

Eased Regulations on Ethical Wall Policy for Financial Investors

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I. Introduction

Regulations has been eased regarding the Chinese Wall policy for financial investors. Amendments on easing of Financial Investment Services and Capital Markets Act (hereinafter "FSCMA") has come into effect as of May 20th, 2021.

Before the amendments took place, FSCMA required prescriptive rule-based regulation. In other words, FSCMA required physical separation of office space (such as setting up separate entrances), prohibition on accepting more than one board level positions (concurrent positions) within the same company, and maintaining of specific methods of restrictions on details regarding the mechanisms of information barrier and selection of target group, where information was to be restricted was required.

These type of restrictions were criticized for not taking into account the different characteristics of individual companies and the type of financial services they provide which in effect resulted in rigid and uniform application standards of the Chinese Wall policy in applying these restrictions to the financial businesses. There were constant criticisms that the restrictions resulted in hindering the elasticity of the organization and that it resulted in creating regulatory blind spots.

In countries such the US and Japan, regulations regarding policies on Chinese Wall information barrier



for financial investment businesses only provide the basic principles for the financial companies to follow so that it may prevent future conflict of interest and leave it to individual companies to implement and oversee their own internal management control system to comply with the Chinese Wall regulations. This trend gave weight to the voices wanting to revise and amend the regulation concerning Chinese Wall policies under FSCMA.

II. Key Points

The key points of the amendment include: (1) shift to principle-based regulation from prescriptive rule-based regulation; (2) improvement of self-regulatory function of financial investment companies; and (3) strengthening of post management system for individual financial companies. The details of the revised regulation are as follows:

A. Shift to principle-based regulation

As summarized in Table 1, before the recent amendments, FSCMA divided the financial companies into certain categories and provided certain rules regulating those companies according to the category each companies belonged to. This form of categorizing dealt specifically with intra-company Chinese Wall policies (Article 45 Paragraph 1 of FSCMA, Article 50 Paragraph 1 of Enforcement Decree). Also, for inter-company Chinese Wall policies, the FSCMA divided the financial companies into certain categories and required similar regulatory restrictions for both information sharing within the companies and also, outside the companies (Article 45, Paragraph 2 of FSCMA).

[Table 1]

Before Revision of FSCMA	
Intra-Company (Internal) Rules on Chinese Wall Policy	
Mandatory maintaining of Chinese Wall policies depending on “type of business/services”	Restrictions on sharing of specific information depending on “content” and other prohibited “conduct”
<ul style="list-style-type: none"> Between asset management, investment trading, investment brokerage services vs. collective investment services Between corporate finance vs. asset management and investment advisory services 	<ul style="list-style-type: none"> Information on financial investors/investors investments on the type of products the financial investors/investors are trading, and information on their investment portfolio Information on investment portfolio and ownership structure of collective investment, investment property, and investment trusts Providing nonpublic information to units that restricted from information sharing Holding concurrent positions (board level officers, such as CEOs, auditors and members of the audit committee who are not members of the board/independent directors are exempted). Holding concurrent position such as being a board level officer and staff member concurrently would not be permitted Using and sharing of same office space and operating system Not setting up separate office space for units that require a Chinese Wall

Inter Company (External) Rules on Chinese Wall policy

Mandatory maintaining of Chinese Wall policies depending on “type of business/services”	Restrictions on sharing of specific information depending on “content” and other prohibited “conduct”
<ul style="list-style-type: none"> • Between financial investors vs. affiliated companies • Between financial investors managing collective investment vs. collective investment business entity • Between foreign financial investors’ domestic branch vs. foreign financial investors 	<ul style="list-style-type: none"> • Information on financial investors/investors investments on the type of products the financial investors/investors are trading, and information on their investment portfolio • Information on investment portfolio and ownership structure of collective investment, investment property, and investment trusts • Providing nonpublic information • Holding concurrent positions (executive officers such as CEO, auditors and members of the audit committee who are not members of the board/independent directors are exempted) such holding an executive position and being a member of the staff at the same time • Using and sharing of the same office and operating system • Not setting up separate office space for units that require a Chinese Wall • Not maintaining a record of communication between the affiliated/subsidiary companies and not checking with the compliance officer

However, the purpose of Chinese Wall policy was not to prevent information sharing of all communication within and outside the company but only among areas that might create a future conflict of interest. The ultimate purpose was to prohibit communications between those high-risk problem areas only. It was inevitable that the need for putting in place the mechanisms for prevention of information sharing be brought to the forefront because regulations concerning such issues have already been put in place within FSCMA through the Enforcement Decrees to prevent illegal conduct relating to conflict of interests cases.

Thus, the current revisions to FSCMA made a shift from using the “type of business” standard that was used to restrict the information sharing according to the type of business of financial investment

companies to “type of information” standard in restricting information to other units of the companies or other branches by focusing more on the content of the information.

