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An Evaluative Analysis of Korean Legislative Development in Relation with Economic Growth

Estabiishment of the Capital Market

Cho Hye Shin

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Abstract

Ⅰ. Background and Purpose

□ In Korea, the role played by the financial ministry in the course of the government-led economic development from the 1960s through the 1980s was called “government-led financial operation” or “policy financing.” Such expressions point to the close partnership between the government and private businesses. The government had such a powerful political and economic influence that it could close businesses outright or rejuvenate failing ones, so businesses earnestly cooperated with the government. The government helped businesses grow based on diligence and adventurism, while trying to control them in a way it found appropriate. Such a firm relationship between the government and businesses formed through financial policy.

□ As a country with an extremely limited capital base, Korea used such a method effectively, and the experience has formed the basis of the achievement made by the country. Thus, the method adopted by the country during its process of development is worth noting. The process of development in the country’s capital market and the relevant legal system, in which the government played a definite role, can provide developing countries with many lessons to learn from.

□ This study will check to see how the legal system regulating the capital market has changed, what institutions have been adopted, and how the policy objective of capital market development has been achieved in detail. It will be difficult to generalize the path of the country's economic development in a few words, but efforts made in this study will help those interested get a better grasp through this model of the capital market-related legal system required for different stages of a national economy's development. The results of this study will be a useful, basic material for developing countries wishing to benchmark Korea's economic development with similar efforts.

Ⅱ. Main Contents

□ It can be said that the formative stage of Korea's capital market-related legal system was from 1956, when the stock market was first opened, to 1976, when the law was revised wholly. The formative stage of the country's capital market-related legal system can be divided into three periods, depending on the overall changes in the government's policy concerning the capital market. The first period was the period in which the stock market first opened, the Securities and Exchange Act was enacted, and the law was revised to deal with the causes behind the stock market crisis that occurred. The second period was the period in which the government

took a series of measures, such as the enactment of the Act on the Furtherance of Capital Market and the Act on Promotion of the Initial Public Offering, to promote the capital market. That period can be called the capital market promotion period. Finally, the third period was the period in which measures for protection and development of investors were taken in step with the growth of the capital (stock) market.

□ During the formative stage of the capital market-related legal system, the country achieved the desired goal of rapid growth of the capital market, but experienced a devastating failure due to various deficiencies in the system and the market participants' immaturity. Following the enactment of the Securities and Exchange Act in January 1962, trade volume increased in the stock market and businesses started issuing stocks briskly. Four months later, the stock market faced a crisis and legislative steps were taken to get the stock market out of the difficulties it faced.

□ In Korea, the financial sector focused for a long time on the role of providing support for the growth of manufacturing, under the government's regulation and influence, in connection with a need to attach importance to manufacturing and exports in order to overcome the limitations of the small domestic market in the course of economic development and earn foreign currencies because the country needed to import technologies and capital

goods. The country's capital market displayed the characteristics of an economic system that selected an export-oriented path of development.

□ At that time, the country's capital market was under the strict control of the Ministry of Finance and thus the country could cope efficiently with difficulties that occurred in the course of the formation of the capital market, including the stock market crisis in 1962. In this respect, it can be said that the government-led development policy exerted its merits in the capital market as in other economic policies.

Ⅲ. Expected Effect

□ In connection with Korea's experience of the formation and development of its capital market-related legal system, items that developing countries may want to benchmark in their effort to design and operate their capital market-related legal system are as follows:

□ First, in the case of a developing country's capital market-related legal system, when it is in a formative stage, it is proper to impose regulations on the securities industry from an industrial perspective in addition to regulations on information disclosure and unfair trade designed for the protection of investors, as Korea did. Especially, it is necessary to operate a

legal system regulating detailed behavioral norms in a way that will train financial market participants to adopt desirable market behaviors, as it is feared that market participants, such as securities business operators, stock exchanges, stock investors, and listed firms, are likely to experience trials and errors due to an insufficient understanding of the capital market or will try to seek private interest by taking advantage of loopholes in the system.

□ Second, it appears desirable to confine the scope of products traded in a financial market (i.e. the scope of products regulated under a capital market-related law) to stocks in the formative stage of a capital market-related legal system that does not yet have a variety of institutional apparatuses that can minimize volatility and risk, which are unavoidable features of a capital market. Transactions of products like derivatives, which entail complexity and risk, must be preceded by the formation of the relevant infrastructure, including human resources.

□ Third, following the stock market crisis in 1962, just a few months after the opening of the market and the enactment of the Securities and Exchange Act, the first step taken by the Korean government was to revamp regulations on the securities industry. The experience showed that it was highly likely that financial market participants would abuse securities business operators or the securities exchange where they had an insufficient

understanding of the market and their market behavior remained immature.

□ Fourth, in a common law-model of a capital market-related legal system, which is regarded as a global standard, private enforcement tends to be emphasized. Such a method of enforcement appears to not be proper for developing a country's capital market-related legal system when it remains in the formative stage. This is due to the lack of a proper judicial system for private enforcement and because people have low trust in the judiciary branch of the government. Thus, it is thought that it is better to leave the enforcement to regulatory agencies that can enforce the law on capital market powerfully and efficiently.

□ Finally, it is Korea's capital market fostering policy (i.e. the policy of encouraging listing on the stock market) that was the most successful item in the country's capital market-related legal system and it will serve as an important lesson for later starting countries. Measures encouraging businesses' IPOs can be made on a diverse level ranging from inactive support to positive incentives.

Key Words : capital market; financial policy; economic development; developing countries; the Securities and Exchange Act

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Chapter 1. Foreword

Section 1. Significance and Purpose of This Study

No one will dispute the fact that the development of the financial sector is very important for a country's economic growth. The importance of a stable and efficient financial system is emphasized even more today, when the shock of a financial crisis spreads worldwide. Today, the level of the development of banks and the stock market of a country is regarded as a barometer of its economic growth. Needless to say, developing countries that do not have an efficient and stable financial system are more vulnerable to a global financial crisis. A study concerning how a financial operation-related legal system provides support to economic growth is very important, as it is not possible to expect development in the financial sector without legal and institutional support.

For a country striving for economic development, establishment of a mechanism for the supply of capital required for economic development is the most important thing to do. The relevant legal systems include those related to foreign capital/investment, banks (the central bank, commercial banks, and specialized banks), capital market (stock market and derivatives market), and the like. Altogether, they can be called a financial legal system. It can be said that a capital market-centered financial system is the most desirable part in the economic development process of today in consideration of the fact that most developing countries use foreign investment to secure the funds required for their economic development. Many countries strive to have an advanced capital market, regarding it as an

item at the top of their agenda, and the level of the development of a country's capital market is viewed as a measure of its economic growth.

The terms "government-led financial operation" or "policy financing" were used to describe the role assumed by the financial sector in the economic development process of Korea in the 1960s through the 1980s, when the government proactively pushed ahead with economic growth. Such expressions point to the close partnership between the government and private businesses. The government had such a powerful political and economic influence that it could close businesses outright or rejuvenate failing ones, so businesses earnestly cooperated with the government. The government helped businesses grow based on diligence and adventurism, while trying to control them in a way it found appropriate. Such a firm partnership between the government and businesses was formed through financial operations. It is worth noting that the country's past development experience accumulated in mobilizing available capital to the fullest extent laid the basis of the economic achievement accomplished by the country, although the financial crisis that hit the country in 1997 was blamed on the inefficiency and backwardness of the financial industry. Particularly, the process of the development of the country's capital market and relevant legal system, in which the government played a positive role, will serve as a lesson for many developing countries.

Today, the current internal and external economic conditions of developing countries are much different from what was experienced by Asian developmental states in the period prior to the 1990s. Businesses are carrying out activities freely across national borders. The effect of their activities does not remain within their border. Individual countries' economic policies and relevant legal systems cannot avoid being influenced by multinational or international organizations, such as the IMF and the

World Bank. Thus, it is difficult for developing countries to push ahead with their economic development by simply copying the strategies and methods that were adopted in the bygone Asian developmental states, including Korea. The same thing can be said of the fostering of the capital market. Nevertheless, it is thought that the diverse institutional means that were used by Korea as a country which produced positive results by having a capital market established in a relatively short period of time, can serve as a significant lesson for them.

In this regard, this study intends to check how the country's capital market-related legal system, particularly the one that regulated the stock market, has changed in the process of a government-led economic growth. This study will also check what institutions were adopted in the formative stage of the capital market and how the country's policy objectives for the fostering of the capital market were accomplished in detail. Efforts made in this study will help interested countries have a better grasp of a model of a capital market-related legal system in different stages of the development of the national economy and capital market, although it will not be easy to generalize the path of the country's economic development in a few words. The results of this study will be a useful, basic material for developing countries wishing to benchmark Korea's economic development through similar effort.

Section 2. Scope of the Study and Methods Used

First of all, this study discusses the role that the capital market-related legal system is expected to play in the initial stage of economic development (Chapter 2) by checking the significance of the said system in the

country's economic development, including that of Korea. Then, the study checks how the capital market-related legal system, particularly the securities market-regulating system, developed in the formative stage of the capital market in Korea, and what role the system played in the country's initial stage of economic development, along with a comprehensive check of relevant success or failure factors (Chapter 3). The study also makes efforts to find a lesson from the development process of Korea's capital market-related legal system based on such a review in an attempt to come up with a model of a capital market-related legal system required in different stages of development of the national economy and capital market, particularly factors that the capital market-related legal system should have in its formative stage.

Chapter 2. Economic Development and the Capital Market-related Legal System

Section 1. Significance of the Capital Market-related Legal System in Economic Development

As for the function of the financial system, it mobilizes domestic savings and distributes them to the capital market and other investment means.[1] A country's financial system is composed of three elements, i.e. savings (formation of capital), loans (credit granting), and brokerage between the two.[2] Basically, a financial transaction is carried out based on credit built between the parties and thus it is hardly made smoothly without legal or institutional devices. In a financial transaction, the timing of the parties' enforcement is different from each other.[3] Thus, trust between the parties is a core condition since a financial transaction and the operation of an effective legal system that provides security is an essential condition for the development of the financial sector.

On the other hand, the financial sector is regarded as the most vulnerable sector in the national economy, as it is affected noticeably even by changes in the economic or political situation or market psychology.[4] It is even more so in the globalized economic environment of today in which the degree of interdependence of such systems has deepened.

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1) Sarkar, *International Development Law - Rule of Law, Human Rights, & Global Finance*, Oxford University Press, 2009, p. 408.
2) Sarkar, Ibid, p. 408.
3) Dam, *The Law-Growth Nexus - The Rule of Law and Economic Development,* Brookings Institution Press, 2006, p. 160.
4) Dam, Ibid, p. 160.

Accordingly, it has become an important task for a finance-related legal system, particularly in developing countries, which is more dependent on foreign countries, to come up with an apparatus that can make up for the vulnerability of their financial system.

Many studies have been carried out concerning the relationship between economic growth and the financial system/finance-related legal system. As a result, experts have generally come to agree that the development of banks and stock markets are a good measure of the country's economic growth.[5] Experts generally agree that laws play a decisive role at least in the development of the financial sector, although they are divided in their opinions about the relationship between economic growth and the legal system, i.e. which legal system is more conducive to economic development.[6]

The importance of a finance-related legal system in a country's economic growth signifies the importance of the role of the government in adopting such a legal system and revamping it. The government of a country should simultaneously play the two roles in the development of the financial sector, which look inter-contradictory at a glance, i.e. maintaining the overall stability of the financial system, and promoting economic growth while running risks of diverse types and levels.[7] "Intercontradictoriness" of the two is as follows: The government should impose wide-ranging action guidelines on individual financial institutions, including limits on the amount of loans and their types and liquidity-related requirements to maintain stability of the financial market. Simultaneously,

5) Dam, Ibid, p. 159.
6) Dam, Ibid, p. 159-60.
7) Refer to Stallings & Studart, *Finance for Development Latin America in Comparative Perspective*, Brookings Institution Press / United Nations ECLAC (Economic Commission for Latin America and the Caribbean), 2006, p. 2.

the government should provide incentives to financial institutions to encourage them to provide investment funds to well-performing businesses to promote economic growth. As such investment is accompanied by diverse types/levels of risks, the government should coordinate the overall stability of the national economy considering a micro-and macro-prudent perspective in consideration of such risks.

In general, provision of credit to SMEs, which create many jobs, is likely to entail serious risks. If the government adopts a policy that puts excessive emphasis on the stability of the financial system, SMEs will be in a difficult position to obtain a fund supply and it will weaken the country's growth potential. Like this, governments need to meet two inter-contradictory requirements to operate the financial sector. Developing countries, for which economic growth is at the top of the agenda, are likely to put more emphasis on the expansion of growth potential, which may entail risk, than stability. Sometimes, this makes developing a country's economy even more vulnerable to internal/external factors.

Section 2. Korea's Economic Development and Capital Market-related Legal System

Developing countries currently pushing ahead with economic development are in an economic environment quite different from what their predecessors went through in the preceding century. Thus, it is necessary to check their situation one by one. First of all, developing countries should rely on foreign investments for a considerable portion of the capital required for their economic development, as their domestic savings alone cannot meet their requirements. There is a clear difference between past

developmental states and those of today in the way they mobilize foreign capital and use mobilized capital for economic development.

In the post-war period, some Asian countries, including Korea, experienced a rapid economic growth, and they relied greatly on borrowings from foreign financial institutions. They used the banking system for systematic allocation and management of the money thus borrowed. Thus, the banking sector was at the center of the financial system and was strictly controlled by the government,[8] partly because of the importance of financial stability, and, perhaps more importantly, because of the usefulness of banks in carrying out national economic development strategies.[9]

In Korea, under such a financial system, the government's control of the financial sector through banks was carried out on diverse levels.[10] Both deposit and lending rates were fixed by the government. The reserve requirement ratio was very high and thus banks found it very difficult to expand their portfolio. The government issued administrative guidelines on credit allocation for banks to comply with. The government could ban specific banks' foreign borrowings and put limits on the amount and usage of such borrowings. Government-run banks provided a huge amount of loans to businesses and acted as mediators between foreign capital and domestic borrowers. Like this, the government used diverse policy means to manage and control the financial system through banks. Such a method of operating the financial system is called a "government-led financial operation" or "financial repression." To summarize, it can be said that the banking system was the most appropriate way of supplying economic development funds through foreign borrowings.

8) Stallings & Studart, Ibid, p. 22.
9) Stallings & Studart, Ibid, p. 22.
10) Stallings & Studart, Ibid, p. 22.

External conditions and capital flow acted as decisive factors behind Korea's adoption of the bank-centered financial system in the past. In the 21st century, developmental states adopt a financial system quite different from that of the past that is also closely associated with changes in the external economic condition and the capital flow. Until the 1970s, the flow of international funds concentrated on the supply of public loans to developing countries.[11] Many American and European banks started lending petrodollar deposits that rushed in following the oil shocks in 1976 and 1979 to developing countries on a large scale. At that time, banks in major lending countries, including the United States, held the belief that public loans would never default. However, such a belief was broken due to the debt crisis in the 1980s.

