THE PRIVATE EQUITY REVIEW

EIGHTH EDITION

Editor
Stephen L Ritchie

THE LAWREVIEWS

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PREFACE

The eighth edition of *The Private Equity Review* follows an extremely active 2018. While the number of global private equity deals completed declined from 2017, the total value of such deals was the highest since 2007, and the third-highest of all time. Deal activity was weighted towards the upper end of the market, and included several large take-private transactions. Fundraising activity was also strong, as institutional investors remained extremely interested in private equity as an asset class because of its strong performance relative to public markets. As a result, private equity funds have significant amounts of available capital, leading to very competitive transactions being completed at increasing purchase price multiples. This has caused private equity firms to become even more creative as they seek opportunities in less competitive markets or in industries where they have unique expertise. Given all of this, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. In addition, we expect the trend of incumbent private equity firms and new players expanding into new and less established geographical markets to continue.

While there are potential headwinds – including trade tensions, a slowing Chinese economy, Brexit and an eventual end to one of the longest-running recoveries in US history – on the horizon for 2019 and beyond, we are confident that private equity will continue to play an important role in the global economy, and is likely to further expand its reach and influence.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 25 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

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I want to thank everyone who contributed their time and labour to making this eighth edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
April 2019

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Part I

FUNDRAISING

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Chapter 12

KOREA

Chris Chang-Hyun Song, Tae-Yong Seo, Joon Hyug Chung, Sang-Yeon Eom and Seung Hyun Dennis Cho[1]

I GENERAL OVERVIEW

Regulations on onshore private equity (PE) funds[2] were first introduced in Korea in 2004 following the enactment of the Indirect Investment Asset Management Business Act (MMIIAA). In 2009, the MIIAA and the Securities and Exchange Act were integrated into a new law known as the Financial Investment Services and Capital Markets Act (FSCMA), which primarily regulates fundraising, formation, management and operation of private equity funds in Korea. Since 2004, there has been a remarkable growth in the Korean PE fund market and the number of PE funds in Korea has increased from two in 2004 to 444 as at the end of 2017.

During the early years after the introduction of PE funds in Korea, limited partners (LPs) were mostly financial institutions. However, as the PE fund market expanded, large pension funds such as the National Pension Service (NPS) have been actively participating as anchor investors. More recently, the number of smaller PE funds, with a commitment amount of 100 billion won or less, has been increasing and project-based funds formed to acquire specific investment targets comprise more than 70 per cent of all PE funds registered with the Financial Services Commission (FSC).

During previous years, financial institutions such as banks, securities companies and asset management companies, have acted as general partners; however, the number of institutions acting solely as general partners has increased and, as a result, they now comprise 66 per cent of the total number of GPs in Korea.

1 Chris Chang-Hyun Song, Tae-Yong Seo, Joon Hyug Chung, Sang-Yeon Eom are partners and Seung Hyun Dennis Cho is a foreign legal consultant at Shin & Kim.

2 A new technology business investment partnership prescribed in the Specialized Credit Finance Business Act, a small or medium-sized enterprise establishment investment partnership prescribed in the Support for Small and Medium Enterprise Establishment Act and a new technology venture investment partnership prescribed in the Act on Special Measures for the Promotion of Venture Businesses are similar to a venture capital fund as understood in the United States and Europe, and can be considered a private equity fund in a broader sense. For the purpose of this article, we discuss the private equity funds governed by the FSCMA.

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The first table below indicates the number of registered PE funds in Korea and the second table sets out the total commitment amounts and total invested amounts in recent years.[3]

Year	2011	2012	2013	2014	2015	2016	2017
Number of funds	181	226	237	277	316	383	444

Year	2011	2012	2013	2014	2015	2016	2017
Total commitment amount (A) (x100 million won)	318,859	399,821	439,999	512,442	585,180	622,261	626,032
Total invested amount (B) (x100 million won)	176,978	210,567	280,844	317,634	383,903	435,931	455,353
Investment ratio (B/A)	55.5%	52.7%	63.8%	62%	65.6%	70.1%	72.7%

The table below sets out the number of PE funds, sorted by volume of commitment amounts.

Year	2011	2012	2013	2014	2015	2016	2017
Large (commitment of 300 billion won or above)	36	45	47	51	57	53	48
Medium-sized (commitment of 100 billion–300 billion won)	50	63	76	100	115	127	130
Small (commitment of 100 billion won or lower)	95	118	114	126	144	203	266
Total	181	226	237	277	316	383	444

The table below indicates the number of institutions acting solely as general partners (Independent GPs) and the number of financial institutions participating as general partners (FI GPs).

