

South Korea

Hyun Ju Helen Pak and Tae-Sung Jeong of Shin & Kim

Section 1 – Bank licences

1.1 What licences or approvals do lenders need to have if lending to a borrower in this jurisdiction if a) the lender is a bank or b) the lender is a not a bank?

Any entity wishing to engage in the lending business in Korea must be appropriately licensed. Foreign banks and non-banking institutions are required to obtain a lending business licence under the Act on Registration of Lending Businesses and Protection of Finance Customers. Whether an entity should be viewed as being engaged in the business of lending requires a factual analysis of the entity's activities.

1.2 Are any exemptions available and/or are any techniques typically used to structure around such requirements?

No.

Section 2 – Taxes

2.1 Are there any requirements to make deductions or withhold tax from payments made to domestic or foreign lenders in this jurisdiction? Are any techniques typically used to structure around such requirements.

Interest paid to a domestic corporate lender is generally subject to Korean withholding tax at the rate of 14%. For a foreign lender (without a permanent establishment in Korea), the withholding tax rate is generally 22%, subject to reductions and exemptions that may be available under an applicable tax treaty.

Interest on foreign currency denominated bonds issued outside of Korea paid to a foreign company without a permanent establishment in Korea is exempt from corporate income tax (but not local income tax). As such, the issuance of bonds may be an alternative source of financing if withholding tax is a concern.

2.2 Is interest on debt tax deductible for borrowers incorporated in this jurisdiction?

Yes.

2.3 Are there any thin capitalisation rules in effect in this jurisdiction which would impact the amount of debt that can be borrowed/guaranteed by entities incorporated there?

There are thin capitalisation rules for: (i) borrowings from certain foreign-controlled shareholders (FCS); or (ii) borrowings from unrelated third parties that are guaranteed by an FCS.

If a Korean company borrows from (i) its FCS or, (ii) an unrelated third party with a guarantee (including grant of security) from the FCS in an amount exceeding 300% (600%, in the case of financial institutions) of its equity, interest on the excess (x) of the amount of such borrowings over (y) 300% (or 600%, as the case may be) of such equity will not be tax-deductible.

2.4 Are there any other important tax concerns that lenders to borrowers incorporated in this jurisdiction should be aware of?

In order to claim a reduced withholding tax rate under a tax treaty, a foreign lender should provide the withholding agent (usually the borrower) with an application for reduced tax rate before receiving payment of such income.

Section 3 – Security interests

3.1 Can security be taken over the following asset classes and what documentation or formalities are required to create, perfect and maintain such security?

- a) shares
- b) bank accounts
- c) receivables
- d) contractual rights
- e) insurance policies
- f) real property
- g) plant and machinery
- h) intellectual property
- i) debt securities
- j) future/after acquired property
- k) floating charges over all assets

Depending on the type of assets offered as collateral, one of the following three types of security interest may be created: mortgage; pledge; or *yangdo dambo* (an assignment for security purposes). There is also a newly-legislated security regime under the Act on Security Over Movables and Receivables which came into force in June 2012, which provides an alternative means for creating security interests in movable properties and receivables (other than intellectual property).

To create and perfect a mortgage, the mortgagor and the mortgagee must execute a mortgage agreement and register the mortgage with the relevant registry.

To create and perfect a pledge: (i) the pledgor and the pledgee must enter into a pledge agreement; (ii) the pledgee must have actual (or deemed) possession of the collateral; and (iii) in the case of a pledge of *chae-kwon*, a notice of pledge is given to, or the consent to pledge is obtained from, the obligor. Notices and consents must be affixed with a fixed-date stamp. There is no registration requirement for creation or perfection of a pledge.

Yangdo dambo is a type of security constituted by way of transferring legal title to the collateral to the creditor for security purposes. This form of security is a non-statutory right which has developed through custom and is now recognised by Korean courts as a valid form of security. There is no registration requirement for the creation or perfection of *yangdo dambo*.

In order to create a valid *yangdo dambo* security interest, the transferor and the transferee must enter into a *yangdo dambo* agreement. The perfection of *yangdo dambo* is the same as for a pledge, except that constructive possession is allowed in the case of *yangdo dambo*.

a) Shares

Security over shares may be taken by way of pledge or *yangdo dambo*.

b) Bank accounts

Security over cash deposits is usually created by way of pledge of bank accounts.