Most of the funds invested in developing countries today are private capital. Some useful public loans from aid institutions or multi-party banks remain for developing countries, but international loans have become an outdated method of mobilizing foreign capital, as developing countries have been closely integrated into the global capital market in the financial sector.[12] In the past, the lion's share of foreign capital supplied to developing countries were commercial loans provided by financial institutions. In contrast, developing countries are showing a clear tendency to rely on private foreign investment, following major developing countries' foreign debt crises in the 1980s. Foreign investment, such as portfolio investment and foreign direct investment (FDI), is made directly through the capital market without going through an intermediary financial institution like a bank. In such a respect, the operation of the system of supplying

11) Sarkar, Ibid, p. 397-8.
12) Sarkar, Ibid, p. 401.

capital for developing countries' economic development is centered on the capital market rather than on banks, and such capital market is integrated into the international capital market some way or other. To summarize, today developing countries are forming and developing a financial system in a way quite different from what Korea experienced in its economic development process.

The financial liberalization reforms in developing countries recently initiated by international organizations and more advanced countries changed the way the bank system operates by putting an end to the government's regulation on interest rates, amount of loans, and depositors.[13] Simultaneously, capital markets in developing countries are being expanded and strengthened through privatization. Privatization of state-owned businesses enhances the importance of capital supply through stocks.[14] It pushes aside ODA or loans made through international organizations, the government, and financial institutions as chief means of foreign capital supply. In this respect, the situation of developing countries in the 21st century is quite different from what was experienced in the preceding century. Thus, we can say that it is difficult to apply the bank-centered financial system, which Korea used effectively, to developing countries today.

Today developing countries are faced with new risks and difficulties, i.e. the instability of international capital markets. Developing countries' capital markets are likely to be influenced by the flow of international capital however volatile it may be.[15] Thus, the development of countries' macroeconomic stability can be threatened by the flow of international capital. Economic growth and balanced development may be affected

13) Stallings & Studart, Ibid, p. 111.
14) Sarkar, Ibid, p. 396.
15) Refer to Stallings & Studart, Ibid, p. 3.

seriously. In reality, investment of international capital in developing countries is not carried out briskly as expected due to various drawbacks of a financial system, including the failure to provide transparent information and insufficient protection of minor shareholders.[16)]

As noted in the foregoing, international capital markets have inherent instability. Developing countries' capital markets that are integrated into them cannot avoid being exposed to such instability amidst changes in internal and external economic situations. How to cope with such a problem is an important task to be solved by developing countries today. Besides, in reality, more advanced countries' capital tends not to flow briskly into developing countries that need it badly for economic development due to a variety of institutional drawbacks, such as the lack of transparent information and the insufficient protection of investors.

Developing countries should set up their capital supply structure and financial system in a way that can attain two goals, i.e. macroeconomic stability and promotion of economic growth, together harmoniously through the government's positive and proper performance of its role. In such a sense, the role of their government is crucially important in both the 20th and 21st century. In the event of a capital market in the formative stage, the governments need to have both the determination and ability to design a system corresponding to the development stage of the local financial market and to be able to solve the problems faced in the course of the operation of the system. Developing countries today will be able to learn important lessons by checking closely how Korea went through such a process with the government's positive involvement.

16) Refer to Litan, Pomerleano & Sundararajan ed., *The Future of Domestic Capital Markets in Developing Countries*, Brookings Institution Press, 2003, p. 8.

In the event of a capital market-related legal system in the formative stage, the governments should carry out the following things: First of all, it is necessary to come up with a combination of things to do that are the most suited to the country's situation by closely checking merits and demerits of diverse sources of capital supply, including Official Development Assistance (ODA), the FDI, international bond/stock markets, and portfolio investment. The governments should keep in mind that it should do its best to reduce the country's vulnerability to changes in external economic conditions, which may be easily caused in today's globalized economic environment. In this respect, it is desirable to avoid the operation of a financial system that should rely excessively on its fund supply through capital markets. Capital markets should be relied on only for a part of the fund supply required for economic development. Of course, a capital supply through international capital markets has many merits and developing countries should use it as an important alternative in designing their capital supply structure. They should also provide core institutional apparatuses, such as disclosure on information and investor protection, to foster a transparent and stable capital market.

The governments of developing countries should establish a clear-cut and well-arranged system of capital market laws. They should decide on the following: the scope of regulation on the stock market; the scope of regulation to be carried out by the government or by self-regulatory organizations (SROs); responsibilities and obligations of those participating in the capital market; and requirements for registration, disclosure, and licenses. These are essential factors in determining how to enforce capital market laws. Based on the selection of these things, the governments

should make regulations on the following: stock ownership/transactions, foreigners' investment/ownership, protection of minor shareholders' interests, prohibition of inside trading, transparency, disclosure, obligation of reports, etc.

Chapter 3. Korea's Capital Market-related Legal System – Its Formative Stage and an Evaluation on It

Section 1. Formation process of the Korea capital market-related legal system

In Korea, the formative stage of the capital market-related legal system was between 1956, when the stock market first opened, and 1976, when the law was revised wholly. The basic composition system of the country's capital market-related legal system was completed with the inclusion of the stipulation for the establishment of the Securities and Exchange Commission and the securities supervisory institutions through the whole revision of the law in 1976. The formative stage can be divided into three stages, depending on overall changes in the government's policy concerning the capital market. The first period was when the stock market first opened and the Securities and Exchange Act was revised in connection with a need to cope with the cause of the stock market crisis in 1962. The second period (the capital market fostering period) was when the government tried to help the capital market develop through a series of legislation steps. Finally, the third period (the period for focusing on protection and development of ordinary investors) was when measures were taken to protect and develop ordinary investors in step with the growth of the capital (securities) market. The details concerning enactment and revision of the laws in each period can be seen through the following.

1. First Period(Launch of the capital market)

(1) Opening of the stock market(1956) and enactment of the Securities and Exchange Act[17](1962)

On March 3, 1956, the country's first early modern securities market was launched with the opening of the Daehan Stock Exchange through joint investment of banks, insurance companies, and securities business operators, but the market did not have enough institutional bases to distribute or issue new stocks or corporate bonds. The securities market only handled previously issued transactions for stock. Most of the items distributed were government bonds. Items issued through the market were almost nil.[18] The securities market did almost nothing for the supply of funds to businesses.[19]

In the early 1960s, when the First 5-Year Economic Development Plan started, the government saw a need to develop the capital market as a means of mobilizing domestic savings.[20] In January 1962, the government enacted the Securities and Exchange Act and changed the Daehan Stock Exchange into a joint stock company. With this, the securities market was upgraded from a market where government bonds were mostly traded to a genuine stock market.[21] The Securities and Exchange Act enacted at that time was aimed at invigorating the securities market through fair transactions in issuance and the transaction of securities. The said act copied the legal

17) Law No. 972 enacted on January 15, 1962 and implemented on April 1, 1962
18) Edited by a team led by Edited by a team led by Kim Du-ol (Korea Development Institute, KDI), *The Six Decades of History of Korean Economy Legislation*, Haenam Publishing, 2011, p. 77
19) Edited by a team led by Kim Du-ol (KDI), Ibid, p. 77
20) David Cole and Park Yeong-cheol, *Financial Development in Korea: 1945~80*, KDI, 1984, p. 93
21) David Cole and Park Yeong-cheol, Ibid, p. 93

systems of the United States and Japan, which held advanced knowhow concerning regulations on securities, rather than on measures taken in light of real needs of the country's securities market, which remained at an incipient stage.[22] Following the enactment of the Securities and Exchange Act, trade volume in the stock market started increasing, stocks were issued briskly, and the number of securities firms increased rapidly to 60.

Major contents of the Securities and Exchange Act enacted at that time are as follows. First, the scope of securities was fixed as follows (Article 2), which remained unchanged in general until the abolition of the Securities and Exchange Act.

1. Government bond securities
2. Municipal bond securities
3. Bonds issued by the government or corporations under a special law
4. Corporate bonds
5. Investment securities issued by corporations established under a special law
6. Instruments indicating stock certificates or stock purchase right
7. Securities or instruments issued by the government of a foreign country or a foreign corporation whose nature correspond to what is stated in the foregoing as designated by the Minister of Finance
8. Other securities or instruments stipulated in the relevant regulation

It was stipulated that public offerings of new/outstanding securities should only be made after effectuation (i.e. upon elapse of 30 days after the receipt of the report by the Minister of Finance – Article 5) of the report submitted to the Minister of Finance (Article 4). Securities could only be acquired or sold after the securities issuer's distribution of the business

22) Edited by a team led by Kim Du-ol (KDI), Ibid, p. 77

explanation (Article 8). The Minister of Finance was authorized to stop or ban issuance or public offering of new/outstanding securities (Article 12).

Under the said Act, "securities business operators" were defined as those engaging in the securities industry (Article 2, Paragraph 7). Securities business operators should be joint stock companies and should obtain a license from the Minister of Finance for establishment (Article 13). They were not allowed to do business without being registered with the Ministry of Finance (Article 17). Their net capital amount had to be at least 30 million hwan (Article 25). They had an obligation to obtain licenses from, or submit reports to, the Minister of Finance as required (Articles 23 and Article 24). They were prevented from distributing or using false quotations (Article 33). No one was allowed to be in any transaction aimed to mark up differences without going through the securities market (Article 41). The Minister of Finance was authorized to have relevant government officials investigate the following acts, ban them, and amortize the relevant assets, either partially or wholly: securities business operators engaging in an excessive amount of transactions in consideration of the status of their business; borrowing of money or securities engaged in unsound transactions; borrowing or receiving deposits (excluding deposits for transaction entrustment) for an excessive amount of securities; and owning assets judged to be unsound (Article 42).

Under the said Act, the "securities exchange" meant the party established under the said Act to open the market for securities transactions (Article 2, Paragraph 8). A "broker" (brokers) meant one registered with the securities exchange and engaged in securities transactions at the securities exchange (Article 2, Paragraph 10). Chapter 4 of the said Act stipulated matters concerning criteria for issuing licenses for the securities exchange and

what should be stated in the securities. Under the regulation, the securities exchange should be a joint stock company (Article 44). As in securities business operators, brokers were governed by the net capital amount (Article 53). The securities exchange was obligated to allow only the securities permitted by the Minister of Finance listed on the exchange. Delisting of securities also had to obtain approval from the Minister of Finance (Articles 73 and 75). The Minister of Finance was authorized to have securities listed on the securities exchange if required for the public good or protection of investors (Article 76).

The said Act also had stipulations concerning transactions in securities market, including limitations on over-the-counter trading (Article 71); no fake trading (Article 86); no price manipulation (Article 91); and recompense for price manipulation (Article 92). In particular, the Minister of Finance was authorized to give instruction to the securities exchange concerning changes in the Articles of Association, operational regulations, entrustment contract rules and other trading-related practices if required to for fair trading and the protection of investors (Article 101). When it was judged that a situation in the securities market was harmful for the public good or for the protection of investors, the Minister of Finance could also issue an order for a remedial step or the temporary stoppage of trading either partially or wholly (Article 103).

(2) A securities crisis(1962) and enactment of the Securities and Exchange Act[23](1963)

The Securities and Exchange Act was enacted in January 1962 and four months later a securities crisis occurred. As a result, the securities

23) Law No. 1334, Implemented on April 27, 1963

exchange remained closed for 74 days. The background of the crisis right after the opening of the securities exchange was as follows. At that time, securities transactions were concentrated in the Korea Securities Finance Corporation, the Daehan Stock Exchange, and Korea Electric Power Corporation. Prices of their stocks jumped. Major shareholders were only interested in earning profit. Besides, clearing transactions[24] spread widely and led to speculative transactions. The situation finally resulted in a securities crisis.[25] Clearing transactions were usually settled at the end of the month and investors could earn a profit by engaging in reverse trade prior to the settlement day with only a small amount of deposit money. Such a method of transaction and price settlement led to speculation and stock price manipulation to an extent that prices of stocks far outdid their real value.[26] Finally, stock prices plummeted at the end of 1962 and the securities market remained closed for three months in early 1963. Ordinary investors left the securities market amid the long-term slump and securities business operators closed one after another.[27][28] Overall,

24) This refers to a securities transaction in which contract execution comes one or two months after the signing of a transaction contract. In such a transaction, only the price difference is paid on the settlement day.

25) Kim Hyeon-jong, *A study of historical, influential factors that have an impact on the ownership governance structure of business groups*, Korea Economic Research Institute (KERI), 2012, p. 67

26) David Cole and Park Yeong-cheol, Ibid, pp. 93 and 94

27) Edited by a team led by Kim Du-ol (KDI), Ibid, p. 78

28) The securities crisis developed as follows. [Park Jin-geun, *Major policies adopted by past regimes of Korea-2* (The May 1962 Coup de'tat – Park Chung-hee, the 3rd 5-year Economic Development Plan. Major economic policies adopted by the military regime (May 16, 196 1～January 12, 1962), www.yif.co.kr/new html/print.html?category=m&serialnum=1185 pp. 8~9 (Seong Seung-je, Securities Crisis, Re-quoted from the presentation material used at the KLRI workshop dated May 25, 2012)].

1962	
January 15	Enactment of the Securities and Exchange Act
May 31	A securities crisis, including non-payment of prices

the basis of the country's securities market was very weak.

The securities exchange reopened in May 1963. This time, the government placed strict control on participants in the exchange in an effort to recover the general public's trust in the securities market.[29] The government judged that the crisis in the stock exchange should be blamed on its form as a joint stock company and changed it to a special public corporation through the revision of the Securities and Exchange Act in April 1963. The following is an explanation on how the country's conditions were not ripe for the stock market taking root.[30]

"Above all, most businesses held on to closed family-type management and thus it was impossible to supply good-quality stocks to the market. Business owners saw no particular reason to make their businesses go public. Besides, they were concerned about the possibility that they might lose control over their businesses through initial public

June 1	All securities transactions stopped
June 6	The government announced a plan for the normalization of the securities market
August 31	The securities market closed
September 4	The securities market reopened
November 28	Enactment of The Securities Transaction Tax Act
1963	
February 25	The securities market closed due to the plummeting of stock prices
April 27	First revision of the Securities and Exchange Act
May 8	The securities market reopened.
July 20	Expansion of price range restrictions in the securities market
October 14	Lifting the ban on stock transfer by banks' major shareholders
1964	
October 31	Second revision of the Securities and Exchange Act
1965	
June 28	Securities business operators decided to close their operation indefinitely
June 29	Priority put on in-kind investment in the securities exchange

29) David Cole and Park Yeong-cheol, Ibid, p. 94
30) David Cole and Park Yeong-cheol, Ibid, p. 94

offering (IPO). IPO meant that they had to disclose their financial statements and pay dividends. In some cases, they might have to incur financial loss as businesses that went public were not allowed to own real estate for non-business purposes.

The general public did not have a favorable opinion on businesses. Success in business operations was at the mercy of the government. The general public thought that businesses were not interested in making honest reports to minor shareholders or treating them fairly. Real estate and private financial markets appeared to be more favorable investment targets than securities. The capital market remained bearish for another five years after the re-opening of the stock exchange in 1963."

The securities crisis was put under control with much difficulty through the government's efforts, banks' bailout, and emergency measures, including haeok.[31] The crisis disclosed problems related to the stock exchange organization, clearing transactions, and securities-related financial operations. It also put a damper on the development of the country's stock market for a long time. It caused investors' distrust in, and stampede from, the securities exchange and the stock market. The inability for capital supply through the securities market provided banks with a motive of serving as policy financing institutions for the government. It also made the government concentrate on mobilization of foreign capital for economic development.[32]

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31) This refers to settlement of a transaction by the parties fixing prices to avoid confusion caused by an abrupt change in stock prices.