Year	2014	2015	2016	2017
Independent GPs	82 (50.6%)	94 (56.3%)	115 (60.5%)	138 (66.0%)
FI GPs	80 (49.6%)	73 (43.7%)	75 (39.5%)	71 (34.0%)
Total	162 (100%)	167 (100%)	190 (100%)	209 (100%)

In a statement dated September 2018, the FSC announced its plan to integrate two categories of private placement fund – specialised investment private funds (hedge funds) and management participation private funds (known as PEFs) – into a single regime, and as such, we expect fundamental changes to the regulation and operation of the PE fund market in Korea. The major changes to the FSCMA announced by the FSC are discussed in detail in Section III.

3 Source: Financial Services Commission, September 2018.

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II LEGAL FRAMEWORK FOR FUNDRAISING

i Incorporation of a PE fund

The legal form of a PE fund in Korea is a corporate vehicle limited company under the Korean Commercial Code (KCC), which is similar to a limited partnership in US law. The formation of a PE fund requires a minimum of one general partner (GP) with unlimited liability and one limited partner[4] with limited liability. In practice, nearly all GPs act as the managing partner of the PE fund.

The qualification requirements for an LP are as follows: (1) professional investors, as defined in the Enforcement Decree of the FSCMA (mostly financial institutions and pension funds), or (2) individuals, corporations or other organisations investing 300 million won or more (however, 100 million won for an executive officer of a GP or a fund manager) in a PE fund. As a PE fund is also categorised as a private placement fund, the total number of members must be 49 or below. A filing with respect to the incorporation of a PE fund must be made to the FSC within two weeks of the registration of its incorporation with the court.

ii Registration requirements for GP

When the PE fund regime was first introduced in Korea in 2004, there was no statutory licence or qualification requirement for a GP. In 2013, the FSCMA was amended to include certain requirements for an entity contemplating becoming a GP in Korea. To register as a GP, the following conditions must be satisfied.

a minimum capital of 100 million won or more;

b compliance of each executive officer of the GP with Article 5 of the Act on Corporate Governance of Financial Companies;

c employment of a minimum of two individual fund managers;

d establishment of an internal compliance policy to identify, assess and manage the possibility of conflicts of interest; and

e maintenance of sound financial standing and social credibility as prescribed in the Enforcement Decree of the FSCMA.

iii PE fund asset management method

The asset classes that a Korean PE fund is permitted to acquire are narrow. The FSCMA requires PE funds to operate such that it participates in the management of its portfolio companies. In this regard, the FSCMA requires a PE fund to manage its assets strictly in the following manner:

a it must acquire 10 per cent or more of the issued and outstanding shares with voting rights in a target company;

b if an investment is being made in relation to less than 10 per cent of the issued and outstanding shares or the total capital amount, the investment must allow the exercise of *de facto* control over the target company's material management issues;[5]

4 In practice, however, at least two LPs are required, as a PE fund is subject to dissolution if the number of LPs is fewer than two. This does not apply in the case when a pension fund becomes the sole LP of a PE fund.

5 In practice, retaining a right to appoint one or more directors of the target company is deemed as exercising *de facto* control over the target company's material management issues.

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c the investment must be in equity-linked bonds (i.e., convertible bonds (CBs), bonds with warrants (BWs) and exchangeable bonds (EBs)) issued by the target company, for the purpose of (a) or (b) above;
d derivatives transactions can be carried out for the purpose of mitigating risks related to investment in securities issued by the target company and fluctuation in currency exchange rate;
e investments can be made in securities issued by an investment company for infrastructure purposes in accordance with the Act on Public–Private Partnerships in Infrastructure; and
f investments can be made in securities issued by a special purpose company.

Further, the following restrictions apply to PE funds' management of investment assets under the FSCMA.
a a PE fund is required to invest at least 50 per cent of its assets in the manner stipulated in paragraphs (a), (b), (e) or (f) above;
b a PE fund must retain the securities acquired in the manner stipulated in paragraphs (a), (b) or (c) above for at least six months and must not dispose of them within the six-month period;
c a PE fund is not allowed to make investment in the shares of a foreign corporation if 30 per cent or more of the assets held by the foreign corporation and its subsidiaries (out of their total assets) are located in Korea; and
d a PE fund is permitted to incur an indebtedness if (1) it is the unavoidable result of repaying a contribution amount to a departing member, (2) there is a temporary shortage in operating costs, or (3) there is a temporary shortage of funds for an investment in a target company, provided that, the total indebtedness does not exceed 10 per cent of the net assets of the PE fund.

If a PE fund enters into a transaction where the PE fund is permitted to exercise a put option for its shares in a target company at an exercise price calculated on the basis of the PE fund's internal rate of return (IRR) during the investment period, on the condition that the target company does not satisfy its initial-public-offering obligation within the agreed period to protect the PE fund's invested capital and the IRR, the FSC has held that such an investment by the PE fund in the target company can be interpreted as a *de facto* loan and, further, that it is in violation of the PE fund asset management method prescribed under the FSCMA.

