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## RECENT INTENSIFICATION OF INVESTOR PROTECTION IN THE KOREAN SECURITIES MARKET: THE MANDATORY AND FAIR DISCLOSURE SYSTEMS

Kwang-Rok Kim<sup>†</sup>

*Abstract:* This Article analyzes the Korean fair disclosure system and the Korean mandatory disclosure system under the Korean Securities and Exchange Act ("KSEA"). After the turbulence in the financial markets resulting from the economic crises of late 1997, the South Korean government realized that the Korean economy had failed to keep pace with the world economy. The Korean economy underwent many changes after being offered financial relief from the International Monetary Fund. As part of these changes, the government adopted a series of structural reform measures to improve the standard of corporate governance and enhance corporate management. The KSEA now provides a vehicle for balancing information within the securities market, as does the Fair Disclosure Standard ("FDS"), adopted in November 2002. The system, while an improvement, is not perfect. This Article compares Korean and U.S. fair disclosure and mandatory disclosure systems and addresses problems in the former. It also makes suggestions for improving Korean fair disclosure and mandatory disclosure regulations and securities practices.

### I. INTRODUCTION

After the turbulence in the financial markets caused by the economic crises of 1997, South Korean leaders realized that the Korean<sup>1</sup> economy had failed to keep pace with the world economy. In response, the government introduced a series of drastic measures for market liberalization and global standardization. As a result, the Korean economy has undergone many changes since being offered financial relief from the International Monetary Fund. The government adopted a series of structural reform measures to improve the standards of corporate governance and to enhance corporate management. The government opened its financial markets to foreign countries by abolishing or amending some restrictions on foreign investments and introducing new securities market systems.

The trend towards internationalization has been a general movement in politics, cultures, and economics throughout the world. The continuing development of industrial technologies and the reorganization of the world

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<sup>1</sup> Hereinafter, "Korea" refers to the Republic of Korea.

economy caused by the collapse of the Communist Bloc brought about globalization of the market economy. During the 1980s and 1990s, the trend towards internationalization transformed capital markets, including global securities markets.<sup>2</sup> This trend has centered on the U.S. securities market. Global markets are increasingly important to U.S. investors because of internationalization, while the U.S. securities markets are increasingly important to foreign investors as well. The data reveal that investor interests in global markets are significantly increasing. Between 1990 and 2000, gross transactions in U.S. equities by foreign investors increased approximately twenty-fold, from about US\$ 361.4 billion to US\$ 703.6 trillion, while gross transactions in foreign stocks by U.S. investors increased more than fourteen-fold, from approximately US\$ 254.5 to US\$ 361.6 trillion, over the same period.<sup>3</sup>

As part of this trend toward internationalization, the Korean government amended its foreign stock exchange regulations in 1988 and implemented a new policy for free foreign exchange and foreign investment. The government also relaxed its limitations on foreign ownership of equity and abolished its limitation on foreign subscriptions for public purchase of shares.<sup>4</sup> Since these changes, the Korean securities market has become much more attractive to U.S. and other foreign investors. It is a general principle that the Korean Securities and Exchange Act ("KSEA") applies not only to domestic firms, but also to foreign firms that offer their securities on the Korean securities market. Foreign securities in the Korean securities market are now treated identically to domestic securities.<sup>5</sup>

The steady growth of any market generally depends on whether share prices are fairly established and whether investors' decisions to invest in these shares are based on sufficient and accurate information. When issuing companies disclose their financial information, investors can make investment decisions based on accurate and sufficient information, which is a key element of steady market growth and public confidence. Consequently, both U.S.

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<sup>2</sup> See Kwang-Rok Kim, *Korean Hostile Takeovers And The Friendly Internationalization of the Securities Market: An Investor Protection Perspective*, 10 MINN. J. GLOBAL TRADE 357, 357 (2001).

<sup>3</sup> See SECURITIES INDUSTRY ASSOCIATION, 2001 SECURITIES INDUSTRY FACTBOOK 78-79, available at [http://www.sia.com/reference\\_materials/pdf/2001FactBook.pdf](http://www.sia.com/reference_materials/pdf/2001FactBook.pdf) (last visited Apr. 23, 2003).

<sup>4</sup> See Kim, *supra* note 2, at 358.

<sup>5</sup> See Korean Securities and Exchange Act, art. 2(1)(7)-(8), amended by Act No. 6695 of Apr. 27, 2002 (latest amendment) (S. Korea), translated in 11 STATUTES OF THE REPUBLIC OF KOREA § 22, available at [http://www.moleg.go.kr/page\\_link.php?left=left5.php&main=econo\\_list.php](http://www.moleg.go.kr/page_link.php?left=left5.php&main=econo_list.php) (last visited May 2, 2003) [hereinafter KSEA].

federal securities laws and the KSEA prescribe mandatory disclosure rules to protect investors in the securities market.

Imbalance of information, therefore, significantly impedes steady market growth and investor protection. Furthermore, even when issuing companies disclose accurate and sufficient information under the mandatory disclosure system, a serious imbalance of information among securities investors can destroy stability and confidence in the market. In practice, issuing companies usually disclose their nonpublic information to analysts, lawyers, institutional investors, investment advisors, and others who have special relationships with the companies before disclosing such information to the public. Such information includes predictions or prospects for the issuer's future business or management plans, financial status, operation results, and some information related to timely disclosure.<sup>6</sup> The KSEA provides a vehicle for balancing information within the securities.<sup>7</sup> If a company officer provides material, non-public information to an analyst, for example, the company must simultaneously report this information to the Korean Stock Exchange.<sup>8</sup>

This Article analyzes Korea's Fair Disclosure System and Mandatory Disclosure System under the KSEA. The KSEA treats all foreign companies' securities the same as domestic securities within the Korean securities market: a U.S. firm, for example, is treated as if it is a domestic Korean firm.<sup>9</sup> This Article compares the Korean and U.S. systems to assess problems within the fair disclosure and mandatory disclosure systems. This Article also makes suggestions for improving Korean fair disclosure and mandatory disclosure regulations and securities practices.