32) Seong Seung-je, Ibid

The government's measures taken to settle the results of the securities crisis and deal stringently with the cause were reflected in the revision of the Securities and Exchange Act made in April 1963. As noted in the foregoing, the government blamed the crisis situation on the Korea Stock Exchange (previously the Daehan Stock Exchange) and thus the revision made at that time focused on the regulation of the securities exchange and securities business operators.

Concerning the securities exchange, Article 44 of the said Act was revised to change the Korea Stock Exchange from a joint stock company to a special corporation. Article 54-2 was inserted to allow the securities exchange to have its employees inspect brokers' securities-related transactions and relevant accounting books after obtaining approval from the Minister of Finance in advance in connection with a need to strengthen the supervision of brokers. Article 80-2 was inserted to have brokers deposit using a Contractual Violation Compensation Joint Fund.

With regard to regulations on securities business operators, the ceiling of capital amount was readjusted upward (Article 13). The conditions for withdrawal of the Minister of Finance's license concerning securities business were strengthened. It is noteworthy that Article 35, Paragraph 2 was newly inserted as part of the strengthened right of the Minister of Finance concerning regulation on securities business operators. The said paragraph authorized the Minister of Finance to order the cancellation of a securities transaction contract (1) when it is impossible to execute a transaction contract due to acts of God, war, an abrupt change in the economic situation or a crisis similar to one of the aforesaid or (2) when it is impossible to normally settle confusion in securities transactions caused by abrupt changes in stock quotes or transaction volumes due to

monopoly or speculation (Article 36, Subparagraph 7). Article 38 authorized the Minister of Finance to stop the business operation of the relevant securities business, either partially or wholly, or dismiss directors in the event of their violation of (newly added) obligations, including what is stated in Article 35. It was the expression of the government's strong will not to repeat such a crisis ever again.

As for regulation on issuance of securities, Articles 8-2 through 8-4 were newly inserted to have the reporter of the relevant securities and the party that has drawn up or distributed the relevant business explanation responsible for compensation, when the securities-related report or business explanation contains false information and thus the acquirer of such securities has incurred loss.

2. Second Period(Positive fostering of the capital market)

(1) Enactment of the Act on the Promotion of Capital Market[33] (1968)

In the second half of the 1960s, the government relied heavily on bank loans and foreign borrowings to supply funds required to achieve high growth targets set in the Second 5-Year (1967~71) Economic Development Plan. It resulted in many businesses' high debt ratio focusing on short-term borrowings.[34] The government started taking a series of reform measures, seeing a need to develop a modern capital market by distributing businesses' ownership and diversifying their fund supply sources.[35]

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33) Law No. 2046, enacted and implemented on November 22, 1968
34) David Cole and Park Yeong-cheol, Ibid, p. 94.
35) David Cole and Park Yeong-cheol, Ibid, p. 94

In November 1968, the government enacted the Act on the Promotion of Capital Market in an effort to develop a healthy capital market by encouraging businesses to go public, promoting distribution of shares, helping people take part in business operations, and pushing ahead with smooth capital supply to businesses. Such an effort was intended to promote distribution of business ownership through the general public's participation in capital and offer incentives for stock investors.

The said Act stipulated that, if the profit dividend rate of a listed corporation was lower than the rate set by the relevant Presidential decree, shareholders other than the government should be given priority in the dividend payout until the said rate was reached and the dividend rate for the government-owned shares be readjusted downward, in connection with a need to distribute stocks and foster conditions conducive to investment (Article 3). It was also arranged that, in the sale of the government-owned shares for the public good and to the employees of the government0managed businesses, the Minister of Finance was authorized to sell the shares at a price lower than market price without limiting the number of shares thus sold off, notwithstanding The Budget and Accounts Act, Articles 70 and 7002 (Article 5, Paragraph 1). Permanent employees (not including directors) of listed or public corporations were given subscription rights for up to 10% of newly issued stocks (even existing stocks in 1972 and thereafter) (Article 6). The said Act made it possible to use stocks listed on the Korea Stock Exchange as guarantee money to be paid to the government, local administrative units, or the government-managed businesses, in an effort to enhance stock value (Article 4).

Tax incentives were a useful way to encourage businesses to go public. Special measures concerning corporate tax rate and depreciation were

provided in Articles 9 and 10. Tax rates for public corporations were set to be lower than those for their non-public cousins. Calculation of depreciation cost concerning fixed assets of public corporations or listed corporations was given special consideration under The Corporate Tax Act. Thus, marginal tax rates for public corporations in the highest tax bracket stood at 35% versus 45% for their non-public counterparts or 25% v. 45% in the 1969~1971 period and 27% v. 40% in 1972 and onwards.

[Table 1] Comparison of corporate tax rate applied to public corporations and non-public corporations[36)37)]

<table>
<tr><th colspan="2">Tax basis</th><th>1968</th><th>1969~1971</th><th>1972~1974</th><th>1975~1976</th></tr>
<tr><td rowspan="2">Less than KRW 1 million</td><td>Public corporation</td><td>20</td><td>15</td><td>16</td><td>20</td></tr>
<tr><td>Non-public corporation</td><td>25</td><td>25</td><td>20</td><td>20</td></tr>
<tr><td rowspan="2">KRW 1 million ~ KRW 3 million</td><td rowspan="3">Public corporation</td><td rowspan="3">30</td><td rowspan="3">20</td><td rowspan="3">20</td><td>20</td></tr>
<tr><td>20</td></tr>
<tr><td rowspan="2">KRW 3 million ~ KRW 5 million</td><td rowspan="2">Non-public corporation</td><td rowspan="2">35</td><td rowspan="2">35</td><td rowspan="2">30</td><td>20</td></tr>
<tr><td>30</td></tr>
<tr><td rowspan="2">More than KRW 5 million</td><td>Public corporation</td><td>35</td><td>25</td><td>27</td><td>27</td></tr>
<tr><td>Non-public corporation</td><td>45</td><td>45</td><td>40</td><td>40</td></tr>
</table>

36) Based on marginal tax rates for specified areas for the tax basis
37) David Cole and Park Yeong-cheol, Ibid, p. 95

Such tax benefits were also given to securities investors. No tax was imposed on dividend paid to minor shareholders owning less than 3% of total outstanding stock issues or interest income related to corporate bonds owned by investors possessing less than 10% of a total credit balance. The tax rate applied to large shareholders (5%) was at a very low level compared to that applied to dividends in non-public corporations (20%).

The Korea Investment Development Corporation was established as a joint venture between the government and commercial banks to promote the issuance and distribution of securities, facilitate securities underwriting, and stabilize securities prices (Article 12). The Investment Deliberation Committee was established within the said corporation in connection with a need to set up a plan for the sale of government-owned stocks, as entrusted by the government, adjust proper stock price, and exercise other necessary functions and rights (Article 20, Paragraphs 1 and 2). The said corporation played a pivotal role as a distributor of new shares and corporate bonds until its dissolution at the end of 1976.[38)]

(2) Revision of the Securities and Exchange Act[39)](1968)

The revision of the Securities and Exchange Act in December 1968 was aimed to reinforce regulations on securities business operators. Securities business licenses were divided into licenses for those focusing on securities transactions and those concurrently engaging in securities underwriting. The former was for those engaged in securities transactions, consignment transactions, brokerage or acting as an agent, while the latter was for those engaged in underwriting and offering concerning securities or their

38) David Cole and Park Yeong-cheol, Ibid, p. 98
39) Law No. 2066, implemented on December 31, 1968

sale (Article 13, Paragraph 1). Capital requirement for securities business operators engaged in the former was set at not less than KRW 30 million, and the latter at not less than KRW 50 million (Article 13, Paragraph 2). The system of having securities business operators registered was abolished through the deletion of Articles 17 through 21.

The said revision stipulated that the debt-net asset value ratio of securities business operators should not exceed a given level set by the Presidential Decree (Article 25). The system concerning a reserve for securities transaction was newly inserted. Under the system, securities business operators were required to set aside the said reserve in proportion to the volume of securities transactions under the Presidential Decree. Such reserve could only be used to cover loss occurring in securities transactions (Article 25-3).

Finally, directors of securities business operators were made to be jointly and severally responsible in the event that a director or an auditor neglected to fulfill his/her duties either willfully or through negligence and inflict loss on a third party, aside from the compensation stipulated in Article 26 (38-2).

(3) Enactment of the Securities Investment Trust Business Act[40] (1969)

The enactment of the Securities Investment Trust Business Act in August 1969 opened a way for indirect investment in the country through a system of securities investment trust designed to carry out securities investment vicariously for non-expert investors and small amount investors for the purpose of increasing the number of people taking part in the

40) Law No. 2129, enacted and implemented on August 4, 1969

securities business and to stabilize the securities market.[41] The said Act was part of an effort to supply industrial funds required for economic development. In 1970, the Korea Investment Development Corporation raised a securities investment trust fund amounting to KRW 100 million, designating Seoul Trust Bank as a trustee, and launched the country's first securities investment trust business under the said Act. Thus, the Korea Investment Development Corporation, which was established under the Act on the Promotion of Capital Market, came to take part in securities transactions firsthand to help stabilize stock prices. Securities investment trust fund, which was formed to attract small-amount savings, contributed significantly to the development of the securities market. In 1974, the business of the Korea Investment Development Corporation was transferred to Korea Invest Trust Co., Ltd., a newly established joint stock company, to be dedicated to a securities investment trust amidst the ever-increasing need for capital supply through the securities market. Such a change provided momentum for the rapid development of the securities investment trust system and encouraged capital increase in securities business operators. Large-sized securities business operators were established through the investment of insurance companies and Korea Trust Bank.

(4) Enactment of the Act on Promotion of the Initial Public Offering[42](1972)

The series of economic policies adopted by the government in the early 1970s went a long way to form an environment conducive for a securities market and encourage businesses and the general public to take

41) Edited by a team led by Kim Du-ol (KDI) , Ibid, p. 81
42) Law No. 2420, enacted on December 30, 1972 and implemented on January 5, 1973

higher interest in the securities market.[43] However, the supply of securities did not increase considerably, despite the noticeable increase in demand. The total number of listed businesses increased to a mere figure of 66 by the end of 1972 with only 32 businesses listing their stocks for the first time on the stock exchange in four years, following the enactment of the Act on the Promotion of Capital Market in 1968.[44] Due to such unbalance between supply and demand, stock prices jumped in 1971 and 1972. In 1972 alone, the composite stock price index jumped more than two-fold, although dividend payout remained at a 20% level of face value.[45]

The government started taking measures to increase the supply of stocks. In December 1972, the Act on Promotion of the Initial Public Offering was enacted as part of such efforts. The said Act stated the reason for its enactment as follows: Businesses started with a small amount of equity capital and they had to rely on short-term loans, paying high interest. Thus, their poor financial status posed a stumbling block to the country's healthy economic growth. The government saw a need to fix the situation and issued an emergency order for economic growth and stability, including forceful readjustment of creditor-borrower relationships and a debt-equity swap. However, it is necessary to improve the way for a long-term fund supply to businesses for the country's continued economic growth. This Act aims to enhance businesses' productivity through improvement of the fund supply method based on stock issuance, strengthen their international competitiveness, invigorate investment activities in the private sector, and bring about economic stability and continued growth by forming a sense of

43) Edited by a team led by Kim Du-ol (KDI), Ibid, p. 80
44) David Cole and Park Yeong-cheol, Ibid, p. 99
45) David Cole and Park Yeong-cheol, Ibid, p. 99

consensus between businesses and the people.

The core content of the Act enacted with such a purpose was to authorize the Minister of Finance to designate suitable businesses and order them to go public. Such businesses were selected among those with an excessively large amount of foreign borrowings or bank loans or those with having more than KRW 100 million in readjusted liabilities through the government-taken special measure on August 3, 1972 in consideration of their capital amount, dividend payout ability, and outlook on the stock exchange.

The said Act stipulated the launch of the Council for Deliberation of Businesses' IPO, chaired by the Prime Minister and composed of the Minister of Economic Planning Board, the Minister of Finance, the Minister of Commerce, the President of the Bank of Korea, the President of the Korea Investment Corporation, the Chairman of the Korea Stock Exchange, and not more than five members appointed by the President among those with sufficient knowledge and experience (Article 3). When ordering a business to go public, matters, such as the number of the relevant stocks, the ratio of per-shareholder stock ownership, and methods/ conditions/deadlines concerning an initial public offering, were to be fixed under a Presidential decree (Article 5, Paragraph 1). The said Act also stipulated that the ratio of stockownership to go public shall not exceed 51% of the total number stocks issued (Article 5, Paragraph 2).

Under the said Act, businesses that did not comply with the order for IPO were subject to unfavorable treatment in terms of corporate tax and income tax (Articles 12 through 18). Businesses that complied with the order for IPO were given some tax benefits, but those that did not comply were made to pay heavy income/corporate taxes and be subject

to restrictions in bank loans. Existing public corporations and those that recently went public were given favorable treatment in reappraisal of non-business purpose land owned by them (i.e. 27% v. 40% for those that did not go public in the rate of re-appraisal).[46] Under the said Act, both underwriters and major shareholders of public corporations were given tax benefits. No tax was imposed until 1976 on capital profit earned by underwriters through the sale of remaining stocks within six months from the initial date of public offering. Major shareholders of public corporations owing not more than 30% of the total stocks issued enjoyed the benefit of a reduction of their dividend income tax by half until 1977.

What is particularly significant in this Act is a clause meant to alleviate the concern about the possibility of a threatened management right associated with the listing. Article 5, Paragraph 2 of the said Act stipulated that the stock ownership ratio to go public should not exceed 51% of the total number of stocks issued, making it possible for the relevant business to secure a majority equity share. The measure adopted to encourage businesses' listings by providing apparatuses meant to protect management right was less effective than differential voting rights as a means of protecting management right, but it could alleviate the threat about management right by making it not possible to concentrate equity shares other than those owned by family members.[47]

The Act on the Promotion of Capital Market and the Act on Promotion of the Initial Public Offering have the same purpose of legislation, i.e. invigoration of capital formation through stock market.[48] However, the

46) For an explanation concerning this paragraph refer to: David Cole and Park Yeong-cheol, Ibid, p. 100

47) Kim Hyeong-jong, Ibid, p. 68

48) For an explanation concerning this paragraph refer to: Edited by a team led by Kim Du-ol (KDI), Ibid, p. 80.

difference between the two is that the former adopts an inactive method of encouraging businesses to go public by offering tax benefits, while the latter adopts a more positive method, i.e. ordering selected businesses to go public and imposing tax-related disadvantages on those not complying. To summarize, the former caused the formation of systems that laid the basis of the securities market, while the latter played an important role in the growth of stock issuance market. Later, The Public Corporation Inducement Act was integrated into the Act on the Promotion of Capital Market, which was wholly revised in 1897.

