

# SECURITIES REGULATIONS IN KOREA

*PROBLEMS AND RECOMMENDATIONS  
FOR  
FEASIBLE REFORMS*

by

YOUNG MOO SHIN

UNIVERSITY OF WASHINGTON PRESS

*Seattle and London*

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*To My Father & Mother*

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This book is an elaboration of the thesis, "Securities Regulations in Korea," which I wrote for the degree of Doctor of Science of Law from Yale Law School in 1978. While the main text of this book remains essentially unchanged from the original thesis, the Appendix contains substantial additions and updating of developments both in the securities regulations and the securities markets in Korea. In writing the thesis, I was deeply indebted to many people who assisted me in various ways; it is impossible for me to enumerate all those people here, though I am forever grateful for their help and contributions.

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Young Moo Shin  
Seoul, Korea  
December, 1982

## Introduction

Developing and maintaining a well-functioning securities market which efficiently allocates ownership of the economy's capital stock is vital to the sound development of the national economy in every country. In a developing country like Korea, lacking a capital formation process capable of sustaining the high rate of investment needed for rapid economic growth and depending heavily on foreign capital, promoting the securities market is a vital issue in designing and implementing national economic policies. By introducing a complex system of legal regulation and by effecting a series of law reforms, Korea has struggled to develop securities markets as a strategy to attain efficient capital formation for the past fifteen years.

Securities regulation relates to a wide range of economic activities of market participants and thus raises various legal problems integral to a country's economic system and policies. Securities regulation in Korea is basically structured with the concept of preserving a free and open market by substantially modeling its primary source of law, the Securities and Exchange Act (SEA of 1962), on the federal securities acts in the United States. However, due to unique socio-economic situations in the society, Korea has enacted special laws under which the government becomes extensively involved in the economic activities of the participants, restraining free ownership and economic freedom.

Unlike business corporations in other developing or developed countries, most business corporations in Korea have been traditionally held by a single family or a group of related persons who had never wanted to go public. Although the Korea Stock Exchange

(KSE) was opened in 1956, there were few listed corporations until 1968. Because of this reluctance to go public, most corporations financed their increasing capital needs in a rapidly growing economy through borrowing, leveraging their capital structure further which thereby threatened to become bankrupt. This reluctance to resort to public equity financing also created a serious shortage of commodity supplies in the market; thus, public investors could not commit their savings to enterprises. Indeed, fair competition among the participants has been seriously distorted because of this disequilibrium in the market. Because reasonable production and investment decisions in the management were lacking, the goals of capital formation and economic development plans were significantly frustrated. Since 1968, the government has enacted a series of special laws to encourage and force certain large business corporations to go public.

Through strenuous government efforts, many corporations went public, and the size and functions of the securities markets in Korea grew rapidly until 1976. Along with the rapid growth of the securities markets, the real growth rate of the gross national product (GNP), which had been below 4% in 1957-1961 and 7.8% in 1962-1968, averaged 10.5% in 1967-1971 and 11.5% in 1972-1976. The excessively high share of foreign capital in gross investment, which had been 75% in 1956-1961 and 54% in 1962-1966, decreased to 39.9% in 1967-1971 and 32% in 1972-1976.

Hoping for sustained rapid economic growth and a further reduction of the share of foreign capital, the government placed the heaviest financing burden on the securities market for the implementation of the Fourth Five-Year Economic Development Plan of 1977-1981. In an attempt to achieve the goals of capital formation placed on the securities market, the government also effected a far-reaching reform in securities laws in late 1976. The 1976 Amendments of the securities laws were to strengthen the regulatory structure, to ensure fair and full disclosure, to strengthen anti-fraud regulation, and to spread further equity ownership among the public for an efficient allocation of the real national resources. However, the 1976 Amendments had significant deficiencies, and left many legal problems unresolved.

Achieving the goal of efficient allocation of real resources requires another far-reaching law reform. One purpose of this thesis is to dis-



cuss an ideal capital market for Korea and formulate basic policies upon which recommendations for another securities law reform can be based. To understand the needed reforms, the thesis analyzes the present Korean securities laws to identify regulatory loopholes and drawbacks in light of moving toward an ideal market.

This thesis consists of Three Parts and nine Chapters. In Part One, Chapters One through Four, this study closely examines the historical development of the Korean securities markets to clarify the unique social situation in Korea. This study describes how one developing nation Korea, has coped with her capital market promotion problems, especially in a rapidly growing economy. Major emphasis is placed on identifying the barriers to the development of the capital market and appraising the measures taken since 1968, their successes and failures. Finally, Chapter 4 of this study describes the background and contents of the 1976 Amendments of the securities laws, a far-reaching reform completed by early 1977.

In Part Two, this study analyzes the present laws governing the securities markets and identifies regulatory problems. Since Korean securities laws are borrowed substantially from the United States through Japan, the writer compares the Korean laws with those of the United States and Japan. In Chapter 5, he describes the sources of Korean securities laws.

In Chapter 6, the writer analyzes the laws governing the distribution of securities, such as preliminary activities for public offerings and secondary distributions, processing of the registration statement for disclosure of relevant information, and civil liability for misstatements or omissions of a material fact. Because of the strong government involvement in going public, special subjects such as forcing corporations to go public, securities analysis for the determination of offering prices, and problems of forced going public will also be dealt with.

