# More Effective Monetary Sanctions for the Violation of Major Shareholding Disclosure

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Korea revised the Financial Investment Services and Capital Markets Act in May 2013 to introduce money penalties seeking to improve the effectiveness of Korea's major shareholding disclosure regulation in line with the global toughening of monetary sanctions. Thus far, however, money penalties for breaking that regulation seem ineffective as a sanction. Today, money penalties have been widely recognized as an effective tool to curb any violation against capital market laws and regulations. A desirable approach toward higher regulatory effectiveness could be seeking to fine-tune the key values used to calculate the amount of money penalties, e.g., the law's maximum limit, the scope expansion of the minimum limit, and the imposing ratio, etc.

## 1. Introduction of monetary penalties

Shareholding information has grave significance as it helps management of listed companies to defend against a hostile takeover, retail investors to value their investment, and prospective acquirers to have some time to weigh up their takeover bid. Accordingly, the Financial Investment Services and Capital Markets Act (FSCMA) mandates the information on any blockholder who has a major stake in a listed company to be disclosed. Because any failure in enforcing such disclosure may possibly undermine fair competition in the market for control and information provision to investors, the FSCMA sets out sanctions for the violation of the disclosure of major shareholdings.

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* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

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Previously, non-reporting or false reporting were subject to either criminal sanctions such as imprisonment and fines, or administrative sanctions such as a limit on voting rights for a certain period or a disposal of the shares involved in the violation. However, the FSCMA revised in May 2013 has introduced monetary penalties with the aim to improve the effectiveness of the disclosure of major shareholdings and to keep in line with the global regulatory trend of tougher monetary penalties.

Despite the revision, monetary penalties imposed for a major shareholding disclosure violation are still ineffective as a monetary sanction. Among many reasons behind this, a primary one could be the low amount of monetary penalties, which might have been designed to help the system easily take hold. Also notable is the innate nature of the major shareholding disclosure regime: Other disclosure rules governing the securities registration statement and other reporting obligations target listed companies, whereas major shareholding disclosure targets investors. In addition, takeover bid disclosure has a more direct impact on business controls, whereas major shareholding disclosure intends to give the market a prior warning. In this article, I explore the limits of Korea's current money penalties, and the global trend for tougher monetary penalties, based on which I present a desirable approach for more effective sanctions against major shareholding disclosure violations.

## 2. Current monetary penalties lack effectiveness

Monetary penalties on any violation of major shareholding disclosure regulation should follow not only the FSCMA and the Enforcement Decree, but also the Regulation on Capital Market Investigation (Regulation, hereinafter) of the Financial Services Commission (FSC). When imposing monetary penalties for a major shareholdings disclosure violation, the FSCMA shall take into account the detail, degree, time period, number of the violation, as well as the size of profits incurred by the violation. The amount of monetary penalties for the violation is calculated by a three-step procedure. The first step is to determine the base amount involved in the violation, and the upper limit of the monetary penalty, while the second step is to compute the base monetary penalty. The third and last step of the procedure is to factor in certain circumstances to reduce or exempt the penalty. Especially, the range of the monetary penalty in the second step is calculated by multiplying the base amount prescribed in the FSCMA by the ratio set forth in the Regulation. Currently, the Regulation uses nine ratios to impose monetary

penalties factoring in the significance of violations (high, moderate, low), and the reason for adjustments (an increase or a decrease).

A major shareholding disclosure violation is subject to a money penalty computed as follows. First, the company's market capitalization is multiplied by 1/100,000, but the maximum money penalty shall not exceed KRW 500 million under the FSCMA. The next step is to multiply the resultant amount by one of the nine ratios ranging from 0.2 to 1.0 that is selected by factoring in the significance of the violation as well as the reason for adjustments. However, such a calculation process results in small monetary penalties, e.g., KRW 16,706 to KRW 738,560 for 869 small to medium listed companies whose market cap is smaller than KRW 100 billion. This certainly undermines the effectiveness of monetary penalties (see Table 1).