Thanks to such efforts, the number of listed businesses, which stood at 50 in 1971 prior to the enactment of the Act on Promotion of the Initial Public Offering, increased 6.5-fold to 323 by 1977 after its enactment. The aggregate value of listed stocks jumped from KRW 108.7 billion in 1971 to KRW 2,350.8 billion by 1977, i.e. 21.6-fold. It is noteworthy that, in 1973 alone, 38 businesses listed their stocks and KRW 21.5 billion of funds were supplied to businesses through the public offering of 35 new issues and 12 outstanding ones. The amount of stock transactions increased from KRW 71 billion in 1972 to KRW 161 billion in 1973,[49] displaying the effects of the said Act.[50]

3. Third Period(focusing on protection and development of ordinary investors)

In the mid-1970s, the country's policymakers saw a need to protect and develop ordinary investors, in addition to establishing a system of

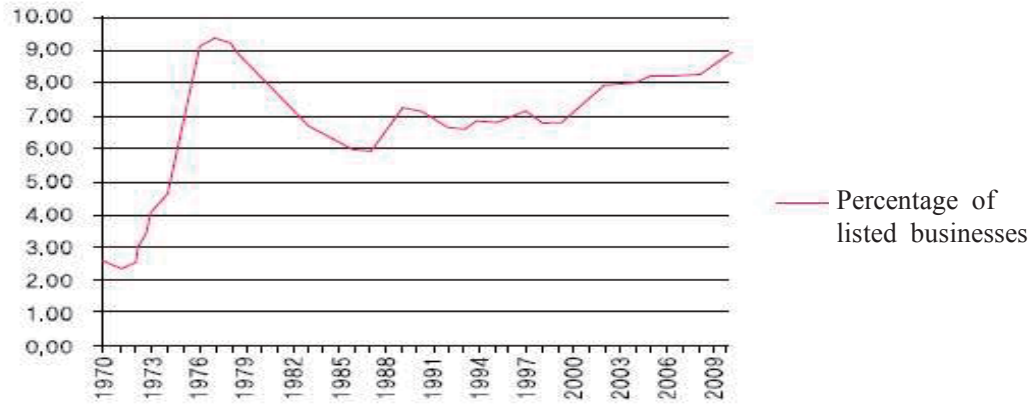
49) David Cole and Park Yeong-cheol, Ibid, p. 100

50) The following diagram shows the trend on the ratio of listed-unlisted businesses. Source: Korea Investors Service, KIS-Value data. Re-quoted from: Kim Hyeon-jong, Ibid, p. 71

supplying a huge amount of capital required for economic development, amid the expansion of the size of the securities market.[51] From a political perspective, the period fell on the latter part of President Park Chung-hee's rule. Following the announcement of the focus on the heavy chemical industry in January 1973, the government was taking a hurried step toward the establishment of a system for the total mobilization of national resources. The financial policies were also focused on provision of support for the said industry.[52]

(1) Revision of the Securities and Exchange Act[53](1973)

The revision of the Securities and Exchange Act made in 1973 also concerned securities business operators and regulations on the securities industry. First, adjustment was made on the division made in 1968 concerning the securities business (Article 13, Paragraph 2). Securities business operators dedicated to underwriting or public offering of new/outstanding securities appeared. The required minimum capital amount for



51) Edited by a team led by Kim Du-ol (KDI), Ibid, p. 81
52) Kim Byeong-ju, *Financial systems and policies*; Cha Dong-se and Kim Gwang-seok, Half century concerning the Korean economy – Historical appraisal and vision for the 21st Century, KDI, 1995, p. 201
53) Law No. 2481, implemented on February 6, 1973

securities business operators was raised again. A securities business engaging in one of Type 1 and Type 2 was required to have a capital amount amounting to not less than KRW 200 million and one engaging in both types not less than KRW 300 million, compared to KRW 30 million and KRW 50 million in 1968 (Article 13, Paragraph 3).

Regulation on securities business operators' business activities were revamped drastically. Article 26-2 was newly inserted, prohibiting securities business operators from granting credit to their directors and employees, using fund reserved to purchase securities or lending securities. Articles 32-2 through 32-5, which were also newly inserted, stipulated that standing directors of securities business operators should not be allowed to engage in permanent business of another company, unless they obtained the approval from the Minister of Finance (Article 32-2). The Minister of Finance was authorized to issue an order concerning the ceiling of credit transactions and collection of guarantee money concerning securities business operators' granting of credit to customers (Article 32-3). Securities business operators were allowed to concurrently engage in other business operations with the licenses from the Minister of Finance (Article 32-5). Securities business operators were allowed to engage in savings business with the license of the Ministry of Finance (Article 32-4).

Article 2, which stipulated the scope of securities, was revised to include "bonds issued by a corporation established under a special law and consignment transactions, brokerage or acting as an agent in the securities market." A revision was also made concerning reporting on the public offering of new/outstanding securities. Previously, public offering of new/outstanding securities could only be done 30 days after the issuer's submittal of the report concerning the securities to the Minister of Finance

(The Securities and Exchange Act, Articles 4 and 5 revised in 1968). Under the 1973 revision, public offering of new/outstanding securities could only be done from the date separately fixed by the Minister of Finance after accepting the relevant report (Article 4, Paragraph 1 and Article 5, Paragraph 1). The designation of the date of effectuation of the report by the Minister of Finance means that what is stated in the report is not automatically recognized as correct or that the government does not guarantee or approve the value of the relevant securities automatically (Article 5, Paragraph 3). The act of acquiring or purchasing securities which have not been reported or do not concern which date of effectuation has not been fixed should not be validated (Article 5-2).

(2) The President's special instruction on businesses' IPOs and the fostering of a healthy corporate and financial environment (on May 29, 1974)

At that time, businesses held on to closed family-type management and did not make earnest efforts to train experts capable of carrying out professional business management despite the government's diverse measures to encourage it. The situation like that was not conducive to labor-management reconciliation either.[54] On May 29, 1974, President Park Chung-hee gave five-item instructions as follows:

1. Operations concerning finance, foreign capital, and the tax system should be made in a way that will encourage businesses' initial public offering.
2. A system should be set up to check and manage borrowings of, and tax paid by, non-public corporations (including their affiliates) and their major shareholders comprehensively.

54) Kim Byeong-ju, Ibid, p. 203

3. Banks' loan made to large-sized businesses (particularly non-public ones) should be managed more strictly, in connection with a need to lower their reliance on credit loans from banks.
4. When businesses relying heavily on credit loans from banks attempt to enter a new sector, they should be made to secure required funds by selling off part of their existing operations.
5. Businesses' creditworthiness should be enhanced through reinforced tax-related management of them and their major shareholders and outside auditor system.

Measures concerning establishment of readiness for accommodation of the capital market and supplementary measures for the promotion of businesses' IPOs were announced on June 7, 1974 and August 8, 1975, respectively, concerning the President's instruction. The former was intended to lay a basis for the stabilization of the capital market by establishing a system for the underwriting of securities and opening up of ordinary people's demands for securities in accordance with a series of measures taken previously for the promotion of businesses' IPOs in expectation of a large quantity of stocks supplied to the securities market. In detail, the contents included: the launch of a securities underwriting body composed of securities business operators, short-term finance companies, banks, insurance companies, etc.; the developing of institutional investors; introduction of the installment-type securities savings system (allocating subscribers 10% of new issues of stocks on a priority basis); and stock distribution by means of a public offering (like raising the percentage of publicly offered stocks from previous 20% to 30%).

The latter enabled the government to force the businesses selected to go public. It pushed ahead with IPOs particularly for large-sized businesses

representing the country with good long-term potential under a plan for a phased promotion of the following: selection of suitable ones, recommendation that they should go public, and forcing non-compliant ones to follow the order.

(3) Revision of the Securities and Exchange Act[55](1974)

As in the previous revision, the 1974 revision of the Securities and Exchange Act bolstered regulations on securities business operators. Revised Article 25-3 made it obligatory for securities business operators to set aside a securities transaction reserve in an amount proportionate to the profit earned as well as transaction volume. Articles 38-3 through 38-5, which were newly inserted, stipulated that employees of securities business operators should not disclose information on securities-related transactions to a third party without the entrusting party's written consent (Article 38-3, Paragraph 1), unless there was a court order for submittal of such information or if required by the Presidential decree. (The Act stipulated that even in such circumstances the relevant questions or investigation should not go beyond what was necessary.) (Article 38-4) Article 38-5 stipulated that employees of securities business operators should refuse to accept any demand, question or investigation that violated Article 38-4.

Concerning the securities exchange, revised Article 84 stipulated that the securities exchange had the right concerning stock-related deposit money, surety guarantee, and the *money or securities paid for delivery settlement* ahead of the other creditors (the italicized part was newly inserted through the revision.). Revised Article 84, Paragraph 2 stipulated that in the event

55) Law No. 2684 implemented on December 21, 1974

that the securities exchange incurred loss due to a broker's failure to execute delivery settlement after the handover of securities prior to the broker's delivery settlement, the securities exchange had the right to claim the broker's assets ahead of the other creditors, but not ahead of a creditors' right secured with jeonse-related right, the right of pledge or mortgage established prior to the deadline for execution of a delivery settlement.

Additionally, listed corporations were required to submit a securities registration statement to the Minister of Finance when they issued new shares to those with subscription right or at the time of public offering of existing/new securities (Article 4, Paragraph 1). Under Article 5, Paragraph 3, which was newly inserted, the Minister of Finance was authorized to not designate the date of effectuation stipulated in Article 4, Paragraph 1 if required for formation and stabilization of the fair price of securities and protection of investors in connection with listed corporations' issuance of new shares to those with subscription right, with a notice served on the registering corporation.

(4) Full revision of the Securities and Exchange Act[56](1976)

In 1976, the Securities and Exchange Act was fully revised with the aim of being prepared for expansion of the securities market, establishing a system of supplying domestic capital for the country's economic development, and protecting and developing ordinary investors. The most noticeable thing about the revision was the establishment of the Securities and Exchange Commission and the securities-related supervisory institution.

56) Law No. 2920 wholly revised on December 22, 1976 and implemented on February 1, 1977

Another noteworthy thing was the sweeping adoption of regulation on listed corporations. It was a far cry from past revisions, which were mostly focused on securities business and improvement of regulations on them.

First, Chapter 7, which concerns the Securities and Exchange Commission will be examined. Article 118 stipulated the establishment of the Securities and Exchange Commission within the Securities Supervisory Board for deliberation and making decisions on matters concerning issuance, management, and fair transaction of securities and supervision of securitiesrelated institutions. The Commission was to be composed of the following members: the President of the Bank of Korea, the Chairman of the Korea Stock Exchange, the Vice Minister of Finance, and three standing members appointed by the President at the recommendation of the Minister of Finance among those with sufficient securities-related knowledge and experience (Article 119). The Chairman of the commission was to be appointed by the President among the standing members (Article 120). The Commission was to report its decisions immediately to the Minister of Finance. The Minister of Finance was authorized to cancel the decisions made by the Commission, partially or wholly, or stop their execution when they were in violation of the law or not conducive to investor protection. The Minister of Finance could also ask the Commission to take a necessary measure required for the public good or investor protection, which the Commission was to comply with immediately (Article 126).

The revision also stipulated the establishment of the Securities Supervisory Board, a no-capital special corporation, as an executing institution of the Securities and Exchange Commission, in connection with a need to encourage issuance of securities and their fair transactions and to

develop a healthy capital market through supervision and inspection of securities-related institutions (Article 130). The President of the Securities Supervisory Board was to serve as the Chairman of the Securities and Exchange Commission. The two Vice Presidents were to be appointed by the Minister of Finance (Article 133). The duties of the Securities Supervisory Board were as follows:

1. Matters concerning registration of securities
2. Matters concerning the securities registration statement
3. Inspection-related matters concerning institutions subject to inspection of the Securities Supervisory Board under this Act
4. Matters concerning management of listed corporations
5. Matters concerning a business analysis of securities-registered corporations and listed corporations and public disclosure of business-related contents
6. Matters concerning supervision of transactions of securities outside the securities market
7. Matters entrusted by the government
8. Others assigned under this Act
9. Matters ancillary to what is stated in the foregoing 1 through 8

The Securities Supervisory Board was authorized to ask the head of the securities-related institutions subject to the inspection of the Board under this Act to take punitive measures against its employees for their illegal acts (Article 136). The Minister of Finance could issue orders for a change in the Articles of Incorporation, regulation or methods of business execution and the like concerning the operation or financial status of the Board (Article 142). The Act has also relatively detailed regulations concerning securities-related bodies, i.e. securities financial businesses, the Korea Securities Dealers Association, book entry clearing businesses, brokerage firms, transfer agent businesses, etc.

Chapter 9, which was newly inserted through the revision, stipulated matters concerning management of listed corporations. First of all, listed corporations were made to report their important management-related matters to the Securities Supervisory Board (Article 186). "Important management-related matters" included dishonored commercial notes or checks issued by them; prohibition of transactions with banks; suspension of business activities; application for commencement of liquidation procedure under the law; commencement of de-facto liquidation; change in business purposes; huge loss incurred due to a disaster; commencement of a lawsuit that would have a grave impact on listed securities; and other factors that might have a grave impact on their business management. Listed corporations were also required to follow the securities-handling regulation set by the Securities Supervisory Board for the more efficient management of listed securities (Article 187).

The revision adopted regulations on unfair trade, particularly insider trading, perpetrated by listed corporations. Article 188 stipulated that employees or major shareholders (who refer to shareholders or investors owning not less than 10% of the total number of, or total investment amount of, shares or investment securities issued in their names or the name of other persons, including fictitious persons) should not sell them without owning them. The said article also stipulated that a listed corporation might ask its employees or major shareholders to provide it with profit earned by them by purchasing stocks using information obtained through their status or position associated with the corporation and then selling them within six months or by selling the corporation's stocks and purchasing them within six months.

It is noteworthy that the revision adopted restrictions over shares in mutual ownership concerning listed corporations except in cases set by the Presidential decree (Article 189). Article 200 set the criteria of stocks that could be owned by a listed corporation on its own account. No one was allowed to own stocks issued by a listed corporation (except for stocks without voting right) in excess of the following criteria, regardless of in whose name the stocks were purchased: a shareholder who owned not less than 10% of the total number of stocks issued at the time of a new listing of the relevant securities – the said percentage of ownership; 10% of the total number of stocks issued for the others. One who owned 10% or more of a listed corporation's total number of stocks issued was required to report the details to the Commission whenever there was a change in the percentage of the ownership (Article 201).

When a listed corporation intended to obtain a resolution stipulated in The Commerce Act, Article 374 for the transfer of its business, partially or wholly, it was required to report the intention to the Commission at least six months prior to the relevant general meeting of shareholders (Article 191). The Securities and Exchange Commission was authorized to fix financial management criteria for listed corporations for their healthy financial operation. The Commission could take measures, including having them set aside a separate reserve other than the legal reserve required under The Commercial Act, Article 458 when required for the protection of investors and the establishment of fair trade order (Article 192). Listed corporations, which operated on a one-year business year, were required to submit a business report for six months for the period from the commencement of the business year (semi-annual report) to the Securities Supervisory Commission and the securities exchange within 45 days following

the end of the said period (Article 93). The Securities and Exchange Commission could also recommend to the general meeting of shareholders of a relevant listed corporation that it should dismiss the directors who failed to comply with an order issued under the Act or if they violated the Act or the Commission's regulation (Article 193).

