



Introduction of Electronic Securities Registration System

I. Background

In keeping with the global trend of paperless or book-entry only securities, the amended Korean Commercial Code (“KCC”) introduces an electronic registration system for shares, bonds and other securities. As there are limitations under the current KCC caused by provisions for securities issuance, transfer and rights exercise being premised on the issuance of physical securities certificates, it is expected that the amended KCC’s introduction of an electronic securities registration system will improve overall societal efficiencies in the following ways: (i) for issuers, there would be reduced financing costs, simplified issuance procedures and less burden in managing and keeping track of shareholders; (ii) for investors, there would be less risk of loss, forgery or falsification of physical securities certificates, and greater convenience in exercising rights; and (iii) for financial investment companies serving as brokers, there would be reduced brokerage costs. The relevant amendments to the KCC are reviewed in more detail below.

II. Key Amendments

1. Structure of Amendments

The amended KCC has no general provisions regarding the electronic registration system, but individually provides for each of the securities subject to the electronic registration system. The electronic registration system will apply not only to shares and bonds, but also to pre-emptive rights, warrants and other securities under the KCC. The amended KCC provides for an electronic registration system for shares (Article 356-2), and permits the application of such provisions to bonds, pre-emptive rights, warrants and other securities under the KCC. It can therefore be said that the provisions for the electronic registration system for shares are actually tantamount to general provisions.

2. Electronic Registration System for Shares

In lieu of issuing physical share certificates in accordance with its articles of incorporation (Paragraph 1, Article 356-2), a company may register its shares on the electronic register of an electronic registration institution (an institution designated for handling electronic registration services for securities). In principle, the amended KCC still respects the process of issuing physical share certificates, but permits a company to adopt the electronic registration system by amending its articles of incorporation if it so desires. However, since the amended KCC does not provide separate provision for companies using the electronic registration system, matters such as the terms of issuance, procedures and effectiveness of, share issuances are still determined in accordance with the general provisions of the KCC. Accordingly, registration is not a condition for effectiveness of a share issuance, and registration on the electronic register does not constitute the creation of a share.

Transfers of, or pledges over, shares registered on the electronic register will only take effect upon registration on the electronic register (Paragraph 2, Article 356-2). Accordingly, any transfer of, or pledge over, shares will only become effective upon registration on the electronic register, and not merely upon the manifestation of an intention of relevant parties to give such effect.

A person who has registered his shares on the electronic register will be deemed to have the lawful rights to such registered shares, and another person can lawfully acquire such rights by registration on such electronic register in good faith and without material negligence or error (Paragraph 3, Article 356-2). However, since cases of erroneous registrations of transfers (or pledges) of shares may arise due to electronic error or an intentional or negligent act of the account management institution, this leaves room for dispute as to whether a good faith acquisition has occurred in such cases. In considering such issue, reference can be made to Article 19 of the newly promulgated Act Concerning Issuance and Distribution of Electronic Short-Term Bonds, which becomes effective from January 15, 2013 (the “ESTBA”), and which obligates the Korea Securities Depository or relevant account management institution to (i) deregister any amounts in excess of the aggregate amount of individual short-term bonds that have been electronically registered, (ii) pay the principal of, and interest on, any such excess registered amount that the Korea Securities Depository or account management institution failed to deregister, and then (iii) demand reimbursement of such principal and interest from the responsible person.

3. Electronic Registration System for Bonds

In lieu of issuance of physical bond certificates, a company may register its bonds on the electronic register of an electronic registration institution in accordance with its articles of incorporation (Paragraph 3, Article 478). As is the case with shares, a company has the choice of using or not using the electronic registration system for its bonds. Since the amended KCC expressly states that the company “..may register..,” – and not “..must register..,” – such language could be interpreted to mean that a company that has elected to use the electronic registration system, may also issue physical bond certificates on a case by case basis, depending on the type of bonds or at the request of bondholders. However, we

view that a company would not be permitted to issue physical bond certificates once it has adopted the electronic registration system in its articles of incorporation: (i) the electronic registration of bonds replaces the need for physical issuances of bond certificates, (ii) the record on the bonds registry by electronic registration is another (i.e., electronic) form of bond certificates, and thus, (iii) the two forms of bond certificates cannot coexist. In addition, the ESTBA prohibits the issuance of physical bond certificates for electronic short-term bonds, and provides that a person in violation of such provision will be subject to imprisonment for not more than three (3) years or a fine not exceeding fifty (50) million won (Articles 14 and 35(3)).