In order to perfect the pledge, a fixed-date stamped notice of the pledge is sent by the pledgor to the account bank, or the account bank provides a fixed-date stamped consent to such pledge.

c) Receivables

Receivables constitute a right or claims against third parties (*chae-kwon*). Either a pledge or *yangdo dambo* may be created with respect to receivables.

d) Contractual rights

See c), but usually *yangdo dambo* is taken with respect to contractual rights.

e) Insurance policies

See c).

f) Real property

Security over real property is constituted by a mortgage. A mortgage of real property is perfected by filing the mortgage with the relevant real estate registry.

g) Plant and machinery

Security over plants and equipment may be taken by way of a comprehensive factory mortgage (*gongjang jeodang*). This type of mortgage creates a security interest in all of the real property, the plant (including fixtures) and equipment constituting a factory property as set out in the registered list.

h) Intellectual property

Security interests in patent, trade mark and design rights and copyrights may be effected by way of pledge. Pledges over patent, trade mark and design rights are registered with the Korea Intellectual Property Office for perfection; a pledge of copyright is registered with the Copyright Commission of Korea.

i) Debt securities

See a).

j) Future/after acquired property

Security interests may be granted in future or after acquired property, but perfection can only be achieved once the pledgor actually obtains title to such property.

k) floating charges over all assets

Not possible under Korean law.

3.2 Highlight any issues with securing obligations that may arise in the future.

As a general rule, Korean law allows obligations that may arise in the future to be secured only if such obligations can be identified with a degree of specificity.

3.3 Can a universal security agreement be used to grant security over all assets in this jurisdiction?

No.

3.4 Can security be granted for the benefit of different classes of creditors under the same security agreement and if so, are there any issues that creditors should be aware of in adopting this approach?

Yes. Please note that the priority of security interests is determined by order of perfection. If the security interest is to be perfected at the same for all classes of creditors, the security agreement should contractually set out the priority of security interest among the classes.

3.5 Can security trustee or security agent structures be used in this jurisdiction to secure obligations that are owed to fluctuating creditor classes?

The generally accepted view in Korea is that a parallel debt structure may be used to provide for such arrangement. Under such structure, the debt owing to the security agent or trustee must be established as an independent and separate obligation owed by the debtor to such person, apart from its obligations to the creditor classes.

3.6 Briefly outline any issues to consider when transferring loans and accompanying security interests between lenders.

In the event that a parallel debt structure is not used, the relevant security agreements will need to be amended to reflect any change in secured parties.

3.7 Can security be granted by third parties? Are there any rights of contribution, subrogation or similar that might arise as a result of granting/enforcing third party security that ought to be/can be waived?

Security can be granted by a third party. The third party has contribution and subrogation rights against a borrower after the third party security is enforced. Such rights may be waived.

3.8 Briefly outline the registration requirements, if any, applicable to security interests created in this jurisdiction, including any practical considerations such as the timing, expense and the consequences of non-registration?

Registration is required for security interests in registrable assets such as real property.

Time and expense associated with registration depend on the type of assets concerned. For instance, the major cost associated with establishing a mortgage over real property is registration tax, which is 0.2% of the maximum secured amount.

3.9 Briefly outline any regulatory or similar consents that are required to create security (other than board/shareholder approvals)?

Loans and certain other transactions between a non-resident and a resident require a filing of a report under the Foreign Exchange Transactions Act.

3.10 Briefly explain the rules governing the priority of competing security interests.

The priority of competing security interests is determined by order of perfection. For mortgages, the date of registration will determine priority. In the case of a pledge or *yangdo dambo*, priority is determined in the order of the date a notice or consent with fixed date stamp is given or obtained.

Section 4 – Guarantees**4.1 Briefly explain the downstream, upstream and cross-stream guarantees available, with reference to any particular restrictions or limitations. Are there any techniques typically used to enhance credit support/guarantees that might otherwise be limited?**

In general, a company is restricted from providing a guarantee to an affiliate without receiving a corporate benefit. Further, if a company is a member of a Korean conglomerate which falls within a 'designated corporate group' under the Monopoly Regulation and Fair Trade Act (Monopoly Act), it is prohibited from providing any type of downstream, upstream or cross-stream guarantees to another group member.

4.2 What regulatory or other consents are required to grant downstream, upstream and cross-stream guarantees (other than board/shareholder approvals)?

The granting of such guarantees does not itself require governmental approval or consents.

4.3 Briefly, outline any enforceability concerns associated with the granting of downstream, upstream and cross-stream guarantees that lenders should be aware of (eg any exchange controls or similar obstacles).

Other than the restrictions discussed above, none.

Section 5 – Enforcement

5.1 Do the local courts generally recognise and enforce foreign-law governed contracts?

Yes, except with respect to certain matters that require application of the mandatory laws of Korea.

5.2 Will the local courts generally recognise and enforce a foreign judgment that is given against a domestic company in foreign courts (particularly the New York or English courts) without re-examining the merits of the decision?