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<sup>6</sup> See Listed Companies' Disclosure Regulation (1988), amended Mar. 23, 2003, art. 5-2(1) (S. Korea) [hereinafter LCDR]. The periodic reports and the timely disclosure requirements are explained *infra* Part III.

<sup>7</sup> Final Rules on Selective Disclosure and Insider Trading, SEC Release Nos. 33-7881, 34-43154, 65 Fed. Reg. 51716, 51738 (Aug. 24, 2000) (codified at 17 C.F.R. §243.100) [hereinafter SEC Release Nos. 33-7881, 34-43154], available at <http://www.sec.gov/rules/final/33-7881.htm> (last visited Apr. 27, 2003). Regulation FD reads as follows:

(a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided § 243.101(e): simultaneously, in the case of an intentional disclosure; and promptly, in the case of a non-intentional disclosure.

17 C.F.R. § 243.100.

<sup>8</sup> See LCDR, *supra* note 6, art. 5-2(4).

<sup>9</sup> See KSEA, *supra* note 5, art. 2(1)(7) & (8).

## II. OVERVIEW OF MANDATORY DISCLOSURE AND FAIR DISCLOSURE SYSTEMS

### A. *Mandatory Disclosure System*

The KSEA was enacted January 15, 1962, and has been amended numerous times. Since the economic crises of late 1997, the KSEA has been used to enhance the Korean Securities Dealers Association ("KSDA") Automated Quotation System market<sup>10</sup> disclosure system to provide investor protection. To date, the KSEA has been amended more than twenty-five times and twelve times since the economic crisis of late 1997.<sup>11</sup> At the time of its enactment, the KSEA was viewed as a means to introduce the well-developed systems of industrialized countries, such as the United States, rather than as a means to effectively and substantially regulate a well-functioning securities market.<sup>12</sup> The Korean Mandatory Disclosure System under the KSEA is structured similarly to the U.S. Securities Act of 1933 ("1933 Act")<sup>13</sup> with regard to disclosure in the issuing market, and to the U.S. Securities Exchange Act of 1934 ("1934 Act")<sup>14</sup> with regard to disclosure in the distribution market.<sup>15</sup> However, unlike the mandatory disclosure systems under U.S. federal securities law,<sup>16</sup> the KSEA is Korea's only means to enforce mandatory

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<sup>10</sup> The KOSDAQ market is a secondary over-the-counter or "OTC" market operated by the Korea Securities Dealers Association (KSDA). The KSDA was established in November 1953 as a nonprofit self-regulatory organization. The KSDA's major functions include maintenance of fair trading practices among members, protection of investors, operation of the KOSDAQ market and management counselors, and research on the securities market system and securities training. In 1996, the KSDA created the KOSDAQ in accordance with the need for an organized system to operate the OTC market. The KSDA became a special legal entity, as an incorporated non-profit body, under the 1997 Amendment of the KSEA.

<sup>11</sup> See Kwang-Rok Kim, *Jusik Sijang eseo ui Tujaja Boho Jedo e kwanha Gochal* [Study on the Investor Protection System in the Securities Market], KOSDAQ JOURNAL 62 (Spring 2002).

<sup>12</sup> See KI-SU LEE & BYUNG-KYU CHOI, JEUNGGWEON KEORAEBOEP [SECURITIES AND EXCHANGE ACT] 4 (2000).

<sup>13</sup> See 15 U.S.C. § 77a (2000).

<sup>14</sup> See 15 U.S.C. § 78a (2000).

<sup>15</sup> In the United States, the Securities Act of 1933 controls the issuing market, while the Securities Exchange Act of 1934 controls the distribution market. Therefore under the 1934 Act, registration is designed to afford largely continuous disclosure, whereas the 1933 Act has a disclosure scheme that is transaction-oriented and episodic. See LUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 435-88 (2001).

<sup>16</sup> *Id.* There are seven federal securities laws: the Securities Act of 1933, 15 U.S.C. § 77a (2000); the Securities Exchange Act of 1934, 15 U.S.C. § 78a (2000); the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (2000); the Trust Indenture Act of 1939, 15 U.S.C. § 77aaa (2000); the Investment Company Act of 1940, 15 U.S.C. § 80a-1 (2000); the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 (2000); and the Securities Investor Protection Act of 1970, 15 U.S.C. § 78aaa (2000). For a general description of the laws, see LUIS LOSS & JOEL SELIGMAN, 1 SECURITIES REGULATION 224-73, (3d ed., 1998).

disclosure in both the issuing and distribution markets.<sup>17</sup> The mandatory disclosure system in the Korean issuing market requires registration of securities issuers, public offerings, and prospectuses. The distribution market's mandatory disclosure system also includes periodic disclosures (including prospectuses, annual, semiannual, and quarterly reporting), timely or at-all-times disclosures, and inquiry disclosures.

### *B. Fair Disclosure System*

In the U.S. securities field, selective disclosure—when an issuing company provides material, nonpublic company information to a stock analyst before disclosing it to the general public—has been a long-standing custom. However, because the practice disadvantages the investing public,<sup>18</sup> in August 2000, the U.S. Securities and Exchange Commission (“SEC”) promulgated Regulation FD which prohibits the selective disclosure of material nonpublic information. Effective on October 23, 2000, Regulation FD was intended to encourage a broad dissemination of investment information by equalizing the information available to individual investors and market insiders.

Selective disclosure has also been a long-standing practice in Korea. Like U.S. regulations, the KSEA was amended in January 2002 to prohibit selective disclosures and thus protect investors from the unfairness of the practice.<sup>19</sup> Under this amendment, the Listed Companies’ Disclosure Regulation (“LCDR”) created the Fair Disclosure Standard (“FDS”), which took effect on November 1, 2002.

