any such suspected violations.
- D. Furthermore, the FSS is taking active steps to detect short selling violations by examining and investigating domestic and international securities companies

#### Hee-Gang Shin

Partner

T 82.2.3404.0156

E heegang.shin@bkl.co.kr

#### Young Mo Kim

Senior Foreign Attorney

T 82.2.3404.0255

E youngmo.kim@bkl.co.kr

#### Chris Kim

Senior Foreign Attorney

T 82.2.3404.0291

E chris.kim@bkl.co.kr

#### Se Yeong Im

Partner

T 82.2.3404.7640

E seyeong.im@bkl.co.kr

<sup>1</sup> FSC previously implemented a temporary ban on all short selling (effective from March 16, 2020 to May 2, 2021) in response to the increased market volatility caused by the COVID-19 crisis, but permitted a partial resumption of short selling limited to large capital stocks (e.g., KOSPI 200 or KOSDAQ 150 shares) as of May 3, 2021. Naked short selling has been and remains banned.

and domestic and foreign investors. The FSS has launched a non-routine examination on a foreign securities company which acted as a local broker (for the offshore investors/traders) for short selling transactions. The FSS seems to have additional local brokers, including both foreign and domestic owned local brokers, on their "to review" list.

## II. Effective as of October 24, 2022

The KRX has recently amended Enforcement Rules of KOSPI Market Business Regulation, KOSDAQ Market Business Regulation and KONEX Market Business Regulation, respectively, which became effective as of October 24, 2022, to expand the application of overheated short-sell stock designation.

Specifically, a stock will be designated as an overheated short-sell stock if:

- A. the stock price declines by more than 3% that day;
- B. the total short trading volume for that stock constitutes at least 30% of the total trading volume for that day; and
- C. the short trading volume of that stock for that day is at least 200% of the average of the short trading volume for the previous 40 trading days.

The main purpose is to expand the list of stocks prohibited for covered short selling.

## III. Proposed New Measures (Expected to be Enacted in the Coming Weeks/Months)

Strengthening Oversight and Penalization of Short Selling Violations	Improvement of the Short Selling System
<ol style="list-style-type: none"> <li>1. <b>Strengthen targeted investigation on unfair transactions related to short selling</b>  Set the theme and select the area for targeted investigation, and carry out targeted investigation immediately upon detecting suspicious activities.</li> <li>2. <b>Pursue prompt investigation on prohibited short selling activities</b>  Launch inspection on short selling regularly and promptly carry out investigation on suspicious activities.</li> <li>3. <b>Carry out robust investigation and strict punishment</b> <ol style="list-style-type: none"> <li>a. Establish a real-time monitoring/information sharing system between the relevant government bodies for detecting short selling and market violations.</li> </ol> </li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Strengthen monitoring over long-term or large-scale stock loan transactions</b> <ol style="list-style-type: none"> <li>a. Impose an obligation to report detailed information on long-term stock loans with a duration of more than 90 days.</li> <li>b. Required to include stock loan information when filing a regulatory report of short position.  <u>Purpose:</u> To be reviewed by KRX, FSS and PPO as appropriate</li> <li>c. Automatically extend and carry over the application of the one-day short sell ban to the following trade date when stock prices decline 5% or more while short selling ban is in place.  <u>Purpose:</u> To extend the designated time period of overheated short-sell stock</li> </ol> </li> </ol>

<p>b. Make use of the fast-track investigation process centered around the joint investigation unit set up at Seoul Southern District Prosecutors' Office, impose strict punishment commensurate with the severity of the crime, and seek forfeiture of illegal profits and concealed properties gained through short selling and market violations.</p> <p>4. <b>Establish and strengthen the short selling violations investigation team</b></p> <p>Enhance organizational capacity at KRX and FSS to strengthen detection of short selling violations.</p>	<p>2. <b>Provide retail investors with fair opportunities for short selling</b></p> <p>Lower individual investors' margin requirement (collateral ratio) from 140% to 120%.</p> <p><u>Purpose:</u> Provide further investment opportunities to individual investors.</p>
---	--

\* \* \*

For any inquiry or questions regarding the content of this newsletter, please contact us.