



Act on Security Over Movables and Receivables

The new “Act on Security Over Movables and Receivables” will come into force on June 11, 2012, two years after its promulgation on June 10, 2010.

To date, the general lending practice of Korean financial institutions has been to secure loans with real estate. In fact, according to statistics published by the Financial Supervisory Service of Korea, loans secured by movables total only 74.6 billion Korean won (approximately US\$ 63.7 million), which accounts for a mere 0.01% of all Korean won loans. This is because, unlike for real estate – for which exists the real property registry to record ownership and other rights in real estate – it is too difficult to perfect security interests in movables•receivables against third parties (i.e., parties other than the security provider), due to the lack of a public registry for movable properties. As a result, small and medium-sized companies – which generally tend to have sizable amounts of movables (i.e., raw materials, inventories) and account receivables to collateralize, but lack real estate – have found it very difficult to obtain adequate financing on favorable terms. In addition, since the Civil Code of Korea permits only pledges of intellectual property rights and not joint or floating security over intellectual property, the securitization of intellectual property has also been under-utilized in Korean financing transactions.

Under the new Act, however, it will now be possible to create and perfect security interests over raw materials, inventories and/or account receivables through registration in a new registry for movable properties and receivables. Security interests may also be created and registered on multiple movables•receivables and/or movables•receivables to be acquired in the future. The securitization of assets such as account receivables was already possible under the Asset-Backed Securitization Act (the “ABS Act”), but due to the complex procedures and requirements, many companies were unable to take advantage of the ABS Act provisions for this kind of financing.

To avoid conflicts with relevant provisions of the ABS Act and the Financial Investment Services and Capital Markets Act, the new Act will not apply to security interests over (i) movable properties such as aircrafts, ships, construction equipment and automobiles, which can be registered under other statutes, (ii) movable properties for which bills of lading are issued, and (iii) ABS securities and securities under the Financial Investment Services and Capital Markets Act.

To provide for the detailed procedures of registering security interests over movables and receivables, the Supreme Court has established the “Supreme Court Rules on Registration of Security over Movables

and Receivables” (the “Supreme Court Rules”). Among other detailed provisions, the Supreme Court Rules provide for the establishment of a Central Registration Bureau within the National Court Administration; also, at the time of registration of any security interest, each security provider will be given a registration number and the underlying security agreement will be given a serial number.

Only legal corporations or individuals with registered trade names may be registered as security providers under the new Act. Registration will not be made available to any individual security provider because of legislators’ concerns that private lenders may exploit the opportunity to earn unreasonably high profits and the stability of secured transactions may be affected due to movables being so easily transferable to third parties. However, this same restriction will not apply to security providers in respect of intellectual property; since only registered owners of intellectual property are able to grant security over their intellectual property rights, any registered owner of intellectual property may be registered as a security provider.

Registered secured parties will have priority in payment. Registered secured parties will also have rights to request the security provider to provide additional security where the value of the secured assets has fallen, and the power to block third party interference with the exercise of the secured parties’ secured rights.

Registered secured parties may enforce their security rights through various methods, including direct sale or auction of the secured assets and/or obtaining ownership title to the assets. In the case of intellectual property, however, only enforcement methods specified under relevant laws will be permitted.

The coming into force of the Act will not affect security interests created by means of yangdo dambo (security interests created by transfer of legal title to assets), factory mortgages and mine mortgages, and these types of security regimes will continue to exist and be maintained.

As regards security interests over receivables, under the new Act, registration of such security interests will have the same effect of perfecting such security interests as against third party obligors and other third parties as perfecting such security interests under the Civil Code regime, which is by means of fixed-date stamped written notice to, or fixed-date stamped written consent of, the third party obligor. However, since perfection by fixed-dated notice/consent under the Civil Code will continue as a valid means of perfection of security interests over receivables, issues of perfection priority will arise. In such cases, where security interests over the same receivables have been perfected by registration under the new Act and by fixed date stamped notices/consents under the Civil Code, perfection priority will be determined chronologically – i.e., whichever of the registration or the fixed-dated notices/consents is of an earlier date will have the priority. Also, as a practical matter, it should be noted that even if a secured party registers its security interest in relevant receivables, it can only enforce such security interest against a third party obligor if such third party obligor has been given notice of the secured party’s security interest in the receivables through the dispatch of a registration certificate or has provided its

consent thereto, each as provided under the new Act. Given the foregoing, secured creditors cannot necessarily rest easy just by the mere fact that their secured interests have been registered. Moreover, for secured assets such as raw materials and inventory, the values and prices for which can fluctuate, secured creditors will need to continuously monitor their security for any declines in values and prices.

With the coming into force of the new Act, it is anticipated that most financial institutions who agree to accept security over movables or receivables under the Act will prefer to provide financing secured by equipment or inventories, for greater ease of valuation, administration and enforcement. They may also use external appraisal companies to appraise the value of the assets to be provided as collateral, before accepting such assets as collateral. Since most financial institutions' lending practices have centered around loans secured by real estate, it is unlikely that they will have sufficient computer systems or knowledgeable staff for administering their security interests under the new Act. Accordingly, it would be advisable for financial institutions to begin educating their staff and adapting relevant computer systems to accommodate the new secured transactions that may be entered into pursuant to the new Act.

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

Byoung Seon Choe (TEL: +82 2 316 4298, E-Mail: bschoe@shinkim.com)

Seoul + 82 2 316 4114

Beijing + 86 10 8447 5343

Shanghai + 86 21 6235 0411

Munich + 49 89 2421 8527

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