Since the first introduction of the PE fund regime in Korea, there have been concerns that chaebols (large family-run conglomerates) would be likely to exploit the PE fund scheme for the purpose of expanding their businesses or unfairly supporting their affiliates. The FSCMA includes the following provisions to prevent potential abuse of the PE fund by chaebols.
a If a PE fund that is an affiliate of a 'business group subject to limitations on cross shareholding' (a Restricted Business Group) as prescribed in the Monopoly Regulation and Fair Trade Act, or a PE fund whose GP is an affiliate of a Restricted Business Group, acquires a target company as an affiliate, the PE fund must sell its shares in the target company to a third party other than its affiliate.
b A PE fund that is an affiliate of a Restricted Business Group or a PE fund whose GP is an affiliate of a Restricted Business Group is prohibited from acquiring equity securities of an affiliate.

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iv Incorporation of a special purpose company

The FSCMA allows an investment by a PE fund by way of incorporating a special purpose company (SPC). The requirements for establishing and operating an SPC are as follows:

a the SPC must be a joint-stock company or a limited company pursuant to the KCC;
b the SPC must be in compliance with the PE fund asset management method provisions of the FSCMA;
c a shareholder or a member of the SPC must be the PE fund, an executive officer of the target company, the major shareholder or a person designated by the Enforcement Decree of the FSCMA, provided that the PE fund's shareholding ratio in the SPC is 50 per cent or greater;
d the sum of (1) the number of shareholders of the SPC or the number of members of the PE fund and (2) the number of non-PE fund shareholders or members must be 49 or fewer; and
e the SPC must not employ a full-time executive officer or staff and nor maintain a place of business other than a head office.

An SPC may borrow an amount of up to 300 per cent of its net assets and, therefore, a PE fund may make a leveraged investment in a target company by incorporating an SPC.

v Monitoring of PE funds by regulators

In Korea, the FSC and the Financial Supervisory Service (FSS), the executive body of the FSC, oversee PE funds and the GPs managing PE funds. If an onshore PE fund or a GP violates the relevant laws, the FSC has the power to take the following measures:

a cancel the PE fund's registration;
b suspend all or part of the fund's business;
c demand that the Korean PE fund dismiss, suspend from duty, issue a warning to or admonition against its officers;
d issue a warning to or admonition against the private equity fund;
e demand that the Korean PE fund dismiss, suspend from duty, reduce salaries, reprimand, or issue warnings or admonitions against its employees; or
f issue a remedial order or demand certain measures for compensation of damage incurred by the PE fund's investors.

III REGULATORY DEVELOPMENTS

The FSCMA provides the general legal framework for the PE fund regime, including incorporation of a PE fund, asset management, and requirements for GPs and LPs, among other matters. A meeting of members of a PE fund, liquidation of a PE fund and other business affairs that are not governed by the FSCMA are covered under the KCC. Since the inception of the PE fund regulations, there have not been many changes from a regulatory perspective; however, there were significant amendments to the PE fund-related provisions of the FSCMA in 2015. Some of the important changes are noted below.

a Previously, registration with the FSC was required prior to the incorporation of a PE fund. This has been changed to allow a filing with the FSC after the incorporation of the PE fund.

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b A PE fund is not allowed to make investments in the shares of a foreign corporation if 30 per cent or more of the assets held by the corporation and its subsidiaries (out of their total assets) are located in Korea. The threshold rate used to be 5 per cent.
c Previously, a PE fund was prohibited from incorporating multiple layers of SPCs (i.e. having its first SPC incorporate a second SPC, and so on). This is no longer applicable and a PE fund may have multiple layers of SPCs.
d A strategic investor can become a member of an SPC. Previously, only a PE fund, an executive officer or the major shareholder of a target company could become a member of an SPC.

At the end of 2016, the amendment to the FSCMA introduced PE funds specifically designed for investing in start-up companies and venture companies (the Start-up and Venture PE fund). Start-up and Venture PE funds enjoy certain corporate tax benefits if they invest 50 per cent or more of their assets in a venture business or a technology and innovation-driven small or medium-sized enterprise within two years of the fund's incorporation.

Under the current FSCMA, private placement funds in Korea can only be categorised as either a hedge fund or a PE fund, and these can be largely distinguished as follows.
a A hedge fund may invest in securities, loans, derivatives and real estate assets, whereas a PE fund's investment is limited to equity securities or equity-linked bonds, such as CBs, BWs or EBs. Furthermore, the PE fund must acquire shares with 10 per cent or more of the voting rights through its investment (alternatively, the PE fund can be granted the right to appoint one or more director of the target company as a condition of its investment), whereas, in contrast, a hedge fund is prohibited from acquiring shares with voting rights of 10 per cent or more when making investments in equity securities or equity-linked bonds.
b A hedge fund is allowed to incur an indebtedness up to the amount of 400 per cent of its net assets, whereas a PE fund is generally prohibited from incurring an indebtedness (aside from a few exceptions), but if the PE fund is making an investment via an SPC, it may leverage its investments up to the amount of 300 per cent of the net assets of the SPC.
c There are stricter requirements for hedge fund managers in terms of capital requirements, for professional managers and for major shareholders when compared with those of PE funds.