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<sup>17</sup> The KSEA requires issuing companies to timely disclose financial information necessary for the purpose of investor protection by “attaining wide and orderly circulation of securities,” and through “fair issuance, purchase, sale or other transaction of securities.” The KSEA is the main law in Korea that regulates issuing and distribution of securities. Article 1 of the Act provides: “[t]he purpose of this Act is to contribute to development of the national economy by attaining wide and orderly circulation of securities, and by protecting investors through fair issuance, purchase, sale or other transactions of securities.” KSEA, *supra* note 5, art. 1.

<sup>18</sup> See Paul P. Brontas, Jr., *Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts*, 92 COLUM. L. REV. 1517, 1531 (1992).

<sup>19</sup> See KSEA, *supra* note 5, art. 89. This provision was adopted on January 26, 2002. *Id.*

### III. MANDATORY DISCLOSURE SYSTEM

#### A. *The Issuing Market*

##### 1. *Securities Registration*

In order to protect investors in the securities market, the KSEA requires companies to disclose details about the securities they issue. Companies that wish to offer securities<sup>20</sup> are required to register with the Financial Supervisory Commission ("FSC").<sup>21</sup> The FSC then discloses this registered information to public investors. Almost all securities must be registered with the FSC, with the exception of government bonds, bonds issued by a corporation that are established under a special act, corporate bonds, and corporate certificates of contribution that are established under a special act.<sup>22</sup>

In the U.S. system, the definitions of "security" in the 1933 Act<sup>23</sup> and 1934 Act<sup>24</sup> apply to a broad range of transactions.<sup>25</sup> The KSEA definition of "security", in contrast, covers only a more limited range: government bonds, municipal bonds, bonds issued by a corporation that are established under a special act, corporate bonds, corporate certificates of contribution that are established under a special act, stock certificates or instruments that represent preemptive rights, certificates or instruments issued by a foreign corporation, securities deposit receipts issued by the Korea Securities Depository on the basis of underlying certificates or instruments issued by foreign corporations, and other certificates or instruments<sup>26</sup> that are similar or related to those

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<sup>20</sup> For the types of securities, see KSEA, *supra* note 5, art. 2.

<sup>21</sup> The KSEA abolished the existing Securities and Exchange Commission in February 1998, transferring most of the authority to the FSC. The FSC was established on April 1, 1998 as a consolidated financial supervisor over the four separate sectors of securities, banking, insurance, and credit management fund. However, in January 1999, the four institutions were integrated into the Financial Supervisory Service ("FSS"), the executive body of the FSC. More information about the FSS and FSC is available at <http://english.fss.or.kr/en/about/abu/establishment.jsp> (last visited on Apr. 21, 2003).

<sup>22</sup> See KSEA, *supra* note 5, art. 3.

<sup>23</sup> The Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1).

<sup>24</sup> The Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10).

<sup>25</sup> Although the term "security" includes stocks, notes, bonds, and any instrument commonly known as a security, the statutory definition also covers a wide variety of extraordinary and unique instruments, such as pyramid sales schemes, chinchillas, whiskey warehouse receipts, and beavers. See the Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1); the Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10).

<sup>26</sup> "Other certificates or instruments" are designated in the Enforcement Decree of the Securities and Exchange Act. Enforcement Decree of the Securities and Exchange Act, Presidential Decree No. 17907, Feb. 24, 2003 (S. Korea) [hereinafter Enforcement Decree]. Article 2-3 of the Enforcement Decree reads as follows:

above.<sup>27</sup> Under the KSEA, all these securities must be registered with the FSC, unless an exception applies.<sup>28</sup>

The KSEA requires that companies register the above-mentioned securities as well as those securities they intend to issue, in order to ensure the fair issuance of securities and provide for the public disclosure of company information.<sup>29</sup> Companies that must register with the FSC include:

- (1) corporations that intend to list their securities on the securities market;
- (2) unlisted corporations that intend to make public offerings of new or outstanding securities;
- (3) stock-unlisted corporations that intend to merge with stock-listed corporations;
- (4) unlisted corporations that intend to have securities traded on the [KSDA's] brokerage market;
- (5) corporations undergoing incorporation that intend to make a public offering of new securities; and

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1. Beneficiary certificates issued by trust companies in accordance with the provisions of the Trust Business Act;
  - 1-2. Beneficiary certificates issued by a trust company according to an asset securitization plan under the Asset-Backed Securitization Act;
  2. Beneficiary certificates issued by management companies in accordance with the Securities Investment Trust Business Act;
  3. Beneficiary certificates issued by a foreign securities investment trust businessman (this refers to a person conducting securities investment trust business in a foreign country under foreign Acts and subordinate statutes thereon);
  - 3-2. Investment certificates issued by a special purpose company according to an asset securitization plan;
  - 3-3. Mortgage-backed bonds issued by a special purpose company for mortgage-backed bonds according to a bond securitization plan Special Purpose Company for Mortgage-Backed Bonds Act;
  4. Bills prescribed by the Minister of Finance and Economy from among those which are issued for the purpose of financing by an enterprise; and
  5. A right which may effect the transactions falling any of the following items between the parties concerned by the unitary declaration of intention of a party in accordance with the criteria and method prescribed by the Korea Stock Exchange: Purchase and sale of stock certificates; Receipt or payment of amount calculated by the difference between the securities index or stock price index which was determined in advance and the securities index or stock price index which is actualized at the time when the intention concerned is declared; and Futures trading of securities index.

*Id.*

<sup>27</sup> KSEA, *supra* note 5, art. 2(1).

<sup>28</sup> See KSEA, *supra* note 5, arts. 2-3.

<sup>29</sup> See *id.* art. 3.



