

Key Amendments to Regulation on Securities Issuance and Disclosure

I. Regulation on Securities Issuance and Disclosure Amended on November 13, 2024

On January 23, 2024, the Financial Services Commission (the “FSC”) announced its plan to improve the soundness of the convertible bond (“CB”) market. The FSC cited existing regulatory issues with CBs, including some major shareholders negatively affecting shareholder value by abusing the distinct characteristics of CBs. On May 28, 2024, the FSC pre-announced changes to the proposed amendment of the Regulation on Securities Issuance and Disclosure. These changes aim to strengthen regulations regarding the disclosure of CBs and bonds with warrants (“BWs”), the conversion price of CBs and convertible shares, and the exercise price for preemptive rights with respect to BWs.

As a result, on November 13, 2024, the FSC amended the Regulation on Securities Issuance and Disclosure (the “Amended Regulation”), with the changes effective as of December 1, 2024 to (i) strengthen regulations on disclosures regarding the issuance and circulation of CBs, BWs, and (redeemable) convertible preferred shares (collectively, “CB/BWs”), (ii) enhance the conversion price adjustment (i.e., refixing) mechanism, and (iii) clarify the base date for calculation of conversion prices. Provided below are the key details of the Amended Regulation.

II. Stricter Regulations on Disclosures Regarding Issuance and Circulation of CB/BWs

Under the Amended Regulation, if a company designates a call option exerciser with respect to CB/BWs or assigns a call option to a third party, the company is required to disclose a report on material matters including the call option exerciser, whether consideration was paid (in the case of assigning the call option to a third party), and the amount paid. This amendment addresses the common disclosure practice where companies issuing CB/BWs simply state that the option would be exercised by “the company or a person designated by the company,” failing to provide meaningful information about who will be exercising the option.

The Amended Regulation also introduces additional disclosure requirements regarding matters related to the acquisition and disposition of CB/BWs prior to maturity, including the reason for acquisition prior to maturity and the anticipated method of disposition (e.g., cancellation or resale).

III. Strengthened Regulations on Conversion Price Adjustments for CB/BWs

The original regulations permitted adjustments below the 70% threshold through a special resolution of the general meeting of shareholders or by including relevant provisions in the articles of incorporation. In this regard, concerns have been raised because companies could circumvent the minimum refixing requirement by way of provisions in the articles of incorporation that allow for refixing below 70% for general corporate purposes such as financing and asset purchases. To address such concern, the Amended Regulation sets the minimum refixing threshold at 70% of the initial conversion price

with respect to conversion price adjustments for CB/BWs through refixing per stock price fluctuations. Any exceptional adjustment below this 70% threshold requires a special resolution of the general meeting of shareholders.

There have been concerns about the original regulations because companies could freely determine the adjustment method through board resolutions, which sometimes resulted in excessive downward adjustments to the conversion price. Thus, the Amended Regulation introduces new restrictions on conversion price adjustments that are made to account for dilutive effects from corporate actions such as capital increases and stock dividends (i.e., anti-dilution adjustments), as well as adjustments through refixing per stock price fluctuations. Under the Amended Regulation, downward adjustments to conversion prices cannot go below the price that reflects the dilution effects, which is calculated as shown below.

[Formula to Reflect Dilution Effect in Value of Conversion Rights]

$$\text{Adjusted Price} = \text{Initial Price} \times \frac{\# \text{ of issued and outstanding shares} + (\# \text{ of new shares} \times \frac{\text{Issue price per share}}{\text{Market price}})}{\# \text{ of issued and outstanding shares} + \# \text{ of new shares}}$$

* “# of issued and outstanding shares” refers to the total number of issued and outstanding shares as of the date immediately preceding the date on which the adjustment event occurs.

* “Issue price per share” is considered zero in the case of bonus issues or stock dividends.

* “Market price” refers to the base share price—which is the basis for calculating the issue price set forth in the Regulation on Securities Issuance and Disclosure—or the theoretical ex-right price. (In cases other than capital increase, it refers to the base share price calculated as of the date immediately preceding the date on which the adjustment event occurs).

IV. Clarification of the Base Date for Calculation of Conversion Prices for Privately Placed CB/BWs

Under the original regulations, a company was permitted to determine a conversion price for CB/BWs as of the date immediately preceding the date of the board resolution of the issuance of CB/BWs, and the certain past market prices before the subscription date acted as reference prices to determine the conversion price. Thus, there have been concerns that, although the purchaser is usually predetermined and accordingly a subscription date serves little purpose, companies could arbitrarily decide that the board resolution date as the subscription date, postpone the date for the payment of subscription price for an extended period and pick a day when the market price is higher than the board resolution date (i.e., the subscription date), in order to secure a lower conversion price. To address this issue, the Amended Regulation requires the conversion price for CB/BWs to be calculated based on the reference price as of the “actual payment date” under certain conditions as provided in the Amended Regulation.

By Ji-Pyoung Kim (Attorney)

Chang-hee Shin (Foreign Legal Consultant)

Seung-Hwan Cheong (Attorney)

Jae-Yeob Lee (Attorney)

Kim & Chang

** The opinions expressed in this article are the author's own and do not reflect the views of KOTRA.*