Paragraphs 2 to 4 of Article 356-2 of the amended KCC also apply to bonds registered by a company on the electronic register of an electronic registration institution (Paragraph 3, Article 478). Accordingly, any transfer of, or pledge over, bonds can become effective only by registration on the electronic register. A person who has registered his bonds on the electronic register will be deemed to lawfully have the rights to such registered bonds.

However, since Paragraph 1 of Article 479 of the KCC provides that any transfer of registered bonds can be effective against a third party and the issuer thereof only when the name and address of the transferee is recorded on the physical bond register and the face of the bonds, it is not entirely clear how to interpret this provision in light of electronic registrations. In this regard, however, the ESTBA provides that no physical bond register is required for electronic short-term bonds in spite of Article 488 of the KCC (Article 31).

In addition, notwithstanding the provisions of Article 469 of the KCC, the ESTBA permits a person desiring to issue electronic short-term bonds to authorize its representative director to determine the terms and conditions of issuance of electronic short-term bonds, to the extent that the issuance limit set forth by the board of directors (based on the aggregate issuance balance of outstanding electronic short-term bonds) is not exceeded (Article 30).

III. Implications

These amendments are meaningful because the introduction of an electronic registration system for shares and bonds provides a platform for maximization of the merits of non-issuance of physical securities certificates. This will significantly reduce the costs and inconvenience of issuance and transfer of physical certificates. However, since the amended KCC provides only for the legal basis for, and basic matters regarding, electronic registration, we need to monitor the development of further legislation of subordinate laws or separate special laws. A company desiring to use the electronic registration system for its shares and bonds, is recommended to seek prior legal advice; the current KCC is based on a system of physical certificate issuance, which does not match with the nature of an electronic registration system, and which means that it does not have the provisions required for an electronic registration

system or has vague provisions requiring legal interpretation. Accordingly, there is a greater likelihood of legal disputes arising until the issues surrounding the new electronic registration system become resolved and settled.

IV. Addendum – Legislative Purpose and Special Exceptions under the ESTBA

Korean companies normally procure their short-term financing through the issuance of commercial papers (CPs). However, since CPs fall within the legal definition of promissory notes under the Act on Bills of Exchange and Promissory Notes of Korea, physical certificates are required to be issued for them and they cannot be distributed in part; as such, it has been difficult to develop the CP distribution market and improve the transparency of information concerning CP issuances. The system of electronic short-term bonds was thus introduced to resolve these problems, while at the same maintaining the economic purpose of CPs, which is short-term financing; its introduction is also part of the government's pursuit of a balanced development of the corporate financing market, invigoration of the short-term financing market and improved transparency. From January 15, 2013, when the ESTBA comes into force, bonds amounting to KRW 100 million or more with a maturity not exceeding one year will be issuable in electronic form. To invigorate the system of electronic short-term bonds by making them as convenient to issue as CPs under the current system, the ESTBA contains provisions for special exceptions to the issuance of bonds under the KCC, such as (i) permitting issuers to authorize their representative directors to determine the terms and conditions of issuance of electronic short-term bonds, to the extent the issuance limit set by the board of directors is not exceeded (Article 30), (ii) permitting issuers to not prepare physical registers of bonds for electronic short-term bonds (Article 31), and (iii) easing the application of the KCC to general meetings of bondholders (Article 32). As the first special law regarding electronic registration systems, the successful operation of the ESTBA will serve as a platform for the resolution and settlement of issues arising under the newly introduced electronic registration system.

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