(6) corporations that intend to grant stock option rights to officers and employees.<sup>30</sup>

However, a company that issues exempt securities is also exempt from the FSC registration process pursuant to Article 3 of the KSEA.<sup>31</sup>

## 2. *Registration Statement*

The U.S. federal securities laws also provide for some exemptions from filing a registration statement with the SEC. Companies that provide “exempt securities”<sup>32</sup> and that conduct “exempt transactions”<sup>33</sup> are not required to provide certain details.<sup>34</sup> In contrast, under the KSEA, as a general rule companies that intend to publicly offer their securities must file a registration statement with the FSC.<sup>35</sup> The purpose of this disclosure obligation is to protect investors in the market. Therefore, the public offering of new or outstanding securities may not be made until a registration statement is accepted by the FSC.<sup>36</sup> As a result, certain transactions can only take place when registration statements become effective after being filed and accepted by the FSC.

Under the KSEA, companies that publicly offer new securities must file a registration statement if more than fifty people are solicited to subscribe.<sup>37</sup> Furthermore, if the securities may later be transferred to more than fifty people within one year of issuance and the security falls under the FSC criteria for resale, the offering is defined as a public offering, and the company must register with the FSC.<sup>38</sup> Additionally, companies must register with the FSC if

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<sup>30</sup> *Id.*

<sup>31</sup> See *supra* note 20 and accompanying text.

<sup>32</sup> For a listing of the securities exempt from registration, see the Securities Act of 1933, § 3(a)(2)-3(a)(8); 15 U.S.C. § 77c(a)(2)-(a)(8).

<sup>33</sup> For the statutory limited offering exemptions, see the Securities Act of 1933, §§ 3(b), 4(6); 15 U.S.C. §§ 77c(b), 77d(6).

<sup>34</sup> See the Securities Act of 1933, § 5; 15 U.S.C. § 77e.

<sup>35</sup> See KSEA, *supra* note 5, art. 8(1). However, in instances where there are no potential investor protection problems, companies are not required to register with the FSC. See *id.* art. 7.

<sup>36</sup> In this case, the total value of a public offering of new or outstanding securities is more than the amount prescribed by the Ordinance of the Ministry of Finance and Economy. KSEA, *supra* note 5, art. 8.

<sup>37</sup> See KSEA, *supra* note 5, art. 2(3); Enforcement Decree, *supra* note 26, arts. 2-4(1), 2-4(2). In calculating the number of people solicited, the KSEA totals the people who have been solicited for an offer during past six months from the date of solicitation with regard to the same type of securities other than through public offering. See Enforcement Decree, *supra* note 26, art. 2-4(3).

<sup>38</sup> See Enforcement Decree, *supra* note 26, art. 2-4(4).

the total value of a public offering exceeds one billion dollars.<sup>39</sup>

### 3. *Prospectus*

Because a prospectus contains information critical for proper investment decisions, U.S. federal securities laws prohibit securities transactions if a prospectus is not delivered to investors.<sup>40</sup> In contrast, the KSEA does not require delivery of a prospectus to investors, it only requires issuing companies to *prepare* an investor prospectus, which need only be filed with the FSC and made available for public inspection at a specific place.<sup>41</sup> The actual location of this place is determined by presidential decree.<sup>42</sup> However, it is generally not easy for investors to inspect the prospectuses. Companies are only required to provide prospectuses to investors upon their request.<sup>43</sup>

Once a registration statement is accepted by the FSC, issuing companies can solicit investors' subscriptions using simpler means than a full prospectus, such as advertisements, handbooks, publicity leaflets in newspapers, television and radio broadcasts, magazines, or electronically transferable media.<sup>44</sup> Because issuing companies do not necessarily create prospectuses with the investor in mind, the investor protection function of the prospectus is weakened.<sup>45</sup> Therefore, to better meet the goal of consumer protection, the KSEA should require that prospectuses be delivered directly to investors as is done in the U.S. system.

## B. *The Distribution Market*

### 1. *Periodic Disclosure*

Under the KSEA, stock-listed, association-registered, issuing and registered companies that have more than 500 stockholders are required to submit annual reports to the FSC and Korea Stock Exchange ("KSE") or to the

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<sup>39</sup> See KSEA, *supra* note 5, art. 8(1); Rule of KSEA, art. 2 (S. Korea). As of May 2003, one US dollar is worth about 1,230 won.

<sup>40</sup> See the Securities Act of 1933, § 5(b)(2); 15 U.S.C. § 77e(b)(2).

<sup>41</sup> See KSEA, *supra* note 5, art. 12(1). For more information that must be, or not be included in the prospectus, see Enforcement Decree, *supra* note 26, arts. 6 & 7.

<sup>42</sup> KSEA, *supra* note 5, art. 12(1).

<sup>43</sup> See KSEA, *supra* note 5, art. 13(1).

<sup>44</sup> See KSEA, *supra* note 5, art. 13(2)(3).

<sup>45</sup> See KUN-SIK KIMI, JEUNGGWEON KEORAEBEOP [SECURITIES AND EXCHANGE ACT] 106 (2000).

KSDA.<sup>46</sup> Annual reports must be submitted within ninety days of the end of each business year.<sup>47</sup> Companies that submit an annual report are also required to submit semi-annual and quarterly reports within forty-five days after the end of the relevant period.<sup>48</sup> An annual report contains the corporation's objectives, trade name, business content, financial particulars, and other matters, such as information about related companies, affiliates, securities, officers, and the Certified Public Accountant's audit statement.<sup>49</sup> The semi-annual and/or quarterly reports generally address the same issues as the annual report.