The revision adopted the securities takeover bid system as part of the effort to stabilize listed corporations' management right. Article 21 stipulated that those who intended to purchase securities through a subscription for purchase or sale (including exchange with other securities) of securities set by the Presidential decree toward an unspecified multitude of people outside the securities market were required to submit the report to the Commission and were not allowed to purchase them without the Commission's acceptance. The party that submitted the takeover bid report (the "takeover bid party") should dispatch a copy of the relevant report to the issuer of the securities subject to the takeover bid before the effectuation of the report. Upon effectuation of the report, the takeover bid party should put up a public notice about contents set by the Ministry of Finance Ordinance and submit a copy of the report to the securities exchange upon the listing of the securities (Article 22). The takeover bid party was not allowed to purchase the securities without going through the takeover bid between the day of effectuation of the takeover bid report and the end of the purchase period. The Securities Supervisory Commission could have the takeover bid party follow the conditions and methods set by it if required for the public good or protection of investors (Article 23).

The revision newly inserted a Chapter 2 concerning registration of securities. The following parties were required to register themselves with the Securities and Exchange Commission for fairness in issuance and

public disclosure of businesses: a corporation that intends to have its securities listed on the securities market; an issuer of securities not listed on the securities market (i.e. a non-listed corporation) that intends to have public offering of its existing/new securities; and a non-listed corporation that intends to merge with a listed corporation (Article 3). Concerning such corporations whose securities were registered, the Securities and Exchange Commission could make necessary recommendations concerning what was fixed by the Presidential decree, including how to supply funds and improve the financial structure (Article 6).

The revision included reinforcement of regulations on securities business operators and the securities industry. First of all, the securities business licenses were divided into three sectors for their specialization and to turn them into larger businesses (Article 28, Paragraph 2). The required amount of capital of securities business operators were set as follows, depending on the type of business they carried out: KRW 500 million for type 1; KRW 2 billion for type-2, and; KRW 3 billion for type-3 (Article 28, Paragraph 3). The transfer of shares owned by oligarchic shareholders of a securities business should obtain the consent of the Commission (Article 28, Paragraph 4). When employees of a securities business set aside a given amount of their monthly pay for securities savings, they were not allowed to engage in securities transactions or entrust them on their own account regardless whose name they used unless provided for by the Presidential decree (Article 42). In the event that a director or an auditor of a securities business neglected to fulfill their duties or inflicted a loss on a third party while carrying out business, he/she, jointly and severally with oligarchic shareholders, were made to take responsibility, unless

oligarchic shareholders could prove that such a result was not caused by their request or consent (Article 58).

4. Summary

The following table concerns major revisions made to the Securities and Exchange Act between the mid-1950s and the mid-1970s, when Korea's capital market-related legal system was in the formative stage:

April 1963	① A new clause was inserted concerning securities issuer's responsibility for compensation of loss ② Upward readjustment of limitations on securities business operators' capital ③ The Minister of Finance was authorized to issue an order for cancellation of a contract for excessively speculative securities transactions ④ Adoption of more stringent conditions for cancellation of licenses issued for securities business operators ⑤ Adoption of more stringent conditions for dismissal of securities business operators' officers and imposition of business suspension ⑥ Turning the Korea Stock Exchange, which was a joint stock company, into a special corporation ⑦ Reinforcing the right of the Korea Stock Exchange and the Minister of Finance for the supervision of brokers ⑧ Establishment of a Contractual Violation Compensation Joint Fund at the Korea Stock Exchange concerning brokers' contractual violations ⑨ Making the establishment of securities financial businesses require authorization ⑩ Setting the scope of business carried out by securities financial businesses

	⑪ Making it required to attach a CPA's audit certification to accounting documents submitted under this Act
December 1964	Measures were taken to allow stocks at the old exchange or investment securities as the stock exchange to be exchanged with other government-owned listed stocks
December 1968	① Securities business licenses were divided into two: Those for businesses engaging mainly in securities transactions and those concurrently engaging in securities underwriting. Required minimum amounts of capital for securities business operators were reset as KRW 30 million and KRW 50 million, respectively. ② Securities business operators were required not to exceed the debt-net asset ratio set by the Presidential decree. ③ A system for securities transaction reserve was newly inserted. ④ Directors of securities business operators were made to be jointly and severally responsible in the event that a director or an auditor neglected to fulfill his/her duties either willfully or through negligence and inflicted loss on a third party.
February 1973	① The scope of securities was readjusted. ② The scope of securities business was readjusted. ③ The timing of effectuation of reports on public offering of existing/new securities was readjusted. ④ It was rearranged that securities should not be acquired or purchased until the effectuation of the report on their public offering. ⑤ The required amount of capital for securities business operators increased. ⑥ Provision of credit to securities business operators' directors and employees was prohibited. ⑦ New regulation on restrictions over officers' concurrent engagement in another job, securities business operators' engaging in securities savings or other types of business

December 1974	① Listed corporations increasing capital were required to submit a securities registration statement. ② Securities business operators' oligarchic shareholders were required to obtain authorization from the Minister of Finance for sale of their owned stocks. ③ Securities business operators were required to set aside a securities transaction reserve concerning profit earned from a securities transaction. ④ Securities business operators were made to keep secret information on customers, including their transactions. ⑤ The securities exchange was given priority rights over the other creditors. ⑥ The basis for the adjustment of stock quotes was laid. ⑦ Establishment of securities-related organizations was required to obtain permits from the Minister of Finance. ⑧ Business of securities financial firms was readjusted. ⑨ The term of officers of securities financial firms was readjusted. Restrictions over their elections and transactions were partially mitigated. ⑩ Book entry clearing businesses were allowed to issue securities deposit certifications. ⑪ Supervision over book entry clearing businesses was bolstered.
December 1976 (Fully revised)	① Securities issuers were required to be registered prior to the listing of securities. ② The securities takeover bid system was adopted as part of the attempt of the stabilization of management right. ③ Securities business licenses were divided into three types in connection with a need to enhance their expertise and turn them into larger ones. Transfer of oligarchic shareholders' stocks was required to obtain the consent of the Commission. ④ Restriction was put over transactions carried out by securities business operators' employees in connection with a need to establish fair trade practices.

	⑤ Oligarchic shareholders were required to be jointly and severally responsible for compensation of loss caused by neglect of duties on the part of securities business operators' employees. ⑥ Listed corporations were required to submit a semi-annual report. ⑦ The Securities and Exchange Commission was established with six members (three of them being standing members) for deliberation and decisions on matters concerning issuance, management, and fair transaction of securities and supervision of securities-related institutions. ⑧ The Securities Supervisory Board, a no-capital special corporation, was established as an executing institution of the Securities and Exchange Commission. ⑨ Listed corporations were required to report important management-related matters to the Securities Supervisory Board. ⑩ Listed corporations were required to comply with the securities-handling regulation set by the Securities Supervisory Board concerning issuance and management of securities for higher efficiency in management of listed securities. ⑪ Restrictions were put on insider trading concerning profit earned illegitimately by employees of listed corporations using inside information. ⑫ Restrictions were put on listed corporations' shares in mutual ownership. ⑬ The Commission was authorized to set financial management criteria for listed corporations. ⑭ The criteria of stocks that could be owned on one's own account were set. ⑮ The basis was laid concerning the government's investment in, or asset lent to, the Securities Supervisory Board.

Other new laws enacted for invigoration of the capital market included: the Act on the Promotion of Capital Market (enacted in November 1968); the Securities Investment Trust Business Act (enacted in April 1969); and the Act on Promotion of the Initial Public Offering (enacted in December 1972). The following table concerns the purpose of their enactment and the like:

The Act on the Promotion of Capital Market (Nov. 1968)	Purpose of enactment: Developing a healthy capital market by encouraging businesses to go public, promoting distribution of shares, helping people take part in business operations, and pushing ahead with a smooth capital supply to businesses. ① If a profit dividend rate of a listed corporation was lower than the rate set by the relevant Presidential decree, shareholders other than the government should be given priority in the dividend payout until the said rate was reached and the dividend rate for the government-owned shares should be readjusted downward. ② Tax rates for public corporations were set to be lower than those for their non-public cousins to encourage businesses to go public. ③ The Korea Investment Development Corporation was established to promote the issuance and distribution of securities, facilitate securities underwriting, and stabilize securities prices. ④ The Investment Deliberation Committee was established within the Korea Investment Development Corporation in connection with a need to deliberate important matters concerning securities, set up a plan for the sale of government-owned stocks as entrusted by the government, and adjust proper stock prices.

The Securities Investment Trust Business Act (August 1969)	Purpose of enactment: Establishment of the securities investment trust system with a view to reducing risk associated with securities investment, helping people invest in securities more easily in economic development, and supplying funds required by industries. ① Securities investment trust contracts were required to be made between an entrustor (trusting business) and a trustee (trustee business). ② An investment trust's beneficiary interest should be split equally. The split beneficiary interest should be marked as benefit securities. Exercise of beneficiary interest and its transfer should be made through benefit securities. ③ Benefit securities should be issued by the entrustor after obtaining the approval of the Minister of Finance and confirmation of the trustee. ④ The beneficiary should be able to ask the entrustor for redemption of the benefit securities at any time. ⑤ The entrustor was allowed to set aside a profit-sharing reserve within the extent of 10% of annual profit. ⑥ Trust assets were made to be invested chiefly in listed securities and the temporary surplus fund should be operated only in the form of a deposit to a financial institution or call loan. ⑦ The entrustor should be a joint stock company with not less than KRW 500 million and should obtain the license from the Minister of Finance. ⑧ When intending to make a trust contract, the entrustor should base it on a securities investment trust contract approved by the Minister of Finance. ⑨ Matters that the entrustor should not instruct the trustee to do were set. ⑩ The entrustor was not allowed to be engaged concurrently in business other than a trust.

	⑪ The trustee was required to manage entrusted assets separately from inherent assets or other entrusted property. ⑫ The trustee was not allowed to use entrusted assets for inherent assets.
The Act on Promotion of the Initial Public Offering (December 1972)	Purpose of enactment: Businesses started with a small amount of equity capital and they had to rely on short-term loans, paying high interest. Thus, their poor financial status poses a stumbling block to the country's healthy economic growth. The government saw a need to fix the situation and issued an emergency order for economic growth and stability, including forceful readjustment of creditor-borrower relationships and a debt-equity swap. It is necessary to improve the way for a long-term fund supply to businesses for the country's continued economic growth and thus the Act aims to enhance businesses' productivity through improvement of the fund supply method based on stock issuance, strengthen their international competitiveness, invigorate investment activities in the private sector, and bring about economic stability and continued growth by forming a sense of consensus between businesses and the people. ① The Act stipulated the launch of the Council for Deliberation of Businesses' IPOs chaired by the Prime Minister. ② Corporations that were required to go public included: those that have borrowed foreign capital, those whose adjusted debt comes to more than KRW 100 million, those that have used loans amounting to more than KRW 1 billion from financial institutions, and those designated by the Presidential decree as required for the national economy. The list was fixed through the deliberation of the Council in consideration of capital amount, asset status, dividend ability, business prospects, and the securities market situation. ③ Businesses that did not comply with the order for IPO were subject to treatment differentiated from other corporations in terms of corporate tax and income tax.

Section 2. Korea's Capital Market-related Legal System – Evaluation of Its Formative Stage

The periods between the mid-1950s and the mid-1970s discussed in this study were periods in which Korea's capital market-related legal system was in a formative stage. During the period, the country achieved a desired result, i.e. a rapid growth of the capital market, but also experienced a painful failure due to a variety of drawbacks of the system and the immaturity of market participants. Following the enactment of the Securities and Exchange Act in January 1962, the capital market showed the signs of a rapid growth amid a rapid increase in trade volume in the stock market and brisk issuance of stocks. However, in May 1962, the securities crisis hit the country and the securities market fell into a long-term recession. The government took a series of legislation measures designed to resuscitate the securities market. Thus, the country's capital market-related legal system experienced both success and failure in its formative stage, which will provide important lessons to the capital market-related legal system of developing countries that are in a similar situation to that of Korea at that time.

First of all, we need to look at how Korea's capital market grew. When the Daehan Stock Exchange opened in 1956 amidst a dire situation right after the Korean War, government bonds were main items that were traded at the exchange. After experiencing a securities crisis right after opening the stock exchange, the securities market remained bearish throughout the 1960s. It was still a vulnerable exchange centered on government bonds and clearing transactions. The situation started changing

in the 1970s, when the government took a positive measure trying to develop the capital market. The securities market expanded rapidly, displaying an almost two-fold growth in the 1972-1973 periods. Based on such a result, it appears that the government's policies adopted for the development of the capital market, including the Act on the Promotion of Capital Market and the Act on Promotion of the Initial Public Offering, achieved considerable success

[Table 2] Growth of Korea's Stock Market(Source: Korea Stock Exchange (1983))[57)]

	Number of listed businesses	Number of brokers	Number of shares (Unit: 1,000 people)	Capital amount listed (Unit: KRW 100 Million)	Aggregate Value of Listed Stocks (Unit: KRW 100 Million)	Aggregate Value Turnover Ratio (%)
1963	15	40	14.8	170	100	223
1964	17	36	13.9	222	171	364
1965	17	35	14.8	232	156	65
1966	24	26	31.8	325	195	57
1967	24	25	33.1	461	385	74
1968	34	27	40.0	966	643	48
1969	42	29	54.3	1,199	866	55
1970	48	28	76.3	1,343	979	46
1971	50	28	81.9	1,414	1,087	37
1972	66	27	103.9	1,743	2,460	39
1973	104	30	200.0	2,516	4,262	45
1974	128	30	199.6	3,813	5,328	38

57) David Cole and Park Yeong-cheol, Ibid, p. 105

	Number of listed businesses	Number of brokers	Number of shares (Unit: 1,000 people)	Capital amount listed (Unit: KRW 100 Million)	Aggregate Value of Listed Stocks (Unit: KRW 100 Million)	Aggregate Value Turnover Ratio (%)
1975	189	28	290.7	6,434	9,161	48
1976	274	28	NA	11,533	14,361	54
1977	323	27	395.3	14,924	23,508	78
1978	356	27	963.0	19,135	28,925	66
1979	355	27	872.1	22,023	26,094	53
1980	352	27	753.3	24,214	25,266	44

The foregoing table shows that it took a considerable time before the securities market could assume the inherent role of supplying funds to businesses despite the rapid growth in its outward appearance. Until 1972, businesses did not issue corporate bonds in the capital market and relied heavily on indirect financing from banks. The market for government/municipal bonds showed a steady growth, but their coupon rates were relatively low, and thus, most of them were sold to government-run financial institutions rather than to individual investors.[58] In the late 1960s, the government adopted a series of capital market policies chiefly aimed at the stock market. On August 3, 1972, the government announced drastic measures, including prohibition of borrowing from the non-institution financial market. The country's economy showed a noticeable recovery in 1972 and onwards. Under such circumstances, businesses judged that the need for funds could not be met only with loans from banks and foreign borrowings. The issuance of corporate bonds started increasing in 1972 and thereafter.