In Chapters 7 and 8, this study discusses the present laws governing trading in securities and other related areas. Chapter 7 discusses the topics of regulations of securities exchanges, manipulating and stabilizing activities, the over-the-counter (OTC) market and securities companies, and securities credit. Chapter 8 discusses the subjects of takeover bids, including ownership increases, proxy solicitation, tender offers, and organic changes and freeze-outs, and disclosure and insider trading. Special emphasis is placed on tracing the regulatory

deficiencies revolving around the lack of a proper disclosure standard and a far-reaching anti-fraud rule, a lack which undermines the basic policy goal of a reliable investment climate.

In Part Three, the writer attempts to design recommendations for feasible reforms to move toward the ideal, an efficiently functioning securities market. First, he discusses the concept of an efficient securities market and actual features on the Korean securities markets to formulate a justifiable foundation of which recommendations can be based. The accompanying specific recommendations for reform will be briefly outlined because details have been discussed in the preceding chapters.

Finally, an Appendix is attached, since this thesis was originally written almost five years ago. In the Appendix, the writer describes some of the recent developments in the securities market, the liberalization of the securities market, and the 1982 amendments to the securities laws.

Despite the rapidly increasing importance and growing social demand for studies on Korean securities laws, such studies have been totally neglected thus far. Not even a single article has been written on the securities laws in Korea until the completion of this thesis. Such a lack of previous studies and the resultant scarcity of literature on the Korean securities laws made research on this thesis difficult. In addition, neither the legislature nor the authorities, in enacting or enforcing the securities laws, provided sufficient legislative histories or other materials useful for the clarification of provisions of statutes which are often vague and ambiguous. Another exacerbating condition for the interpretation of the statutes is the lack of court decisions in this field. Therefore, this study had to depend heavily on the inference of the statutes, language by comparing it with those of the United States and Japan on which the former is substantially modeled. It is thus hoped that this study will not only serve as an analysis of the Korean securities laws and a recommendation for legislative actions, but also will provide momentum for more studies in this area.

## List of Abbreviations

<b>AMU</b>	The Association of Managing Underwriters. 139, 140, 142, 169, 402
<b>BOK</b>	The Bank of Korea. 37, 44, 168, 241, 281
<b>CITA</b>	Corporate Income Tax Act (Law No. 1964, Promulgated On Nov. 29, 1967). 47, 48
<b>CMPA</b>	Capital Market Promotion Act (Law No. 2046, Promulgated on Nov. 22, 1968). 45, 46, 53, 67, 118, 164, 394
<b>CPA</b>	Certified Public Accountant. 69, 104, 155, 254, 402
<b>DSITC</b>	Daehan Securities Investment Trust Co., Ltd. 91, 99
<b>EPB</b>	Economic Planning Board. 7, 92
<b>FCIA</b>	Foreign Capital Inducement Act (Law No. 1802, Promulgated on Aug. 3, 1966). 65
<b>GPEA</b>	Going Public Encouragement Act (Law No. 2420, Promulgated on Dec. 30, 1972). 61, 64, 66, 83, 118
<b>KDB</b>	Korea Development Bank. 168
<b>KDFC</b>	Korea Development Finance Corporation. 34, 38, 54
<b>KDI</b>	Korea Development Institute. 79
<b>KIC</b>	Korea Investment Corporation. 42, 49, 54, 80, 99
<b>KIDC</b>	Korea Investment and Development Corporation. 49
<b>KMBC</b>	Korea Merchant Banking Corporation. 41, 91
<b>KSDA</b>	The Korea Securities Dealers Association. 6, 118, 138, 224, 259, 267, 402, 414
<b>KSE</b>	Korea Stock Exchange. 7, 49, 51, 89, 177, 201, 270, 362, 412
<b>KSFC</b>	Korea Securities Finance Corporation. 22, 56, 89, 206, 256, 281, 417

<b>KSIC</b>	Korea Securities Investment Corporation. 71
<b>KSITC</b>	Korea Securities Investment Trust Co., Ltd. 91
<b>KTB</b>	Korea Trust Bank (now, The Bank of Seoul and Trust Company). 38, 51
<b>KUSFC</b>	Korea United Securities Finance Corporation. 11
<b>MBC</b>	Money & Banking Commission. 37
<b>MOF</b>	Ministry of Finance. 8, 65, 96, 182, 242, 400, 412
<b>MS &amp; FC</b>	Mutual Savings and Finance Company. 41
<b>NASD</b>	National Association of Securities Dealers in the United States. 118, 236, 246, 259
<b>NCU</b>	National Credit Union. 41
<b>NYSE</b>	New York Stock Exchange. 193, 201, 327
<b>PCBRA</b>	Public and Corporate Bonds Registration Act (Law No. 2164, Promulgated on Jan. 1, 1970). 118
<b>SAC</b>	Securities Administrative Commission. 95, 182, 223, 250, 330, 366, 400
<b>SDAJ</b>	The Securities Dealers Association of Japan. 119, 239, 240, 268
<b>SEA</b>	Securities & Exchange Act (Law No. 972, Promulgated on Jan. 15, 1962). 16, 51, 69, 93, 104, 115, 223, 250, 341, 399
<b>SEC</b>	U.S. Securities and Exchange Commission. 117, 201, 263, 327, 401
<b>SIPA</b>	Securities Investor Protection Act in the United States. 247
<b>SITA</b>	Securities Investment Trust Act (Law No. 2129, Promulgated on Aug. 4, 1969). 50, 90, 118
<b>SSB</b>	Securities Supervisory Board. 96, 102, 182, 223, 254, 363, 403
<b>STI</b>	Securities Training Institute. 100, 262, 269
<b>STI &amp; FC</b>	Short-Term Investment and Finance Company. 39, 50, 129
<b>TIA</b>	Trust Indenture Act (Law No. 991, Promulgated on Jan. 20, 1962). 118

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