## 2. *Timely Disclosure*

The issue of timely disclosure is important when information that can affect the corporate value arrives after issuance of a periodic report. Although this information cannot be included within periodic reports because it arrives past the issuance of the report, it is of such significance that it should be disclosed immediately. Investors may be harmed unless companies promptly disclose this information in time to allow investors to protect their investments. The KSEA acknowledges this situation and requires companies' timely disclosure of such information. Therefore, if a company, such as those listed or registered with the KSDA, triggers one of the protective thresholds,<sup>50</sup> the

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<sup>46</sup> See KSEA, *supra* note 5, arts. 186-2, 186-3; Enforcement Decree, *supra* note 26, art. 83-2(1).

<sup>47</sup> KSEA, *supra* note 5, art. 186-2(1).

<sup>48</sup> *Id.* art. 186-3.

<sup>49</sup> See KSEA, *supra* note 5, art. 186-2; Enforcement Decree, *supra* note 26, article 83-2(1), (for more information about matters that must be addressed within annual reports).

<sup>50</sup> The KSEA, *supra* note 5, art. 186(1), provides those instances as follows:

1. Where any issued bill or check is dishonored, or when any transaction with a bank is suspended or prohibited;
2. Where the corporation's business is suspended in part or in whole;
3. Where the corporation files a petition for the reorganization (of the corporation) or where the reorganization procedure has actually commenced pursuant to the provisions of relevant laws;
4. Where there is a resolution of the board of directors with respect to changing the objective of the business;
5. Where the corporation suffers from enormous damages caused by a disaster;
6. Where a lawsuit that may have great influence upon the listed securities or the securities registered with the Association is filed against the corporation;
7. Where any of the events referred to in Articles 374, 522, 527-2, 527-3 and 530-2 of the Commercial Act occurs;
8. Where causes for dissolution pursuant to the provisions of relevant statutes occur;
9. Where there is a resolution of the board of directors on the increase or decrease of capital or the retirement of stocks;
10. Where the operation is suspended or is unable to be continued due to special causes;

company must notify the FSC and KSE or the KSDA without delay.

If a company fails to faithfully report such information as specified in the periodic and timely reporting requirements, the FSC may recommend at a general stockholder meeting that the stockholders terminate the company's directors or officers. The FSC may also restrict the issuance of securities, demand the announcement of the unlawful contents, demand a submission of commitment letter, complain or report the violation to the relevant investigation agencies, or warn or caution the company.<sup>51</sup>

### 3. *Inquiry Disclosure*

Securities registration, prospectuses, periodic reports, and timely reports are all systems where the company itself is responsible for disclosing information. However, through the device of an inquiry disclosure, the KSE or the KSDA may request that companies disclose certain information or confirm or deny rumors regarding the company. Under the KSEA, the KSE or the KSDA can request a listed company or KSDA-registered company to address the probity of a rumor or news concerning the company if necessary for the fair transaction of securities and/or investor protection.<sup>52</sup> When companies are asked to disclose information, these companies must comply without delay.<sup>53</sup>

If a company fails to comply with a KSE or KSDA request for confirmation or disclosure, these bodies inform the FSC of the refusal, so that it may take appropriate measures. The FSC can also take action when companies fail to faithfully report pursuant to the periodic and timely reporting requirements. For example, the FSC can issue an order to file an amended statement.<sup>54</sup> When an order is issued, the FSC cancels the registration statement

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11. Where a correspondent bank assumes control of the corporation concerned;

12. Where there is a resolution of the board of directors, or a decision of the representative director or other person who is prescribed by Presidential Decree with respect to the acquisition and disposal of treasury stocks; and,

13. Where a fact occurs, as prescribed by Presidential Decree that has serious effects on the management and properties, etc., of the corporation other than subparagraphs 1 through 12.

<sup>51</sup> See KSEA, *supra* note 5, arts. 186(3), 193; Enforcement Decree, *supra* note 26, arts. 9-3(2)-(6) & 84-26.

<sup>52</sup> See KSEA, *supra* note 5, art. 186(2).

<sup>53</sup> *Id.* However, a company does not have to comply with the request only if it is having difficulties making such a disclosure due to other statutes or subordinate statutes, natural disaster, or for other similar reasons. *Id.*

<sup>54</sup> *Id.* art. 11(1).

that the offending company originally submitted.<sup>55</sup> The FSC then orders the companies to make an amendment and, if necessary, the FSC may suspend or prohibit the issuance of securities, the public offering of new or outstanding securities, or other transactions.<sup>56</sup>

However, companies that do not follow the FSC's order or violate the FSC's measures are punished by a fine of not more than five million won (about US\$ 4500).<sup>57</sup> Because the FSC penalty is so light when compared to the potential investor harm, heavier penalties are needed. One possible sanction would be to impose civil liability for investors' damages caused by a company's violation of inquiry disclosure requirements.<sup>58</sup>

### C. *Affirmative Mandatory Disclosure*

#### 1. *Soft Information*

In the United States, there is no obligation to affirmatively disclose general material information if it is nonpublic. However, when Item 303 of Regulation S-K, which pertains to "Management's Discussion and Analysis of Financial Condition and Results of Operation," calls for the mandatory disclosure of soft information,<sup>59</sup> the issuer is required to affirmatively disclose it.<sup>60</sup>

The KSEA, in contrast, only requires that an issuer state predictions or prospects for the issuer's future financial status or their operations results in the registration statement. Results that must be reported include:

- (1) information regarding the issuer's operation results, such as the size of sales and revenues, or other predictions or prospects on

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<sup>55</sup> *Id.* art. 11(2).

<sup>56</sup> *Id.* art. 20(1).

<sup>57</sup> *Id.* art. 210, 211.

<sup>58</sup> I suggest that such civil liability is also needed to address companies' failure to faithfully report information under the periodic and timely reports.

<sup>59</sup> Soft information is defined as "statements of objective analysis or extrapolation, such as opinions, motives, and intentions, or forward-looking statements, such as projections, forecasts, and predictions." In re Craftmatic Securities Litigation, 890 F.2d 628, 642 (3d Cir. 1989). See generally Securities Act Release No. 6084 (1979).