Furthermore, more autonomy was given to the financial investment companies in implementing, maintaining, and overseeing of detailed rules and guidelines regarding information barriers and prevention of information sharing. The details would be left to the individual financial companies depending on their service areas and needs so that they may manage their organization more flexibly and effectively. This change in standards brought forth a shift from the previous prescriptive rule-based regulation to principles-based regulation.

[Table 2]

Changes After the Revision of Chinese Wall Policy of FSCMA ¹		
Type	Revised FSCMA	Action needed to set up guidelines and control measures of the following contents according to each individual company's internal management policy
Restricted Information	<ul style="list-style-type: none"> Nonpublic material information Client's investment trading information asset management information 	<ul style="list-style-type: none"> Method on how to identify and select restricted information Range of permitted client information
Setting up of separate office space	<ul style="list-style-type: none"> Deleted (Left it to company's discretion in deciding whether to setup separate office or not according to their internal management policy) 	<ul style="list-style-type: none"> Restriction on communication depending on type of businesses, departments, affiliated companies Appointment of executive officer in charge of restricting information sharing for each department and types of information
Restricted Conduct	<ul style="list-style-type: none"> Deleted (Left it to company's discretion in deciding whether to set up separate office or not according to their internal management policy) 	<ul style="list-style-type: none"> Method for restricting information Protocol for exceptions (Keeping and maintaining all records of communication)
Implementation and Management	<p>New</p> <ul style="list-style-type: none"> Train executive officers on compliance measures and inspect of internal management control standards Appoint an executive level person in charge 	<p>(If needed)</p> <ul style="list-style-type: none"> Set periodic inspection dates, and training method for internal management control standards Identify responsibilities and grant authority to the board level executive officer in charge of internal management control Set internal guidelines for information that may be eligible for public notice

¹ Source: 2021. 3. 12 Press Release. On Management of Chinese Wall Policy, Financial Services Commission.

B. Strengthening of self-regulation of financial investment companies

As mentioned above, one of the key points of the revision was to eliminate the previous direct and uniform method of regulation and provide more autonomy to the financial companies to make decisions regarding putting into place detailed internal management policies prohibiting information sharing.

The Financial Investment Association has taken into account such changes in the revised the “Standards for Internal Management Policies for Financial Investors” and provided core guidelines on prevention of future conflict of interest. The revised standard lets the financial investment companies to decide on their own by leaving it to the financial investment companies to find a method that would take into consideration the business needs of their organization by giving them autonomy to maintain and oversees such internal management policies on their own accord which in effect would match their business needs allow them more flexibility and effective management. The revised standards are as follows:

[Table 3]

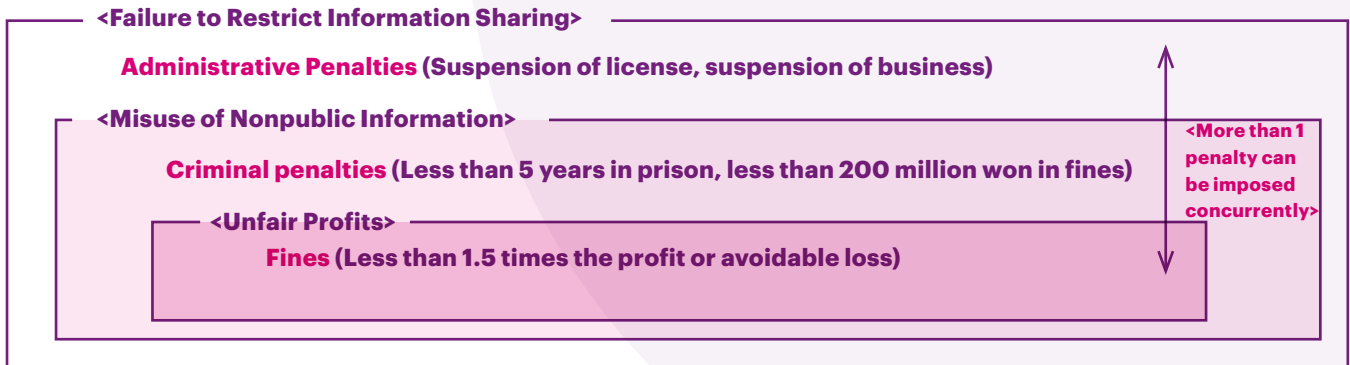
Major Points of Revision	
Article	Contents
Types of information to be restricted (Article 56)	<ul style="list-style-type: none"> Standards for deciding which information are eligible for restriction and the range of information to be restricted Possibly excluding information that does not contain the risk of future conflict of interest
Identifying Units that are to be Restricted (Article 57)	<ul style="list-style-type: none"> Identify units of the company that are to be restricted from sharing of information based on individual companies service area and types of business
Establishing Special Unit to Handle Restrictions on Information	<ul style="list-style-type: none"> Establishing a special unit and appointing a board level officer to independently and exclusively manage and supervise restrictions on information sharing and its exceptions
Sharing (Article 58, 59)	<ul style="list-style-type: none"> Appoint independent board level officers responsible for restrictions of information sharing based on type of information and units of companies Establish a periodic monitoring system for compliance with restrictions on information sharing
General Principles for Restrictions on Information Sharing (Article 61)	<ul style="list-style-type: none"> Establish general principles for restrictions on information sharing Restrict information to all officers except for board level executive officers who are directly involved in the transaction Limit the use of information to carry out specific projects When officers who do not have the authority comes into contact with such restricted information, instruct them to notify the authorities immediately and limit and restrict the obtained information and establish limitations on its use Allow for exceptions in cases where there are justifiable reasons that are related to the specific transaction