In September 2018, the FSC announced that there will be an amendment to the FSCMA to reform the private placement fund scheme in Korea. Under the newly amended FSCMA, the FSC will only allow a single type of private placement fund, which will integrate the hedge fund and the PE fund schemes. According to the FSC's statement, the major changes will be as follows.
a The new integrated private placement fund (the Integrated Fund) will be able to invest in shares, loans, derivatives or real estate assets. In particular, in relation to securities investment, there will no longer be any minimum or maximum limitation on the shareholding in a portfolio company.
b The Integrated Fund will be permitted to incur indebtedness of an amount up to 400 per cent of its net assets.
c An Integrated Fund fund manager will be required to comply with the current requirements for hedge fund managers.

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d Existing PE fund GPs that cannot comply with current hedge fund manager requirements will be able to manage an Integrated Fund in which only institutional investors (as prescribed in the FSCMA) participate as LPs.

e Previously, the standard for distinguishing a public offering fund from a private placement fund was whether a solicitation or offer was made to 50 or more parties, whereas under the newly amended FSCMA the standard will require 50 or more parties to have actually accepted the offer.

IV OUTLOOK

Since the first introduction of the onshore PE fund scheme in 2004, there has been a continuous growth of the PE fund market in Korea. In particular, there has been a remarkable expansion in the market in the past decade and, in fact, PE funds have been leading Korea's M&A sector for many years. It is expected that the Korean PE fund market will continue to grow in the near future while large pension funds such as the NPS continue to play the role of anchor investor to large PE funds.

One of the current features of Korea's PE fund market is that secondary PE funds are not yet very active compared with activity in seasoned PE markets such as the United States and the EU. This is mainly because a few large pension funds tend to widely allocate their investments to various PE funds, which results in overlapping of LPs in many PE funds. However, the need for secondary PE funds has been developing and it is expected that the number of secondary PE funds will increase.

Also, it is expected that the private placement fund market will grow rapidly once the proposed amendment to the FSCMA expands the scope of the investment method and asset classes applicable to PE funds, and relaxes the standard for being recognised as a 'private placement' fund. Existing GPs will have to decide whether to increase their capital, and professional manpower, to continue their business as a fund manager of an Integrated Fund under the new regime, or to maintain their current capital volume and manpower, and maintain their status as fund managers for private placement funds for institutional investors.

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Appendix 1

ABOUT THE AUTHORS

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Dr Chang-Hyun Song is a partner at Shin & Kim in the firm's corporate/M&A group. His main areas of practice include M&A, private equity and corporate governance. As a member of leading law firms in Korea and in the United States, Dr Song has undertaken major M&A projects in the fields of banking, securities, insurance, telecommunications, information technology, games, automotive parts, energy, chemistry, paper manufacturing and shipbuilding. Based on considerable field and academic experience, his expertise extends to various other legal areas such as overseas direct investment, capital markets and securities.

Dr Song received a Doctor of Juridical Science (JSD) degree in corporate and financial law from the University of California, Berkeley, School of Law, and currently teaches M&A and corporate law at Yonsei University and the Seoul Bar Association. Dr Song also publishes various legal articles and periodic columns on corporate, competition and finance law, and he is an active participant in several academic societies and conferences.

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JOON HYUG CHUNG

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Dr Joon Hyug Chung is a partner in the M&A practice at Shin & Kim, and is one of the most active M&A lawyers in Korea. He has been involved in numerous M&A projects representing strategic and financial investors, with a focus on private equity transactions and cross-border transactions between Korea and European countries.

Dr Chung obtained a PhD degree at Seoul National University School of Law, and holds an LLM degree from Columbia Law School, as well as a Master of Laws from Seoul National University. He was named 'M&A Lawyer of the Year' in 2016 by *Legal Times* and was among the top three lawyers in *The Korea Economic Daily*'s 'M&A Power Lawyers' in

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2016. Thomson Reuters magazine *Asian Legal Business* named him one of the '40 Under 40' outstanding lawyers in the region in 2017. Dr Chung has been distinguished as a leading lawyer by *Chambers Global*, *Chambers Asia-Pacific*, *The Legal 500*, *IFLR1000* and *Legal Times* in the practice areas of corporate law, M&A and private equity.

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