58) David Cole and Park Yeong-cheol, Ibid, p. 107

[Table 3] Growth of bond market in Korea(Source: Korea Stock Exchange, Stocks, January 1983)[59]

	Government/municipal bonds			Corporate bonds			
	Number issued	Balance of listed stocks (Unit: KRW 100 Million)	Amount of transactions (Unit: KRW 100 Million)	Number of businesses	Number issued	Balance of listed stocks (Unit: KRW 100 Million)	Amount of transactions (Unit: KRW 100 Million)
1963	16	60	11	-	-	-	-
1965	14	36	2	-	-	-	-
1967	8	14	0	-	-	-	-
1969	26	175	3	-	-	-	-
1970	35	267	36	-	-	-	-
1971	55	441	72	-	-	-	-
1972	80	641	83	12	16	47	1
1973	128	1,204	72	14	18	53	2
1974	197	1,695	30	42	54	224	2
1975	234	1,679	127	71	110	522	6
1976	254	2,801	300	105	180	1,184	67
1977	253	3,397	1,143	165	293	2,323	162
1978	240	4,296	1,951	278	553	5,389	435
1979	217	5,401	1,955	356	792	10,014	3,278
1980	230	8,954	2,460	434	1,004	16,493	6,439

As noted in the foregoing, Korea achieved a desired result through the adoption of an appropriate capital market-related legal system. However, overall, the financial sector served only as an industry that provided

59) David Cole and Park Yeong-cheol, Ibid, p.106

support for the manufacturing sector in the 1960s and the 1970s. The situation has not changed much so far. Some experts point out that the country's financial sector has not overcome a variety of vulnerable points completely from a perspective of global standards.[60] According to statistics about transaction volume in financial products and their share in the entire picture, financial institutions specializing in loans were and still are at the center of the country's financial transactions, except that the share of bonds has grown noticeably and the share of each financial product displayed a drastic change temporarily right after the country's foreign exchange crisis in 1997.

[Table 4] Transaction volume in each financial product and its share[61]
(Source: The Bank of Korea / Unit: KRW Trillion or %)

Annual average transaction volume	1970s	1980s	1990s			2000~2005	2003~2010
				Before the foreign exchange crisis (until 1997)	After the foreign exchange crisis (1998~1999)		
Total	12.0 (100.0%)	52.9 (100.0%)	251.2 (100.0%)	242.3 (100.0%)	287.2 (100.0%)	342.8 (100.0%)	466.4 (100.0%)
Cash and deposits	2.4 (20.0%)	11.5 (21.7%)	53.4 (21.3%)	55.0 (22.7%)	47.2 (16.4%)	60.0 (17.5%)	103.2 (22.1%)

60) Jo Jong-hwa, Park Yeong-jun, Lee Hyeong-geun, Yang Da-yeong, *Evaluation of East Asian Development Models – With the focus on the comparison with Anglo-American models*, Korea Institute for International Economic Policy (KIEP) 11-08, 2011, p. 63

61) Korea Institute of Finance, *Korea's Financial Operation – Its Past, Present, and Future*, September 2011, p. 138

Annual average transaction volume	1970s	1980s	1990s			2000~2005	2003~2010
				Before the foreign exchange crisis (until 1997)	After the foreign exchange crisis (1998~1999)		
Loans	3.2 (26.8%)	14.3 (27.0%)	49.8 (19.8%)	61.5 (25.4%)	3.0 (1.0%)	74.8 (21.8%)	115.8 (24.8%)
Bonds	0.7 (6.2%)	6.3 (11.9%)	45.5 (18.1%)	40.1 (16.5%)	67.3 (23.4%)	81.5 (23.8%)	103.1 (22.1%)
Investment fund (investment trust)	0.1 (0.7%)	1.8 (3.5%)	16.4 (6.5%)	8.4 (3.5%)	48.5 (16.9%)	2.0 (0.6%)	17.7 (3.8%)
Stocks and investment	1.0 (8.3%)	5.5 (10.3%)	21.6 (8.6%)	14.2 (5.9%)	51.4 (17.9%)	32.2 (9.4%)	42.4 (9.1%)
Insurance and pension	0.2 (1.7%)	2.5 (4.8%)	10.1 (4.0%)	11.0 (4.6%)	6.2 (2.2%)	22.8 (6.7%)	37.6 (8.1%)
Others	4.4 (36.4%)	11.0 (20.9%)	54.4 (21.7%)	52.1 (21.5%)	63.7 (22.2%)	69.3 (20.2%)	46.6 (10.0%)

What is stated in the foregoing paragraph has been an overall trend in East Asia, including Korea. In East Asian developmental states, the financial sector has focused on the role of providing support for the growth of the manufacturing sector, long under their governments' regulation and influence.[62] That is because East Asian developmental states concentrated on manufacturing rather than the service sector, which is non-tradable goods, while putting stress on export promotion to earn the foreign currencies

62) Jo Jong-hwa, Park Yeong-jun, Lee Hyeong-geun, Yang Da-yeong, Ibid, p. 62

they needed for the import of technology and capital goods and trying to overcome their small domestic market in the course of their development process.[63] Such can be regarded as a characteristic of the Korean economic system, which chose a path of export-oriented development.

Here, attention needs be paid to limitations displayed by Korea's capital market-related legal system. The country's capital market started recording a rapid growth in the 1970s, but it is a matter of deep regret that the country was not quick to revamp the executing organizations and systems that dealt with problems stemming from the rapid growth. It was not until 1977 that the country established the Securities and Exchange Commission in charge of the supervision of the capital market and its executing body, the Securities Supervisory Board. In the 1960s through the 1980s, central government agencies, such as the Economic Planning Board and the Ministry of Finance, controlled most of the country's economic policies, including those concerning the capital market. Considering the development made by the capital market, the launch of an agency in charge of the supervision of the capital market should have been made much earlier.

On the other hand, there was a bright side to such a situation. The capital market was fully managed and controlled by the Ministry of Finance during the formative stage of the country's capital market-related legal system. Thus, the government could cope with difficulties related to the capital market, such as the securities crisis, promptly and strongly. The measures taken earnestly by the government in the late 1960s for the

63) Jo Jong-hwa, Park Yeong-jun, Lee Hyeong-geun, Yang Da-yeong, Ibid, p.62. Korea, Japan, Taiwan, and China show high reliance on manufacturing, compared to the United States or the United Kingdom. They all enjoy long-term surplus in foreign trade based on their competitiveness in manufacturing. In 2008, the share of manufacturing in GDP of Korea, Japan, and China stood at 28%, 20%, and 33%, respectively, compared to 13% and 12% in the United States and the United Kingdom.

development of the capital market could achieve good results, supposedly thanks to the fact that the central government agencies fully managed and controlled the capital market through the enactment of the relevant laws, including the Act on the Promotion of Capital Market and the Act on Promotion of the Initial Public Offering. In such a respect, the government-led development policies appear to have exerted its strength fully in the capital market as in other economic policies carried out at that time.

The following table summarizes the development process of the country's capital market-related legal system per major regulation, with the focus on major revisions made in the 1962~1994 period.

[Table 5] Changes in Korea's capital market-related legal system(1962~1994) with the focus on major revisions

Target of regulation	Year of enactment or revision	Details of enactment or revision
Scope of securities	1973 / revision	• Readjustment of the scope of securities
	1991 / revision	• Redefining securities in consideration of new financial products
Securities business operators	1962 / enactment	• All securities business operators should be joint stock companies. The establishment of a securities business should obtain a permit from the Minister of Finance. • Lower limit for net capital amount: 30 million hwan; no dishonesty in transactions; no over-the-counter investment; no transactions in excessive quantity
	1963 / revision	• Readjustment of lower limits of capital for securities business operators • Adoption of more stringent conditions concerning cancellation of a security business license • The Minister of Finance was authorized to issue an order for the cancellation of a contract for excessively speculative securities transactions • Adoption of more stringent conditions for the dismissal of securities business operators' officers and imposition of business suspension securities business operators

Target of regulation	Year of enactment or revision	Details of enactment or revision
	1968 / revision	• Securities business licenses were divided into two: Those for businesses engaging mainly in securities transactions and those concurrently engaging in securities underwriting. Required minimum amounts of capital for securities business operators were reset as KRW 30 million and KRW 50 million, respectively. • Securities business operators were required not to exceed the debt-net asset ratio set by the Presidential decree. • A system for a securities transaction reserve was newly inserted. • Directors of securities business operators were made to be jointly and severally responsible in the event that a director or an auditor neglected to fulfill his/her duties either willfully or through negligence and inflicted loss on a third party, separately from the securities business operators' inherent responsibility.
	1973 / revision	• Readjustment of the scope of a securities business • Capital amount for securities business operators was heightened (to KRW 200 million and KRW 300 million, respectively). • Provision of credit to securities business operators' directors and employees was prohibited • Restriction over officers' concurrent engagement in another job, securities business operators' engaging in securities savings or other types of business

Target of regulation	Year of enactment or revision	Details of enactment or revision
	1974 / revision	• Securities business operators were required to set aside securities transaction reserve concerning profit earned from securities transactions. • Securities business operators were made keep secret information on customers, including their transactions. • Transfer of oligarchic shareholders' stocks was required to obtain the consent of the Commission.
	1976 / full revision	• Securities business licenses were divided into three types in connection with a need to enhance their expertise and turn them into larger ones. • Transfer of oligarchic shareholders' stocks was required to obtain the consent of the Commission. • Restriction was put over transactions carried out by securities business operators' employees in connection with a need to establish fair trade practices. • Oligarchic shareholders were required to be jointly and severally responsible for a compensation of loss caused by the neglect of duties on the part of securities business operators' employees.
Stock exchange	1962 / enactment	• All securities business operators should be joint stock companies. The establishment of a securities business should obtain a permit from the Minister of Finance.

Target of regulation	Year of enactment or revision	Details of enactment or revision
	1963 / revision	• Turing the Korea Stock Exchange, which was a joint stock company, into a special corporation • Reinforcing the right of the Korea Stock Exchange and the Minister of Finance for supervision of brokers • Establishment of the Contractual Violation Compensation Joint Fund at the Korea Stock Exchange concerning brokers' contractual violations
	1974 / revision	• Reinforcing securities exchange priority right over other creditors
	1987 / revision	• Turning the securities exchange into a membership system
Issuance and distribution of securities	1963 / revision	• Putting in a new clause concerning securities issuer's responsibility for compensation of loss incurred by investors
	1973 / revision	• Readjustment of the timing for effectuation of securities business operators' reports on public offering of existing/new securities • Making it not possible to acquire or sell securities whose effectuation in reports on public offerings of outstanding securities has not occurred
	1974 / revision	• A securities registration statement should be submitted to the Minister of Finance when listed corporations issue new shares. The Minister of Finance was authorized to not designate a date of effectuation when necessary.

Target of regulation	Year of enactment or revision	Details of enactment or revision
	1976 / full revision	• Registration of securities issuers prior to a listing
Public disclosure of information	1963 / revision	• A new clause concerning responsibility for the compensation of loss caused by false information in a securities registration statement
	1973 / revision	• Listed corporations increasing capital were required to submit a securities registration statement.
	1976 / full revision	• Listed corporations were required to report important management-related matters to the Securities Supervisory Board.
	1982 / revision	• Turing the securities-related report system into a public disclosure system
	1987 / revision	• Improvement in the business public disclosure system
	1991 / revision	• Adoption of a system for public disclosure concerning consolidating financial statements
Business merger	1976 / full revision	• Adoption of the securities takeover bid system as part of the measure for management right stabilization
	1991 / revision	• Adoption of a system of making it a rule to report on owning a large number of stocks ("the 5% rule") and on business mergers

Target of regulation	Year of enactment or revision	Details of enactment or revision
	1994 / revision	• Expansion of the scope of those subject to the 5% rule
Unfair trade	1963 / revision	• The Minister of Finance was authorized to issue an order for the cancellation of a contract for excessively speculative securities transactions
	1976 / full revision	• Restrictions were put on insider trading concerning profit earned illegitimately by employees of listed corporations using inside information.
	1982 / revision	• Reinforcement of regulations on insider trading, price manipulation, and illegitimate acts of recommendation
	1987 / revision	• Adoption of obligation to return a short-term margin
	1991 / revision	• A new clause on prohibition of the use of undisclosed information
Listed corporations	1976 / full revision	• Making it obligatory for listed corporations to report important management-related matters to the Securities Supervisory Board • Listed corporations were required to follow the securities-handling regulation set by the Securities Supervisory Board for a more efficient management of listed securities. • Adoption of a system for registration of corporations intending to list their securities • Restrictions were put on listed corporations' shares in mutual ownership.

Target of regulation	Year of enactment or revision	Details of enactment or revision
		• Criteria were set concerning stocks that could be owned by a listed corporation on its own account. • The Securities and Exchange Commission was authorized to fix financial management criteria for listed corporations for their healthy financial operation. • Making it required for listed corporations to submit a semi-annual report
	1982 / revision	• Adoption of the stock option system • Criteria were reinforced concerning stocks that could be owned by a listed corporation for the stabilization of management right of listed corporations.
	1987 / revision	• Reinforcement of restrictions on the ownership of shares and voting rights for the protection of management right of privatized public corporations
	1994 / revision	• Abolition of the system of restrictions on ownership of a large number of listed shares • Granting a stock option right to shareholders with preferred stocks with no voting right • Allowing listed corporations to acquire treasury stocks
Financial investment businesses	1976 / full revision	• The Securities and Exchange Commission was established with six members (three of them being standing members) for deliberation and decision on

Target of regulation	Year of enactment or revision	Details of enactment or revision
		matters concerning issuance, management, and fair transaction of securities and supervision of securities-related institutions. • The Securities Supervisory Board was established, a no-capital special corporation, as an executive body of the Securities and Exchange Commission.
Financial investment business-related organizations or institutions	1963 / revision	• Adoption of a system for authorization of the establishment of a securities financial business • Fixing the business to be carried out by securities financial businesses
	1974 / revision	• Making it required to obtain a permit from the Minister of Finance for establishment of securities-related organizations

Chapter 4. Lessons to be Learned from Korea's Experience Concerning a Capital Market-related Legal System in the Formative Stage

Proper regulation is an essential factor in maintenance and development of a financial market. Financial regulation has developed in each of the three sectors, i.e. banking, securities, and insurance, of the financial market, with the reality of business reflected. The regulations have been made chiefly in three sectors, i.e. transactions, businesses, and the market.[64] The core idea of the capital market-related legal system is protection of investors.[65] It is generally understood that regulation on the capital market made under such an objective is centered on public disclosure of information and unfair trade practices, but the capital market-related legal system adopted by Korea contains a variety of regulations not falling under the said categories.

The country's Law on capital market also contains factors associated with the financial investment business sector, in addition to their inherent objectives for protection of investors through regulation on public disclosure and unfair trade practices. In Japan, a law that incorporates regulations for protection of investors and regulations associated with industrial regulation-related factors into one is called "one-set regulation."[66] Each method of regulation has its merits and demerits.[67] Those focusing on protection of investors, including the proponents of the Securities Act of 1933 of the United States, will strive to expand the scope of financial investment

64) Kim Geon-sik and Jeong Sun-seop, *Capital Market Laws*, Duseong Publishing, 2010, p. 4
65) Kim Geon-sik, The Securities and Exchange Act, Duseong Publishing, 2004, p. 40
66) Kim Geon-sik, Ibid, p. 57
67) Kim Geon-sik, Ibid, pp. 57-58

products and include all new investment tools in the scope of the law. In contrast, in the capital market-related legal system of Korea, which is based on the "one-set regulation," the scope of the financial business sector expands, depending on the scope of financial investment products, which in turn leads to expansion of the scope of financial businesses.

It is thought that the capital market-related legal system of a developing country, which remains in the formative stage, will require more than regulations on public disclosure and unfair trade practices designed for the protection of investors and need to encompass industrial factors. Thus, the scope of securities or securities business, which will be dealt with in detail in the following, should be considered from not only a perspective of a transaction-related regulation, but that of industrial regulation-related factors, and be stipulated clearly in the law.

