Expanded Legal Basis for Corporate Bond Issuances

A distinctive feature of the recent amendments to the Korean Commercial Code (KCC) is the amendment to its "corporate bonds" section – the first amendment of this section since the KCC's enactment. Prior to this amendment, the KCC only contained express provisions for issuances of ordinary corporate bonds, convertible bonds and bonds with warrants, sparking debate over whether issuances of other types of corporate bonds are permitted under the KCC. Now that the amended KCC provisions expressly provide for issuances of more varied types of corporate bonds and are specified as illustrative provisions, the debate has been put to rest. The relevant provisions of the amended KCC are examined in more detail below.

1. Participating Bonds

The Financial Investment Services and Capital Markets Act (FISCMA) provides that a listed company may issue participating bonds (Article 165-11 of the FISCMA, Article 176-12 of the FISCMA's Enforcement Decree), and defines participating bonds as "bonds entitling bondholders to participate in distributions of dividends in addition to receiving interest." By expressly providing that a company may issue corporate bonds to bondholders entitling them to participate in distributions of dividends (Article 469(2)(1) of the amended KCC), the amended KCC establishes a clear basis for the issuance of participating bonds by non-listed companies. In addition, while the FISCMA's Enforcement Decree requires issuances of participating bonds to be conditioned on the bondholders' receipt of interest at the then applicable bond-interest rate, the definition of participating bonds under the amended KCC contains no such conditions; participating bonds are defined merely as "bonds entitling bondholders to participate in distributions of dividends", which provides more discretion in determining the terms and conditions of participating bonds.

2. Exchangeable Bonds

The FISCMA provides that a listed company may issue exchangeable bonds (Article 165-11 of the FISCMA, Article 176-13 of the FISCMA's Enforcement Decree), and defines exchangeable bonds as "bonds entitling bondholders to exchange the bonds for listed securities owned by the listed company."

As with participating bonds, the amended KCC now establishes a basis for the issuance of exchangeable bonds by non-listed companies by expressly providing that a company may issue exchangeable bonds (Article 469(2)(2) of the amended KCC). In addition, since the scope of shares subject to exchange is not limited to listed securities under the provisions of the amended KCC, the amended KCC allows a company more discretion in determining the terms and conditions of exchangeable bonds than the FISCMA

3. Redeemable Bonds

The amended KCC puts an end to debates over whether redeemable bonds may be issued by expressly providing that a company may issue bonds which can be redeemed for shares or other securities (Article 469(2)(2) of the amended KCC). A company issuing redeemable bonds may redeem such bonds and, at its option, repay their principal amount in cash, shares or other securities.

4. Derivative Bonds

The amended KCC also establishes a basis for the issuance of "bonds for which the redemption or payment amounts are determined according to a pre-determined formula linked to changes in prices of securities, currencies or other assets or indexes designated under the Presidential Decree" (Article 469(2)(3) of the amended KCC). This definition and legal basis for derivative bonds in the amended KCC is a citation of the relevant definition for derivative bonds provided under Article 4(7) of the FISCMA. As the language of the aforesaid provision in the amended KCC places no restriction on the types of underlying assets for the bonds, or the transaction structure or trading venue of the derivatives, it allows a company greater discretion in determining the terms and conditions and the structuring of its derivative bond issuance. However, it should be noted that Article 469(3) of the amended KCC provides that specific matters regarding the terms and conditions, the method of issuance and other like matters regarding bonds may be determined by the Enforcement Decree of the KCC; as such, certain restrictions may later be imposed by amendments to the Enforcement Decree of the KCC.

5. Illustrative Provisions

Prior to this round of amendments, there was debate over whether the KCC provisions regarding corporate bonds should be read as restrictive or illustrative provisions. Regulators often took the view that the relevant KCC provisions are restrictive provisions that specifically list the types of corporate bonds permitted for issuance, interpreting the provisions to mean that issuances of any types of corporate bonds not so specified are not permitted. Such view has been criticized for hampering the ability of companies to obtain more varied and expedient funding options. For example, companies have found it difficult to issue newer types of financial instruments having the nature of corporate bonds that have emerged with the continuous development of capital markets. However, the amended KCC now specifies that the provisions enumerating the types of corporate bonds that may be issued are illustrative provisions, by stating that "the term 'bonds' under Paragraph 1 includes the bonds listed in each of the following subparagraphs" (Article 469(2) of the amended KCC).

Implications of the Amended KCC

As exemplified by the aggregate amount of non-guaranteed bonds issued in the Korean capital markets reaching KRW 46.56 trillion in 2010, there is growing demand for the use of corporate bonds as a means of corporate financing. Since the amended KCC now establishes a legal basis for the issuance of various types of corporate bonds, an increased use of corporate bonds as funding methods can be expected, as well as an expanded scope of the types of corporate bonds, due to offerings of new financial products. However, as noted above, since the amended KCC (Article 469(3) of the amended KCC) provides that specific matters regarding issuances of corporate bonds, including their terms and methods of issuance, may be determined under the Enforcement Decree of the KCC, companies are advised to keep tabs on the progress of amendments to the Enforcement Decree of the KCC.

Further, since the emergence of new types of corporate bonds in the capital markets will give rise to legal issues, including how to coordinate the interests of concerned parties such as shareholders, and legal issues and needs associated with the introduction of a new regulation system, companies are advised to proceed with the assistance of legal experts when considering the use of various types of corporate bonds as funding methods or as offerings of new financial products.

For additional information, please contact following professionals at Shin & Kim.

Genny S. Kim (TEL: 02 316 4292, E-Mail: gskim@shinkim.com)
Tae-Yong Seo (TEL: 02 316 4096, E-Mail: tyseo@shinkim.com)
Una Kim (TEL: 02 316 4705, E-Mail: ukim@shinkim.com)
Yun Ho Choi (TEL: 02 316 1671, E-Mail: yhchoi@shinkim.com)