Major Points of Revision

<p>Continuous Restrictions on Information Sharing (Article 62)</p>	<ul style="list-style-type: none"> • Allow for exceptions when justifiable cause exists, however, proper records must be maintained and approved by the board level officer in-charge. Such detailed procedures related to the above record keeping must be established • Allow for exceptions to above cases that do not have high risk of conflict of interest
<p>Watch List and restricted list (Article 65)</p>	<ul style="list-style-type: none"> • To minimize the risk of conflict of interest on self-trading of company or executive/board level officers, establish rules on designating responsibilities for keeping a watch list and restricted list
<p>Trades with Risk of Conflict of Interest (Article 66)</p>	<ul style="list-style-type: none"> • Establish guidelines on how to manage conflicts of interest arising from high-risk trades according to types of trade and also establish response plans
<p>Information Sharing with Affiliated Companies and Third Parties (Article 67)</p>	<ul style="list-style-type: none"> • Follow company's internal management guidelines on restrictions on information sharing and allow for exceptions in setting up of Chinese Wall policies
<p>Officers with Concurrent Positions (Article 62, 70)</p>	<ul style="list-style-type: none"> • If holding of concurrent positions of executive officers/staff exists within the same company, one must comply with rules regarding sharing of information for executive/board level officers and its exceptions • If the concurrent position of executive level officers exists outside the company it may be allowed up to the extent the Corporate Governance Act allows for such concurrent positions
<p>Public Notice (Article 72, 73)</p>	<ul style="list-style-type: none"> • Carry out periodic training for staffs and executive/board level officers to raises awareness • Make public notice of company's internal management policy regarding Chinese Wall policy

C. Strengthening of post-management system

Under the revised FSCMA the following heavy penalties would be imposed to companies that do not abide by the policies on restrictions on information sharing and sharing of specific information that are considered nonpublic or misusing of such information (Article 428, Paragraph 4, and Article 444, Paragraph 6.2).



If a violation occurs by an executive/board level officer occurs, but there is a high-level internal management standard and policies being put in place and being implemented, there is a reduction in the penalties for those who are in charge of the overseeing the internal management of the Chinese Wall policy at their business organization. (Regulation on Financial Investment Companies, Article 4-6 Paragraph 3).

III. Conclusion

The current revision which increased the autonomy and responsibility of the financial companies aimed to justify the regulations on Chinese Wall policy. It is expected that foreign financial investors would be able to benefit from the revised regulation because the previous regulation did not take into account the difficulties the foreign investors faced such as requiring physical division of office space when the organization's size did not match the required separate office space, differences between the foreign and domestic regulations, and the specific need for information exchange between the overseas branch offices. These kinds of limitations made it hard for them to follow the previous regulations on Chinese Wall that took on a more uniformed approach that did not take into account the specifics of the financial investment companies service areas. However, with the new revisions in place the financial investment companies would be able to manage and oversee their Chinese Wall policy in a more effective a flexible manner.

On the other hand, while the financial companies have been granted more autonomy, each individual companies would have to take on extra an extra duty to put into place and implement procedures for an

internal management policy that regulates sharing of information with other units and other branch offices. Especially, since the new revisions on the regulation made a shift towards a principle-based regulation, the focus of the post management system would be not on if whether the company violated the regulation per se but rather on whether the company is taking the rights steps and whether it has achieved its purpose in restricting certain information. An example would be whether it has met its purpose of maintain, overseeing and supervising such an internal management policy within the organization (whether the policies were implemented in a transparent and appropriate manner taking into account the companies' service areas and specific needs). It would put greater emphasis on whether the financial companies have achieved its purpose of restricting the conduct of sharing nonpublic information within and outside the company.

Therefore, the financial companies' internal management standards will have to be streamlined and the companies must put extra effort into setting up internal control measures and also training their executive level board members. In sum, financial companies must put all efforts into meeting their compliance requirements related to the revisions on the Chinese Wall policy under the FSCMA.

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