<sup>60</sup> As stated by one source, "the MD&A has become a major, if not the major, item of narrative disclosure that is studied, together with financial statements, for investment decision and analysis purposes." Carl W. Schneider, *Soft Information Disclosure*, C737 ALI-ABA 143, 251 (1993). See also SEC Financial Report Release No. 36 (1989).

operation results;

(2) information regarding the predictions or prospects for the issuer's financial status, such as the size of capital stock and fund flows;

(3) materials on the issuer's operation results or changes in financial status, and targeted levels of the company's management goals at certain points based on the occurrence of a particular event or the establishment of a particular plan; and

(4) other materials prescribed by presidential decree.<sup>61</sup>

In other words, under the KSEA, disclosure of soft information in the Korean securities market is an issuer's *right*, rather than an issuer's *duty*. Although the KSEA does provide terms of release of soft information, including "predicted information,"<sup>62</sup> which issuers may disclose, it is not like the mandatory obligation to affirmatively disclose required in the U.S. securities market. To better protect investors, therefore, disclosure of soft information should be made an affirmative and mandatory duty for issuers in the Korean market.

## 2. *Duty to Correct*

The KSEA imposes a duty on issuing companies to file amended statements with the FSC. If a registration statement filed with the FSC is incomplete, the FSC can order the company to file an amended statement.<sup>63</sup> Furthermore, even absent an FSC order, a company may file such an amended statement if any of the information originally included changes.<sup>64</sup> The effective date of the securities registration is then considered to be the amended statement's day of receipt.<sup>65</sup> This requirement is similar to the duty to correct in the United States.<sup>66</sup> In the United States, a company's duty to correct is triggered when the information it disclosed to the public through the securities market contains an error. This duty attaches from the time the incorrect information is publicly disclosed. After an error is found in the initial disclosure

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<sup>61</sup> See KSEA, *supra* note 5, art. 8(2).

<sup>62</sup> See *id.*

<sup>63</sup> *Id.* art. 11(1).

<sup>64</sup> *Id.* art. 11(3).

<sup>65</sup> *Id.* art. 11(5).

<sup>66</sup> For the concept of the duty to correct, see *Electronic Specialty Co. v. International Controls Corp.*, 295 F. Supp. 1063 (S.D.N.Y. 1968), *rev'd in part*, 409 F.2d 937 (2d Cir. 1969).

of hard information,<sup>67</sup> companies have a duty to correct the error.<sup>68</sup>

However, although the duty to correct exists under Korean regulation, it is only triggered by a procedural defect in a submitted registration statement when it occurs before the registration statement becomes effective. As a result, the Korean system acts as a procedural measure to correct errors within registration statements, rather than as a system to protect investors in the active securities market. In order to better protect investors, Korea must consider mandating an affirmative duty to correct more like that of the United States.

### 3. *Duty to Update*

The duty to update in the United States applies to many different situations. Generally, though, it is triggered when a company's previously disclosed information<sup>69</sup> becomes materially false or misleading due to subsequent events. The duty attaches even though the information was accurate and correct when originally disclosed.

Korea's timely disclosure system is similar to the duty to update in the United States in the sense that companies may disclose additional information after their initial public disclosures. However, the duties are very different in key ways. In the United States, the duty to update depends on whether the available information has become materially false or misleading as a result of subsequent events. On the other hand, in Korea, a company is responsible for the disclosure of new information<sup>70</sup> that affects the company's value, but was not included in any periodic disclosure measures.<sup>71</sup> In other words, the U.S. duty to update is designed to help investors make wise investment decisions by giving them access to information used in present-time corporate decision-making, whereas the Korean timely disclosure duty is designed to compel companies to disclose facts that simply might happen in the future. Korean companies, therefore, have no obligation to disclose any information that has become materially false or misleading as a result of subsequent events so long as the information was correct when it was initially disclosed. Because the

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<sup>67</sup> For a definition of "hard information," see Securities Act Release No. 6084 (1979).

<sup>68</sup> For more information about the duty to correct, see *Electronic Specialty Co.*, 295 F. Supp. 1063; F. Philip Manns, Jr., *Duty to Correct: A Suggested Framework*, 46 MD. L. REV. 1259 (1987).

<sup>69</sup> The subject of the duty to update is generally soft information, such as the context of merger negotiations, rumors, and so forth.

<sup>70</sup> See *supra* note 36 and accompanying text.

<sup>71</sup> See KSEA, *supra* note 5, art. 186(1).

Korean system inadequately protects investors, the KSEA should instead provide a device similar to the duty to update in the United States.

#### IV. FAIR DISCLOSURE SYSTEM

##### A. *Object Information*

If information has not been disseminated in a manner that makes it available to investors generally, this information is deemed nonpublic. The Fair Disclosure Standard (“FDS”) applies when an issuing company discloses material nonpublic information to specific persons. While “materiality” is not defined within the regulations, the Listed Companies’ Disclosure Regulation (“LCDR”)<sup>72</sup> roughly provides the definition of material information as predictions or prospects for the issuer’s plans for the future business or management, predictions or prospects for the company’s financial status or results of operation, the company’s financial status or results of operation which must be written in the periodic reports, and information required to be timely disclosed.<sup>73</sup>

In the United States, on the other hand, the SEC provides a list that sets forth the types of information that might be material, emphasizing that this list is not exclusive and the items on it are not per se material.<sup>74</sup> Listed items include earnings information, mergers and acquisitions, new products or discoveries, acquisitions or major contracts lost, changes in control or management, changes in auditors or withdrawal of audit reports, defaults on senior securities, changes in dividends, stock splits, repurchases and recapitalizations, and sales of additional securities.<sup>75</sup>

##### B. *Provider and Receiver of Information*

In the United States, SEC Regulation FD applies not only to issuers of stock, but also to any persons acting on the issuers’ behalf. Persons whose disclosures can trigger Regulation FD, therefore, include directors, executive

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<sup>72</sup> See discussion *supra* Part II.B, and accompanying text.