**Table 1. Maximum monetary penalty limits by market capitalization**

| Market Cap | No. of Firms | Total Market Cap (KRW million) | Market Cap Average (KRW million) | Maximum Monetary Penalty Limit (KRW) | Base Monetary Penalty (KRW) |
|---|---|---|---|---|---|
| KRW 10 trillion or higher | 30 | 859,515,109 | 28,650,503 | 286,505,030 | 57,301,006 ~286,505,030 |
| KRW 5 trillion ~ KRW 10 trillion | 23 | 151,723,543 | 6,596,675 | 65,966,750 | 13,193,350 ~65,966,750 |
| KRW 1 trillion ~ KRW 5 trillion | 129 | 287,696,920 | 2,230,208 | 22,302,080 | 4,460,416 ~22,302,080 |
| KRW 500 billion ~ KRW 1 trillion | 101 | 73,281,481 | 725,559 | 7,255,590 | 1,451,118 ~7,255,590 |
| KRW 100 billion ~ KRW 500 billion | 841 | 179,884,550 | 213,893 | 2,138,930 | 436,786 ~2,138,930 |
| KRW 50 billion ~ KRW 100 billion | 527 | 38,922,473 | 73,856 | 738,560 | 147,712 ~738,560 |
| KRW 10 billion ~ KRW 50 billion | 319 | 10,820,062 | 33,918 | 339,180 | 67,836 ~339,180 |
| Less than KRW 10 billion | 23 | 192,141 | 8,353 | 83,530 | 16,706 ~83,530 |

Note: 1) Total market cap means the market capitalization of all companies listed on the KOSPI and KOSDAQ combined.
2) The maximum monetary penalty limit means the amount of market cap multiplied by the ratio set forth in the law (1/100,000).
3) The base monetary penalty refers to the amount computed by multiplying the maximum monetary penalty limit by one of the nine monetary penalty ratios (from 0.2 to 1.0) determined by factoring in the significance of the violation and reasons for adjustments.

### 3. Monetary penalties are increasing globally

Stronger monetary sanctions for non-compliance with capital market laws is a global trend. Not only Korea, but also the US and Japan have sought to flexibly and effectively regulate any non-compliance by adopting monetary sanctions primarily enforced by respective authorities such as the FSC, SEC, and Financial Service Agency, meaning that monetary sanctions such as money penalties have been proved effective globally. Indeed, a monetary penalty system has many benefits. First, it has been adopted by many anti-trust laws and securities laws, proving the legal compatibility. Second, the amount has grown fairly large. Third, it can mobilize the expertise of financial authorities. Fourth, it takes lower costs and less time to enforce the system. Lastly, it is unrelated with unnecessary criminal charges.

Korea first introduced the monetary penalty system in 1999 with the aim to make the disclosure regime more effective. Later in 2002, it was expanded to asset management of securities companies. The efforts in using monetary penalties for higher regulatory effectiveness elevated as monetary penalties were expanded to major shareholding disclosure in 2013 and market abuses in 2014. Especially, the 2013 revision on the FSCMA toughened monetary sanctions by raising the monetary penalty on financial investment companies two-fold from 20% to 40%. As a result, most violations of the FSCMA, except for insider trading, price manipulation, and some other unfair trade practices, are now subject to monetary penalties.

In the US, Section 13(d) of the Securities Exchange Act of 1934 amended by the Williams Act in 1968 requires anyone who beneficially owns more than 5% of equity securities in a registered or public company to file the information related to ownership to the SEC, the securities exchange, and the issuer under Schedule 13D. This provision is enforced by the SEC. With the aim to make the Federal Securities Law more effective, the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 was enacted, which enables monetary penalties for not only insider trading, but also any violation of the Federal Securities Law, which as a result has given the SEC stronger tools to address securities regulation violations. Accordingly, the enactment has enabled the SEC to start a civil action to impose money penalties for a violation of Section 13(d).

Section 21(d) of the Securities Exchange Act of 1934 sets forth three-tier money penalties: the maximum amount of the first tier is $5,000 on a natural person and $50,000 on any other person whose violation is without scienter; the second tier maximum is $50,000 on a natural person and $250,000 on any other person involved in fraud, deceit, manipulation, or deliberate

or reckless disregard of a regulatory requirement; and the third tier is $100,000 on a natural person and $500,000 on any other person involved in the cases described in the second tier and if the act of violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses. If the amount of illicit gains from the violation is larger than the penalty set forth in each tier, the penalty can rise to the larger amount. The tiers of money penalties are adjusted every four years under the Federal Civil Penalties Inflation Adjustment Act of 1990 (see Table 2).