In the following, factors that should be considered carefully in a capital market-related legal system in the formative stage are discussed based on what was experienced by Korea.[68)]

Section 1. Scope of Financial Investment Products(or Securities[69)])

In Korea, in the Securities and Exchange Act, which is now abolished, the scope of marketable securities was enumerated in a limited way, but

68) In the capital market-related legal system of Korea, regulation on, or special treatment of, listed corporations constitute a very important part. However, technically, special regulations on corporations listed on the stock exchange or registered with the Kosdaq market (e.g. regulation concerning required conditions for exercising rights of minor shareholders of listed corporations) are really those that should be included in the part concerning companies in The Commercial Act. Generally, experts say that it is not desirable to adopt wide-ranging regulations concerning special treatment of listed corporations in capital market laws, as it causes a hollowing out of The Commercial Act and confusion in legal interpretations.

69) In the Stock Transaction Act of Korea, which is now abolished, the term "marketable

the principle of all-inclusiveness was adopted amidst a switch to the Capital Market and Financial Investment Act system and financial investment products came to be divided into securities and derivatives. The Securities and Exchange Act adopted a method of using the concept and scope of "securities" in its clauses in a limited way based on the name or the laws forming its basis and thus new financial products that appeared on the market were not included in the list of products subject to regulation as long as they were not stated in the law as "securities." At it caused problems, including difficulties in the development of a new product due to the insufficient protection of investors caused by a loophole in regulations and the inability of legal predictability. Thus, the Law on capital market adopted the principle of all-inclusiveness to make definitions comprehensively based on the functional attributes of the relevant products concerning the concept and scope of financial investment products to solve the said problem.[70)]

The concept "marketable securities" causes a variety of difficulties amid the development of the capital market.[71)] They can be summarized as two problems.[72)] Under the limited positive system, reviews had to be done to see whether a financial product fell under the category of investment whenever such a product was newly introduced. If the new product was not included in the list enumerated for investment, a securities business operator was not allowed to trade it, but a transaction of it by a non-securities

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securities" was used as a concept of a tool for the protection of investors, which caused confusion with the same term used among judicial circles. Many people expressed criticism abut it. The current Law on capital market adopted the term "securities," making it clearly distinctive from the term used among judicial circles. Kim Geon-sik and Jeong Sun-seop, Ibid, p. 30.

70) Im Jae-yeon, The Law on capital market, Pakyoungsa, 2012, p. 22

71) Kim Geon-sik and Jeong Sun-seop, Ibid, p. 21

72) Concerning the content of this paragraph, refer to: Kim Geon-sik and Jeong Sun-seop, Ibid, p. 21

business operator was not subject to legal regulations and thus a loophole occurred in protection of investors. Investment objects listed as securities in the law were subject to legal formality rather than to economic reality. Such a static approach was unable to regulate the dynamic reality of the securities market properly.

The external economic conditions of today are a far cry from those that Korea went through in the process of development, but it is not difficult to predict diverse or adverse side effects in introduction of derivatives, which entail high volatility and risks, into a capital market that remains in the formative stage. Thus, policymakers of a developing country should consider confining financial products traded in its capital market to securities until the capital market grows up and is staffed with capable human resources and equipped with necessary physical infrastructure. Meanwhile, Cambodia's long-term Financial Sector Development Strategy recently announced includes a timetable for establishment of a derivatives market by 2015.[73)]

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Financial Sector Development Strategy 2006-2015

Immediate Priorities (2006-2009)
- Enact Bankruptcy Law
- Develop progressive company framework with graduated requirement from small to listed company.
- Investor education and human resource development
- Put in place interbank market
- Enact law on non-government securities (Enforcement framework for fraud and central electronic securities depository)
- Continuing improvement of accounting/auditing capacity

Intermediate and Medium term priorities (2009-2012)
- Implement progressive, graduated framework for companies

Looking at Korea's capital market-related legal system, the switch from the system of enumeration of the scope of "securities" to the system of a comprehensive definition based on function and risks was made when the country adopted the integrative Capital Market Act, i.e. after considerable development of the market. The countries that operate an integrated capital market-related legal system similar to Korea's Capital Market and Financial Investment Act include: the United Kingdom (The Financial Services and Market Act 2000), Australia (The Financial Services Reform Act 2001), Singapore (The Securities and Futures Act 2001), and Japan (The Financial Products Transaction Act 2006). Thus, it will not be out of place to say that a comprehensive method of regulation should be adopted by an advanced capital market-related legal system from a perspective of the history of the legal system.

For a country whose capital market remains in the formative stage, the concept of financial investment products and comprehensive stipulation about the relevant definitions currently adopted in Korea's Capital Market and Financial Investment Act do not appear suitable. In the formative stage of a capital market, the number and types of securities traded are likely to

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- Securities depository for all public company
- Implementation of financial enforcement and regulation
- Continuing development of financial regulation
- Preparation for the Securities Exchange: IPOs, Securities intermediaries, consideration of the investor compensation scheme.

Long Term Goals (2012-2015)
- Development of:
  · Investment funds
  · Pensions/Provident fund scheme
  · Securitization framework/Institution
  · Derivatives

be limited. In such a stage, the country needs to specify the scope of financial products to minimize unpredictability and have the relevant parties (i.e. both the regulators and the regulated) experience learning effects about the rules of a new market. In the formative stage of a capital market, which is not likely to be provided with necessary human resources or physical infrastructure that can handle derivatives, it is not recommendable to allow financial investment businesses operators (mainly securities business operators) to handle products whose functions or risks have not been fully recognized.

Section 2. Regulation on Securities business operators and the Securities Exchange

Securities business operators and investors are the two main components of the capital market.[74] Looking at how the country's securities transaction-related legal system has developed, regulations on securities business were revamped intensively in the beginning. The securities exchange is another factor that should be checked along with securities business operators and regulations on them. In Korea, the securities exchange was the cause of the securities crisis in the 1962~1963 period. The country's experience tells us that the most important factor in the formative stage of a capital market-related legal system is the design of the system of regulations on the securities industry and the securities exchange.

In Korea, the securities exchange was operated in the form of an organization invested by a group of securities business, financial businesses, and insurance businesses until 1962, when it was turned into a joint stock

74) Kim Geon-sik and Jeong Sun-seop, Ibid, p. 14

company under the newly enacted Securities and Exchange Act.[75] Under the Securities and Exchange Act, the securities exchange switched to a joint stock company. However, following the securities crisis, the Korea Stock Exchange changed into a special corporation through the revision of the Securities and Exchange Act in 1963, as it was pointed out that the securities exchange was only interested in earning profit and paid little attention to fair management of the market. Later, in March 1988, the stock exchange turned into a membership-type with no-capital special corporation under the government's plan for privatization of public corporations. Through the revision of the Securities and Exchange Act in 1963, measures were taken to strengthen the supervision of brokers by the Korea Stock Exchange and the Minister of Finance. The Contractual Violation Compensation Joint Fund was established at the Korea Stock Exchange to have brokers make up for loss incurred by investors due to their contractual violations.

During the formative stage of the capital market-related legal system, regulations on business entry, soundness or business activities concerning securities business were reinforced and supplemented. When the Securities and Exchange Act was first enacted, the establishment of a securities business required a permit from the Minister of Finance. The requirement for obtaining the permit changed to a requirement for authorization/ registration under the current Capital Market Act. In 1968, securities business operators were divided into two types, with different minimum required capital amount set for each. In the 1973 revision, the scope of the securities industry was readjusted. In the 1976 revision, securities business operators were divided into three types with the aim of making them enhance their specialties and grow larger, with minimum required capital

75) Seong Seung-je, Ibid

amount raised for each type. The 1968 revision set an upper limit for the securities business operators' debt ratio under the Presidential decree.

A few examples of regulations concerning securities business operators contained in the Securities and Exchange Act first enacted were: no dishonest act, including distribution or use of false information, no over-the-counter investment outside of the securities market, and no transaction of securities in excessive quantities. The 1963 revision granted the Minister of Finance the right to issue an order for the cancellation of a contract for excessively speculative securities transactions, which was adopted due to the bitter experience of the securities crisis that occurred right before the revision. The revision also adopted more stringent conditions for the cancellation of securities business permits, dismissal of officers, and business suspension, which signified the commencement of stronger administrative regulations on the securities industry.

Revisions of the said Act made in 1968 and thereafter imposed stricter responsibilities on the directors and employees of securities business operators. The 1968 revision required that directors of securities business operators be jointly and severally responsible in the event that a director or an auditor neglected to fulfill his/her duties either willfully or through negligence and inflicted loss on a third party, aside from the inherent responsibility of the securities business operators. The 1973 revision imposed regulations, such as no provision of credit to directors or employees of securities business operators and restrictions on directors' engaging concurrently in another job outside their companies. The 1974 revision imposed duties of not disclosing inside information to a third party on directors and employees of securities business operators. The 1976 revision expanded the responsibility for making up for loss incurred by customers due to a director's neglect of his/her duty to

oligarchic shareholders. In addition, restrictions were imposed on transactions carried out by directors and employees of securities business operators. Oligarchic shareholders were required to obtain consent of the Securities and Exchange Commission concerning transfer of their stocks. All these were part of the effort for stricter regulations on securities business operators' transactions. However, until that time, regulations on securities business operators concerning protection of investors left much to be desired. Measures concerning it started in the 1980s.[76)]

Korea's capital market experienced a lethal crisis right after the first opening of the stock exchange due to a deficient system and market participants' excessive speculation. Since then, the country has made efforts to overhaul the capital market-related legal system. In Korea, the revisions have been focused on the securities exchange and the industry. There is a lesson that those operating a capital market-related legal system in its formative stage need to learn from Korea's experience, i.e. the importance of setting up exquisite apparatuses that can block attempts to seek dishonest or excessive private interest. Past experiences of Korea show that the capital market in a developing country can be abused by those holding political power. Thus, it is essential to operate regulatory agencies whose political and economic independence is ensured and apparatuses that can block market participants' attempt to abuse the market for their own private good.

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76) Clauses concerning protection of financial investors in the Law on capital market include: general/comprehensive obligations (Article 37), apparatus for blocking disclosure of inside information (Article 45, Paragraph 1), distinction between professional investors and ordinary investors (Article 46, Paragraph 1), ascertainment of investment information (Article 46, Paragraph 2), principle of propriety (Article 46, Paragraph 3), principle of suitableness (Article 46-2, Paragraph 1), obligation for explanation (Article 47, Paragraph 1), and no unjustifiable recommendation (Article 49).

Section 3. Methods of execution and supervisory institutions

Generally, Anglo-American models of the capital market-related legal system tend to stress private execution, but their counterparts in the formative stage that is not fully supported by the judicial system or in which investors' positive private execution is difficult to predict need to stress public execution. Even the public execution-centered system may have two aspects as shown in Korea's experience in the development of the capital market-related legal system: the Ministry of Finance-centered execution prior to 1976 and the execution centered on the Securities and Exchange Commission and the Securities Supervisory Board in the post-1976 period following the full revision of the Securities and Exchange Act.

Concerning the Securities and Exchange Commission, the Minister of Finance could give instructions to the Commission and supervise its activities. The Commission was required to report its decisions immediately to the Minister of Finance. The Minister of Finance was authorized to cancel the decisions made by the commission, partially or wholly, or stop their execution when they were in violation of the law or not conducive to investor protection. The Minister of Finance could also ask the Commission to take necessary measures required for the public good or investor protection, which the Commission was to comply with immediately. The launch of the Securities and Exchange Commission in 1976 was a landmark event in Korea's capital market-related legal system, but the Ministry of Finance continued to be at the center of the real execution of the system,

which was the most noticeable feature of the system at that time.

Operation of a professional regulatory institution is essential for the development of the capital market. The experience of Poland and the Czech Republic tells us how much of a difference can be made by the existence or absence of an independent and earnest-working institution.[77] Poland had an independent and highly motivated regulatory institution. In contrast, the Czech Republic left the execution of capital market laws to passive-minded officials in the Ministry of Finance. Poland saw a very rapid growth of its capital market, while the fund supply to businesses through the capital market did not go smoothly in the Czech Republic.

As for Korea, the Ministry of Finance played a dominant role in the execution of the capital market-related legal system in its initial stage, but it appears that the country did not have particular difficulties in achieving the desired goal, i.e. having the capital market take root and develop. It does not mean that the country's capital market performed much better than those of other countries that adopted different development objectives and strategies. At that time, the Ministry of Finance,[78] along with the Economic Planning Board, was in charge of the country's economic policies. The ministry was also in control of banks and the capital market. It is possible that the ministry operated the policy concerning the capital

77) Dam, ibid, p. 189

78) The Ministry of Finance was established in July 1948 under the Government Organization Act. In 1994, the ministry, along with the Economic Planning Board, was replaced by the Ministry of Finance-Economy. In 1998, its name was changed to the Ministry of Finance and Economy. In 2008, the ministry, along with the Planning and Budget Ministry, was replaced by the Ministry of Strategy and Finance. Main business handled by the Ministry of Finance included matters concerning currencies, finance, government bonds, government accounting, taxation, foreign exchange, economic cooperation with foreign countries, nationally-owned property and monopoly. National Archives & Records Service Homepage (http://theme.archives.go.kr/next/organ/organBasicInfo.do?code=OG0017062)

market by coordinating it with a policy concerning banks, as it pushed ahead with economic development based on the banking-centered financial system.

At that time, the organization of the Ministry of Finance and its rights and functions were being expanded while the relevant laws were adopted and revamped. Regulation on information disclosure and unfair trade practices was carried out as follows:

1. Regulation on information disclosure

Generally, information disclosure stipulated in the Law on capital market is divided into disclosure in the primary market and disclosure in the secondary market. The disclosure in the primary market refers to the procedure imposed on the issuer to help investors make judgments at the time of the issuance of securities. It is carried out chiefly in the form of a securities registration statement and business explanation.[79] The disclosure in the secondary market refers to the procedure provided to help with investment judgment or the exercise of rights concerning securities issued and traded in the secondary market. It is divided into periodical disclosure, extraordinary disclosure, special disclosure, and fair disclosure.[80]

Regulation on information disclosure is the most important item in developing countries' capital market-related legal system. In a country with a mature capital market and judicial system, imposition of information disclosure can be done through private execution. However, in developing countries not equipped with a proper judicial system, it appears more

79) Kim Geon-sik, Ibid, p. 42
80) Kim Geon-sik, Ibid, pp. 42-43

appropriate to achieve the purpose of the relevant laws through public execution.[81)]

As for public execution-centered regulations on issuance-related disclosure, there are two ways to do it: regulators screening out issuers who have first-hand access to the capital market ("merit regulation"), and; having issuers disclose information on themselves ("disclosure regulation"). Generally, more advanced countries adopt the latter, while only a few of developing countries choose it.

For developing countries, the "merit regulation" appears to be more appropriate, as they are likely not to be equipped with conditions (such as experts specializing in law, accounting, bankruptcy and securities capable of making investment-related analyses) that can support the information disclosure system and investors do not have much experience. In many developing countries, the government owns major listed businesses and thus the "disclosure regulation" may not provide issuers with sufficient motivation about information disclosure.

When the Securities and Exchange Act was enacted, Korea adopted the merit regulation. The 1963 revision inserted a clause for compensation of loss concerning false information in a securities registration statement. The 1973 revision required corporations planning on a capital increase to submit a securities registration statement. The 1976 full revision required listed corporations to report their important management-related matters[82)]

81) Dam, Ibid, p. 187 stresses the importance of imposition of information disclosure through private execution.