<sup>73</sup> See LCDR, *supra* note 6, art. 5-2(1). The periodic reports and the timely disclosure are explained *supra* Part III.

<sup>74</sup> Stanley Keller & Palmer & Dodge LLP, *SEC Regulation FD—The Selective Disclosure Rules*, SH013 ALI-ABA 307, 310 (2002).

<sup>75</sup> *Id.*



officers, senior officials, investor relations or public relations officers, and any other officer, employee or agent, such as public relations firm that regularly communicates to securities market professionals or security holders on the issuer's behalf.<sup>76</sup> Senior officials are defined as any directors, executive officers, investor relations or public relations officers, or other persons with similar functions.<sup>77</sup> However, an officer, director, employee, or agent of the issuer who discloses information in breach of a duty of trust to, or a confidence of, the issuer is not considered to be acting on behalf of the issuer.<sup>78</sup>

Similarly, the Korean FDS applies to disclosures by public companies or by persons acting on their behalf. Persons whose disclosures can trigger the FDS are directors, executive officers, and any other officers, employees, or agents with access to relevant information.<sup>79</sup> Thus, a company's insiders are the people responsible for providing the information controlled by the FDS.

On the other end, the LCDR identifies seven types of receivers of information: (1) securities companies, securities investment companies, securities advisory companies, future traders, and officers and employees of the above-mentioned types of companies and their affiliates, (2) institutional investors, and officers and employees of those institutions, (3) foreign institutional investors, and officers and employees of those institutions, (4) organs of expression, (5) securities information sites which use communication networks, (6) securities holders who attempt to use the selective information, and (7) other persons prescribed by the Stock Exchange.<sup>80</sup>

### *C. Application of the Fair Disclosure Standard*

In the United States, if an insider intentionally discloses regulated information to anyone, he or she must make a simultaneous public disclosure.<sup>81</sup> A disclosure is considered intentional when the person discloses regulated information to lawyers, analysts, investment advisers, or some other persons who have special relationships with the companies, if the disclosing person knows, or should know, that the information is both material and nonpublic. Regulated information includes predictions or prospects for the issuer's plans

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<sup>76</sup> *Id.* at 311.

<sup>77</sup> *See* 17 C.F.R. § 243.101(f).

<sup>78</sup> *Id.*

<sup>79</sup> *See* LCDR, *supra* note 6, art. 5-2(2).

<sup>80</sup> *See id.* art. 5-2(3).

<sup>81</sup> *See* 17 C.F.R. § 243.100.

for future business or management, predictions or prospects for the financial status or results of operation, the company's financial status or results of operation which must be reported within periodic reports, and information which is the object of the timely disclosure requirement.<sup>82</sup> In determining whether a person should have known that the information was both material and nonpublic, the person can be considered legally negligent if no reasonable person under the circumstances would make the same determination.

If the disclosure is non-intentional, on the other hand, it may be cured by prompt public disclosure.<sup>83</sup> "Prompt" means as soon as reasonably practicable, but, in any event, within twenty-four hours after a senior official of the stock issuer learns that there has been a non-intentional disclosure which he or she believes is both material and nonpublic, or was reckless in not identifying it as such.<sup>84</sup>

In Korea, however, the LCDR does not draw such a line between "intentional" and "non-intentional" disclosure. Rather, the LCDR provides a general rule, which might be called "plain selective disclosure." Under this rule, the LCDR requires the person who discloses regulated information to file such information and does not inquire about the person's intention for disclosure. If a company officer provides material non-public information to a securities analyst, the company must file a declaration of the information with the Stock Exchange prior to the officer's disclosure.<sup>85</sup> If the officer believes that the information was already disclosed or filed with the Stock Exchange, the company must file this information with the Stock Exchange up until the date the officer provides the information to an analyst or other individual.<sup>86</sup> The officer must immediately report the information in order to make it public upon realizing a selective information disclosure occurred prior to public disclosure of that information. Additionally, if the officer does not have any idea about the information as provided, the company must file the information on the date the officer becomes aware that it was not disclosed.<sup>87</sup>

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<sup>82</sup> See LCDR, *supra* note 6, art. 5-2(1). The periodic reports and the timely disclosure are explained *supra* Part III.

<sup>83</sup> *Id.*

<sup>84</sup> Keller and Palmer & Dodge LLP, *supra* note 74, at 312.

<sup>85</sup> LCDR, *supra* note 6, art. 7(2).

<sup>86</sup> *Id.* art. 7(3).

<sup>87</sup> *Id.* art. 7(4).

#### D. *Exception of Application*

In the United States, selective disclosure is permitted in some instances. First, Regulation FD does not apply to business communications between a company and a person who has a duty of trust or confidence with the company, including lawyers, accountants, investment companies, and others who may be classified as "temporary insiders"<sup>88</sup> of the company.<sup>89</sup> Second, Regulation FD does not cover persons who may assume a duty of trust or confidence with the company vis-à-vis the acquisition of the information.<sup>90</sup> Third, Regulation FD does not apply when an issuer selectively discloses particular information to a credit valuation company whose primary business is the issuance of credit ratings, provided that the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available.<sup>91</sup> Lastly, in some situations an issuer may selectively disclose information that has already been disclosed through securities registration in connection with a public offering under the 1933 Act.<sup>92</sup>

In Korea, similarly, the FDS does not apply to individuals who assume a duty of confidentiality to a company, such as lawyers, accountants, and credit valuation companies under the LCDR.<sup>93</sup> In addition, the LCDR provides that the disclosure of new information to the press is not covered under the FDS.<sup>94</sup>

#### V. CONCLUSION

Korean and U.S. federal securities laws and regulations provide mandatory disclosure systems and fair disclosure systems as vehicles for protecting investors in the securities markets. The main objective of both the U.S. federal securities laws and the KSEA is to facilitate correctly priced

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<sup>88</sup> For the definition of "temporary insider," see SEC Release Nos. 33-7881, 34-43154, *supra* note 7, at 8.