**Table 2. Civil penalty tiers**

(Unit: $)

| | Subject | Before Dec.'96 | Dec.'96 ~ Feb.'01 | Feb.'01~ Feb.'05 | Feb.'05~ Mar.'09 | Mar.'09~ Feb.'13 | Feb.'13~ Jan.'17 | After Jan.'17 |
|---|---|---|---|---|---|---|---|---|
| First Tier (Simple Violation) | Natural Person | 5,000 | 5,500 | 6,000 | 6,500 | 7,500 | 7,500 | 8,289 |
| | Legal Entity | 50,000 | 55,000 | 60,000 | 65,000 | 75,000 | 80,000 | 82,893 |
| Second Tier (Fraud, etc.) | Natural Person | 50,000 | 55,000 | 60,000 | 65,000 | 75,000 | 80,000 | 82,893 |
| | Legal Entity | 250,000 | 275,000 | 300,000 | 325,000 | 375,000 | 400,000 | 414,466 |
| Third Tier (Substantial Losses) | Natural Person | 100,000 | 110,000 | 120,000 | 130,000 | 150,000 | 160,000 | 165,787 |
| | Legal Entity | 500,000 | 550,000 | 600,000 | 650,000 | 725,000 | 775,000 | 801,299 |

Japan introduced monetary penalties when it revised the Securities and Exchange Act in 2004, seeking to diversify types of sanctions for violations of securities laws and regulations. After this was proven effective, its application scope has been expanded. Although the initial purpose was to make unfair trade regulation more effective, monetary penalties since then have been expanded to other areas, e.g., disclosure regulation. At the early stage in 2004, monetary penalties were used in limited areas such as false statement in issuance disclosure, rumor circulation, deceptive schemes, undue trades to cause a fluctuation of quotations, and insider trading. Subsequently, the application area widened to include: false statement in continuous disclosure in the 2005 revision of the Securities and Exchange Act; and failure to submit issuance and continuous disclosure documents, false statement or failure to submit a tender offer registration statement or a large shareholding report, wash sales, and matching

transactions, and manipulation for stabilization in the 2008 revision of the Financial Instruments and Exchange Act. The amount of monetary penalties is determined by the relevant laws depending on the amount of gains from the violation, but there is no discretionary reduction in the penalty amount. This aroused criticism that the requirement and procedure of monetary penalties were excessively formal and rigid, even taking into consideration the law's need to maintain objectivity. Accordingly, the 2008 revision tried to add flexibility to the law by allowing the monetary penalty to be reduced or increased under certain circumstances.

Article 27-23 of the Financial Instruments and Exchange Act requires anyone who owns more than 5% of securities and etc. of a listed company to disclose relevant information. As one of the sanction tools, a monetary penalty equivalent to 1/100,000 of market capitalization is imposed for false or no reporting. However, the absence of differentiated sanctions depending on the significance of each violence is still regarded problematic.

### 4. A desirable approach for higher regulatory effectiveness

Korea's regime to impose monetary penalties for major shareholding disclosure violations is a slap on the wrist compared to that of the US and Japan. In the US, the maximum limit of civil penalties is set on violations of the Securities Exchange Act across the board, and thus it is hard to grasp exactly how much civil penalties are imposed for the major shareholding disclosure violation alone. However, the maximum limit seems formidable given the range of civil penalties from $8,289 to $801,299. Japan's monetary penalty regime is similar to Korea in that the upper limit of the monetary penalty the Prime Minister can impose for a major shareholding disclosure violation is 1/100,000 of market capitalization. However, no adjustment is made unlike Korea sometimes imposes only 20% of the penalty considering the significance and other circumstances of the violation. Because Japan imposes the monetary penalty as stipulated in the Financial Instruments and Exchange Act without any adjustment, Japan's penalties appear much stronger than those of Korea.

Also notable is that a major shareholding disclosure violation in Korea does not necessarily end up with monetary penalties. The FSCMA prescribes that the FSC "can impose" monetary penalties, which leaves the decision up to the FSC's discretion. Given that a monetary penalty for a violation is a must without any discretion given to the Prime Minister, Japan's monetary penalty system is much tougher than Korea's.

Korea's monetary penalty system for major shareholding disclosure violations might require a supplementary action if it seems ineffective. However, a desirable approach is seeking for an optimal tool to raise regulatory effectiveness because the monetary penalty system itself has been widely recognized as an effective tool to address non-compliance of the capital market laws. Toward that end, there are many ideas that seem applicable in practice, e.g., adjusting the current monetary penalty limit (currently at 1/100,000 of market capitalization), changing the ratio (currently ranging from 0.2 to 1) while keeping the monetary penalty limit intact, mandating over 50% of the monetary penalty ceiling to be actually imposed, etc. In addition, further in-depth discussions should take place about a wider range of issues that are directly or indirectly related to major shareholding disclosure violations.