82) Matters, such as the dishonoring of their commercial notes or checks; prohibition of their transactions with banks; suspension of business activities, either partially or wholly; application for commencement of a corporate liquidation procedure; change of purpose of doing business; huge loss incurred due to a disaster; commencement of a lawsuit that may have a serious impact on listed securities, etc.

to the Securities Supervisory Board as part of an effort to improve the disclosure system. It was in 1982 that Korea switched from the merit regulation to the disclosure regulation. The foregoing details a focus on the rights granted to the Ministry of Finance or the Securities and Exchange Commission.

When the said Act was enacted in 1962, public offering of existing or new securities were required be reported to the Minister of Finance and could be effected only after the effectuation of the report (i.e. 30 days after the acceptance of the report). Under the 1973 revision, the effectuation occurred on a day designated by the Minister of Finance, after the acceptance of securities registration statement. Insertion of the new stipulation concerning the designation of the day of effectuation meant the Minister of Finance's right expanded concerning issuance and distribution of securities. It is thought that in some cases the Minister of Finance's judgment on the truth of securities registration statements or the value of the relevant securities became a decisive factor concerning issuance or distribution of securities.

The 1974 revision required a listed corporation planning on the issuance of new shares to submit a securities registration statement to the Minister of Finance and authorized the Minister of Finance not to designate a day of effectuation if necessary for the formation of fair prices for securities or price stabilization or protection of investors. Thus, the rights granted to the Minister of Finance concerning issuance of new shares were expanded so far as to block their issuance.

Finally, the 1976 full revision handed over the rights concerning the registration of securities and public offering of existing or new shares to the newly established Securities and Exchange Commission. Under a newly

inserted chapter, the following corporations were required to be registered with the Commission: those planning on listing; unlisted corporations planning on public offering of existing/new securities; and an unlisted corporation planning on merger with a listed corporation. The Commission could make recommendations concerning methods for a fund supply or improvement of financial structures to such corporations.

2. Regulation on unfair trade practices

Generally, regulations on unfair trade practices under the Law on capital market are divided into those targeting all actors and those targeting securities business operators.[83] Examples of those targeting all actors include those prohibiting insider trading, price manipulation, or fraud. Those targeting securities business operators include prohibiting unfair transactions done by securities business operators or their employees. Regulations on unfair trade practices targeting all actors are explained in detail.

When the Securities and Exchange Act was enacted in 1962, it had clauses concerning transactions in the securities market, such as no fraud in transactions, no price manipulation, and responsibility for compensation of loss caused by price manipulation. It is noteworthy that the Minister of Finance had the right for a rather comprehensive control over transactions in the securities market. The Minister of Finance was authorized to issue an order for a remedial action concerning an act or transactions performed by the securities exchange or temporary stoppage of a transaction, either partially or wholly, for fair trade and the protection of investors.

83) Kim Geon-sik, Ibid, p. 43

The 1963 revision, which was made right after the securities crisis, authorized the Minister of Finance to impose more stringent control over securities business operators' unfair trade practices, as reviewed in the foregoing part concerning regulations on securities business and the securities exchange. The revision authorized the Minister of Finance to cancel securities transaction contracts in the event of the following cases: (1) when it is impossible to carry out a transaction contract due to occurrence of a situation, such as acts of God, war or an abrupt change in the economic situation, or (2) when it is impossible to settle a chaotic situation caused by an abrupt change in price or transaction volume amid speculation and the like. Revisions made in the ensuing period, including the full revision in 1976, put much stricter regulations on listed corporations' unfair trade practices, including prohibition of insider trading. Such revisions continued until the late 1980s.

Considering the fact that it is necessary to have a considerable period of learning before investors' healthy investment behavior is established in the formative stage of a capital market (as showcased by the securities crisis in 1962 and 1963 in Korea), it is desirable for the regulatory authority to be involved in the market for a given period of time. Not only that, but it is difficult to put an end to unfair trade practices perpetrated in a capital market through private execution considering that people do not have place much trust in the judicial system in many developing countries. Thus, it is inevitable to operate a public execution-centered system even in the case of regulation on unfair trade practices.

Section 4. Policies for Promotion of Listing on the Stock Exchange

The capital market development policy (or the policy for promotion of businesses' listing on the stock exchange) has been the most successful item in Korea's capital market-related legal system and it is the area developing countries can learn a valuable lesson from. The country's relevant measures were taken mostly through two special laws, i.e. the Act on Promotion of the Initial Public Offering and the Act on the Promotion of Capital Market, in addition to the takeover bid system, which was adopted as part of an effort to stabilize management rights under the Securities and Exchange Act. Next, the incentives that were provided to businesses through the legal system will be examined.

As summarized in the following table, the policy for promotion of businesses' listing on the stock exchange, which was adopted in the formative stage of the country's capital market-related legal system, is divided into passive support measures and measures for positive motivation through the Act on the Promotion of Capital Market and the Act on Promotion of the Initial Public Offering, respectively. Tax incentives were a major item of passive support measures. Even the Act on Promotion of the Initial Public Offering offered diverse tax incentives. Other measures were also taken to promote distribution of governmentowned shares, encourage initial public offering, and push ahead with the circulation of shares. A system of allowing businesses to pay guarantee or deposit money to the government with listed securities was adopted to enhance the value of shares.

Drastic measures were used to encourage businesses to list their stocks on the stock exchange. The Minister of Finance designated businesses and

forced them to go public. Such a measure proved very effective, apparently due to reward for compliant ones, including protection of management right, and punitive measures against non-compliant businesses, including cutting off loans provided to them.

The policy for promotion of businesses' listings on the stock exchange was an extensive and comprehensive measure. In addition, the Ministry of Finance, along with the Economic Planning Board, exerted powerful influence though the economic policies it adopted. That is how such policy achieved great results.

[Table 6] The policy for promotion of businesses' listings on the stock exchange in the capital market-related legal system of Korea

Contents of policy		Law	Details
Passive support	Tax benefit	The Act on the Promotion of Capital Market	• Favorable treatment concerning corporate tax rate and depreciation compliant businesses • Exemption of taxes on dividend and interest income for investors
		The Act on Promotion of the Initial Public Offering	• Favorable treatment concerning asset revaluation (Applying a low rate on land for non-business purpose) • Favorable treatment concerning composite income taxes • Favorable treatment concerning punishment of tax evaders • Favorable treatment through non-taxation on stock underwriting organizations
	Distribution of government-owned shares	The Act on the Promotion of Capital Market	• Selling government-owned shares at prices lower than market prices • Establishment of the Korea Investment Development Corporation for the sale of government-owned shares
	Promotion of IPO		• Granting subscription right to employees of listed corporations

Contents of policy		Law	Details
	Promotion of circulation of shares		• Placing priority on private-owned shares in dividend payouts and lowering dividend rates for government-owned shares
	Enhancement of share value		• Allowing businesses to pay a guarantee or deposit money to the government with listed securities
Positive encouragement	Issuing orders to go public	The Act on Promotion of the Initial Public Offering	• The Minister of Finance was authorized to designate businesses and order them to become a public corporation
	Punitive measures against non-compliant businesses		• Imposing disadvantages, such as raising corporate tax amounts, non-deduction of expenses, or no favorable treatment in special depreciation • Curtailing the scope of income tax deduction and raising income tax amounts • Cutting off loans
	Protection of management right		• Guaranteeing that the relevant business secures a majority of equity share
		The Securities and Exchange Act of 1976	• Adoption of the takeover bid system

Chapter 5. Conclusion

In the late 1960s through the 1970s, which was a formative stage in Korea's capital market-related legal system, the country ambitiously opened its first stock exchange right after the Korean War through the enactment of the Securities and Exchange Act, but experienced a bitter failure due to the securities crisis right after the opening of the market. The Ministry of Finance played a central role through its positive efforts to overcome the difficulties. The noteworthy part of the country's capital market-related legal system during that period was that the country strived to develop the capital market through the enactment of the Act on the Promotion of Capital Market and the Act on Promotion of the Initial Public Offering. According to statistics about transaction volume in financial products and their share in the entire picture, financial institutions specializing in loans were and still are at the center of the country's financial transactions, except that the share of bonds has grown noticeably and the share of each financial product displayed a drastic change temporarily right after the country's foreign exchange crisis in 1997.[84)]

If we focus on the growth and development of the country's capital market, it will be hard to say that its capital market-related legal system has achieved great success, compared to what more advanced capitalist countries, including the United States and countries in Europe, have done. Besides, Korea's capital market-related legal system can be said to have a long way to go compared to other financial systems regarded as global standards. It was for this reason that the country's capital market-related

84) Chapter 3, § 2 of this report

legal system was faced with harsh criticisms and tremendous challenges when the foreign exchange crisis hit the country in 1997. However, the function and role assumed by the capital market in Korea and the level of development required should be judged in light of the economic development strategy adopted by the country in the past and the system for promotion of development formulated in step with it, as the policy and the legal system concerning the capital market are part of the country's overall economic development policy and system if viewed from a perspective of the growth and development of the entire national economy.

In such a respect, Korea's capital market-related legal system, particularly the system operated in the country's capital market in its formative stage, shows how a capital market could be formed and developed in step with an economic development strategy and system based on the bank-centered financial system that supplied and allocated capital to businesses, as those in other leading developing countries in Asia did in the 1960s and the 1970s. Looking at the process of development of Korea's capital market-related legal system, the concrete purposes pursued by the capital market-related legal system have changed amidst the continued development of the capital market. The country has added new regulations, improved exiting ones accordingly and enacted separate laws to meet specific purposes. It is thought that the Act on the Promotion of Capital Market and the Act on Promotion of the Initial Public Offering, which were enacted to serve as a means of positive development of the country's capital market, are well worth being noted by developing countries, in consideration of the results they achieved.

Today, developing countries tend to establish a capital market-centered financial system. They need to think what has caused changes in economic

development strategies adopted by countries, what their strengths and weaknesses are, and whether the bank-centered development strategy used by Korea can still be a valid model for them, keeping some distance from the mainstream discussions. Korea's capital market-related legal system, in which the government played a dominant role, will tell them many things, as their capital market involves volatility and uncertainty and may jeopardize the entire national economy all at once, so the government should play the role of managing and controlling it properly.

The following are the things that developing countries need to consider when they design and operate their capital market-related legal system based on Korea's experience in formation and development of a capital market-related legal system.

First, in the formative stage of a capital market-related legal system, developing countries need to apply regulations on financial investment businesses or (if the scope of financial investment products is confined to securities) the securities industry from a perspective of industry-related laws in addition to regulations concerning information disclosure and unfair trade practices designed for the protection of investors. That is because it is more important to form the market and lay the basis required to maintain the market rather than trying to regulate specific transactions in a capital market-related legal system in its formative stage. In Korea, revisions of the Securities and Exchange Act revision made during the formative stage were mostly concentrated on the revamp of regulations made from a perspective of industry-related laws. Market participants, such as securities business operators, the securities exchange, securities investors, and listed corporations, are likely to seek unjustifiable private interest, using loopholes in the system, due to a lack of sufficient understanding of the capital

market. Thus, it is necessary to enact laws regulating their market behavior in order to train them so that they are used to desired behavioral patterns. It may take some time before the organization and system that will execute such legal regulations are established, but it is thought that such a legal system can carry out the function of training and publicizing concerning the market even before the establishment of such an organization.

Second, it appears desirable to confine the target of regulations of capital market laws to securities in a capital market-related legal system that still remain in the formative stage in consideration of the volatility and risks associated with the market. Today, developing countries cannot avoid being integrated into the global capital market some way or another from the formative stage of their capital market. Thus, they need to take measures to block external factors that may threaten the national economy, including limiting the scope of financial products in a way suited to the level of development of their capital market. Past experiences in Korea shows that the capital market is likely to be affected easily by internal and external political factors as well as external economic factors in its formative stage. Concerning complicated and risky products like derivatives, human resources and physical infrastructure should be trained and formed first. It is desirable to confine the scope of financial investment products handled in the capital market to securities until the market reaches a certain level of maturity.

Third, Korea went through the securities crisis right after the opening of the securities market and enactment of the country's first Securities and Exchange Act. The first step taken by the government in response to such a situation was to revamp the regulations on the securities industry. The

Korean experience shows that market participants are likely to abuse the market until it reaches a stage of maturity due to their lack of the understanding of the market. Following the securities crisis, the Korean government adopted regulations concerning businesses' entry into the securities market, their soundness in business operation, and business activities. The Minister of Finance was granted the right to issue permits for the establishment of securities business operators and cancel them and order cancellation of transaction contracts. These were alarmingly powerful rights, but it is worthy to consider adopting such tools of regulation if the relevant ministry has the capability of carrying them out and maintains sufficient independence. It is also very important to impose strict responsibility on the employees of securities business operators concerning their business. The relevant regulation needs to define clearly what the employees are prohibited from doing, along with their responsibility for compensation of loss incurred by customers due to their action.

Fourth, the most important thing in the operation of laws and systems is to design the most suitable method of execution. The Anglo-American model of a capital market-related legal system, which is regarded as a global standard tends to stress private execution, but such a method appears to not be suitable for developing countries' capital market-related legal systems, which are still in the formative stage. In most cases, they are not equipped with a judicial system suited to private execution and the people do not have high trust in the system. Under such circumstances, it appears better to have a powerful and efficiently working regulatory institution execute capital market laws. Generally, an independent expert institution should assume such a role, but in some cases, a ministry of the central government can execute the laws effectively, if it has sufficient

capability and maintains independence. As for Korea, the Ministry of Finance took such responsibility in the initial stage. It is thought that, as a country that adopted a centralized economic development method, Korea could enhance the effectiveness of laws and policies with such a method of execution. In adoption of such a method of public execution, “merit regulation” (a system in which regulators screen out issuers who have a first-hand access to the capital market) can be more effective than “disclosure regulation” (a system in which issuers are made to disclose information on themselves). That is because many developing countries are likely not to have a systematic apparatus that ensures the reliability of public disclosure and many listed businesses are state-owned enterprises. Concerning this, the regulatory authorities are likely to have powerful rights. In the past, the Ministry of Finance of Korea was authorized to designate the day of effectuation concerning securities-related reports or granted the right to decide whether to make such designation. Such a method of regulation is worthy of consideration, if the regulatory authorities maintain independence and have sufficient capability and integrity. A factor that should be considered together with that is if the item at the top of the list of inhibitive factors concerning foreign investment in developing countries is a lack of transparency of information.

Finally, we should pay attention to Korea’s capital market fostering policy (i.e. the policy of encouraging listing on the stock market) that was the most successful item in the country’s capital market-related legal system, which will serve as an important lesson for later starting countries. A country ready to pour powerful and extensive execution into the capital market as Korea did will go a long way in achieving a desired goal. Encouraging businesses to go public can be done in a variety of ways.

The most effective one will be tax benefits. It must be a very effective method to have business go public to offer protection of their management rights to compliant businesses and impose legal and factual disadvantages on non-compliant ones, as Korea did in the past, although it is an outdated, authoritative, and one-sided method. It should be kept in mind that the policy for developing the capital market should be formulated with a focus on what appears to be the most effective incentive by checking to see what management environment the overall financial system can give businesses. In such a respect, the regulatory authorities should consider the policy for developing the capital market together with the policies for loans or foreign capital introduction, while taking into account the way capital is supplied and allocated in the national economy.

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