<sup>89</sup> See 17 C.F.R. § 243.100(b)(2)(i).

<sup>90</sup> See *id.* § 243.100(b)(2)(ii). The person's agreement to take the duty of trust or confidence must be express. In this case, an express oral agreement will suffice and a written agreement is not required. Moreover, it is not necessary for the issuing company to obtain the person's agreement before making the disclosure. An agreement obtained after the disclosure is made, but before the recipient of the information discloses or trades on the basis of it, will be sufficient. SEC Release Nos. 33-7881, 34-43154, *supra* note 7, at fn. 28. See 17 C.F.R. § 243.100(b)(2)(iii).

<sup>91</sup> See 17 C.F.R. § 243.100(b)(2)(iii).

<sup>92</sup> See 17 C.F.R. § 243.100(b)(2)(iv). For the details in this situation, see SEC Release Nos. 33-7881, 34-43154, *supra* note 7, discussed in Part II.B.6.

<sup>93</sup> LCDR, *supra* note 6, art. 5-5.

<sup>94</sup> *Id.*

securities and secure the stability of securities investment, thus ensuring the fair and efficient functioning of the securities market as a whole.<sup>95</sup> A wide and harmonious circulation of securities that protect investors through fair issuance, purchase, sale, or transaction of securities should be achieved in order to protect and maintain the fairness and efficiency of the securities market. For this reason, both the KSEA and the U.S. securities laws specify mandatory disclosure requirements to ensure timely disclosure of the information needed to make impartial investment decisions.

The Korean mandatory disclosure system in the issuing market under the KSEA is structurally similar to the U.S. Securities Act of 1933. In the distribution market, the terms of the disclosure system under the KSEA is also similar to the 1934 Act. However, the KSEA is very different from both in that it does not have an affirmative disclosure system, nor does it impose a duty to correct or a duty to update. Although the KSEA uses terms similar to “duty to correct” and “the duty to update,” the essence of these duties is quite different from those specified by U.S. regulations. In comparison to the duty to correct in the United States, the duty to correct in Korea is a rather limited complementary measure for addressing procedural errors within registration statements. The Korean duty to update is designed to compel companies to disclose facts that may simply occur in the future, rather than to help investors make wise investment decisions by releasing indicator forecasts. To address these shortcomings, the KSEA should be amended to make these duties to correct and to update affirmative mandatory disclosure duties as they are in the U.S. This would better protect investors and ensure the more fair and efficient operation of the Korean securities market.

In the United States, Regulation FD was not universally embraced. The Proposed Release<sup>96</sup> of Regulation FD generated extensive commentary on the materiality standard.<sup>97</sup> Many commentators—including securities industry representatives, securities lawyers, and issuers—asserted that the general materiality standard of Regulation FD was too vague for issuing companies to use in making selective disclosure judgments.<sup>98</sup> These commentators argued

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<sup>95</sup> See LAWRENCE E. MITCHELL & LEWIS D. SOLOMON, *CORPORATE FINANCE AND GOVERNANCE* 239 (1992).

<sup>96</sup> See *Selective Disclosure of Insider Trading*, 64 Fed. Reg. 72,590 (Dec. 28, 1999) (to be codified at 17 C.F.R. pts. 230, 240, 243, and 249).

<sup>97</sup> For the comments, see *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716, at 51,721 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

<sup>98</sup> See Shannon M. Mudd, *The Missing Piece of the Mosaic: Improving Regulation FD*, 80 WASH. U. L.Q. 971, 973 n.20 (Fall 2002).

that Regulation FD would produce a “chilling effect” by restricting an issuing company’s ability to provide immaterial information for fear that the information may be deemed material.<sup>99</sup> In response to concerns that Regulation FD would threaten market efficiency by restricting issuer communication, the SEC argued that Regulation FD promotes market efficiency by encouraging broader disclosure of information.<sup>100</sup> Moreover, the SEC has noted that investors no longer need rely on market analysts as information intermediaries because technological advancements now allow public investors to access unprecedented levels of information.<sup>101</sup> As a result, the SEC has supported Regulation FD as a means to encourage real-time communication with public investors.<sup>102</sup>

In Korea, commentators have made similar arguments that the FDS would shrink the securities market by making companies reluctant to disclose information. Moreover, some commentators have noted that because the Korean securities market is not as advanced as the U.S. market, it is not yet appropriate to introduce a Korean version of Regulation FD. However, equal access to information is the most important factor in achieving a fair and efficient securities market. Once a market loses investor confidence, it loses its life. In the Korean securities market, the FDS will at least make companies adopt greater sincerity and honesty. The result will be the promotion of investor trust. In the long run, the Korean securities market will become more efficient. Wide and harmonious circulation of securities can only be achieved by protecting investors through ensuring the fair issuance, purchase, sale, and transaction of securities. A mandatory disclosure system and a fair disclosure system akin to those in the United States are necessary and essential for an efficient Korean securities market.

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<sup>99</sup> See *id.* at 972-73.

<sup>100</sup> See Selective Disclosure and Insider Trading, *supra* note 96, at 51,721.

<sup>101</sup> *Id.* at 51,717; see Statement by Former SEC Chairman Arthur Levitt Concerning On-Line Trading (Jan. 27, 1999), available at <http://www.sec.gov/news/press/prssarchive/1999/99-9.txt> (last visited Apr. 24, 2003).

<sup>102</sup> Selective Disclosure and Insider Trading, *supra* note 96, at 51,717.