The Korean courts will enforce a judgment without re-examining the merits of the case if the following factors are satisfied:

- such judgment was finally and conclusively given by a court with valid jurisdiction;
- a defendant, who has lost a case, received service of process, other than by publication or similar means, in sufficient time to enable such party to prepare its defence in conformity with the laws of the relevant foreign jurisdiction (or in conformity with the laws of Korea, if service of process was made on the defendant in Korea) or responded to the action without being served with process;
- such judgment is not contrary to the public policy of Korea; and,
- (i) judgments of the courts of Korea are accorded reciprocal treatment under the laws of the relevant foreign jurisdiction, or (ii) judgments of the Korean courts in the relevant foreign jurisdiction are not treated in a manner which is considerably prejudicial to their recognition and their treatment is substantially the same as treatment by the Korean courts of the judgments obtained in the foreign jurisdiction in material respects.

5.3 Will the local courts recognise and enforce an arbitral award given against the company without re-examining the merits of the decision?

If the country where the seat of the arbitration lies is a signatory to the United Nations Convention on the Recognition and Enforcement of Arbitral Awards (the New York Convention), the award will be recognised and enforced so long as it meets the requirements under the New York Convention.

If the New York Convention does not apply, the Civil Procedures Code of Korea regulates the recognition and enforcement of foreign court decisions.

5.4 When enforcing security, what factors significantly impact the time such enforcement takes and the value of the proceeds received from such enforcement? For example, are there any statutory requirements such as (a) holding a public auction; (b) court involvement; or (c) obtaining regulatory consents?

A secured creditor is not prescribed by law to enforce its security interest in any particular manner and may elect from remedies specified in the relevant security agreement.

5.5 Are there any restrictions that apply specifically to foreign lenders when taking enforcement action?

No.

Section 6 – Bankruptcy and insolvency proceedings

6.1 Briefly, outline the main bankruptcy/insolvency processes in this jurisdiction, including any control or influence that creditors can exert on the process, the timeframes usually involved and any mandatory filing requirements.

The Debtor Rehabilitation and Bankruptcy Act (Act) provides for bankruptcy proceedings and corporate rehabilitation proceedings.

A bankruptcy proceeding may be initiated by the insolvent debtor, any director of the debtor company or the creditors of the debtor. The adjudication of bankruptcy is usually made within one month of filing of a bankruptcy petition.

A corporate rehabilitation proceeding may be initiated by any creditor that holds claims of an aggregate amount that is at least 10% of the debtor's stated capital or by any shareholder controlling 10% or more of the total issued and outstanding shares of the debtor.

Upon commencement of the rehabilitation proceeding, there is a statutorily prescribed period during which: (i) creditors may object to the list of creditors and claims filed by the receiver by filing a proof of claim; (ii) the receiver and other interested parties may dispute claims filed by a creditor; and (iii) a creditor may file for a review of claim and initiate a claim allowance proceeding.

The rehabilitation plan is generally prepared and submitted to the court by the receiver. The plan must be approved by each group of interested persons (secured creditors, unsecured creditors and shareholders). Once the plan is ratified by interested persons, the court makes a determination as to whether the plan should be accepted.

6.2 Are there any preference, fraudulent conveyance, claw-back, hardening periods or similar issues or preferential creditor rights that lenders should be aware of?

The Act allows a trustee or a receiver in insolvency proceedings to avoid or set aside transactions that are deemed to harm the interests of the creditors. Also, under the Korean Civil Code, creditors may raise fraudulent conveyance claims regardless of a commencement of bankruptcy or rehabilitation proceedings.

6.3 Do bankruptcy/insolvency processes provide for any kind of stay/moratorium on enforcement of lender claims? If so, does the stay/moratorium apply to the enforcement of security interests?

Secured creditors remain free to exercise their security interests in a bankruptcy proceeding. In a corporate rehabilitation proceeding, however, creditors may be stayed from exercising their creditors' rights, including enforcement of security interests.

Section 7 – Other matters

Financial assistance

7.1 Are there any restrictions in place on locally incorporated companies in assisting the acquisition of shares in itself, its sister companies or in its holding companies? Do these prohibitions apply to all forms of company, to companies being acquired which are incorporated outside this jurisdiction and indirect holding companies?

A company may acquire its own shares up to an amount equal to its distributable income. Accordingly, a company may assist such acquisition to the extent it has distributable income.

A company may not acquire shares in its parent company (a company which owns at least 50% of the shares in the subsidiary). If a company is a member of a certain designated Korean conglomerate under the Monopoly Act, the company may not acquire the shares in its sister companies or holding companies that already own shares in the company.

7.2 Are there any exceptions to these restrictions and/or are there any structuring techniques that can be used to achieve target collateral support?

Certain structuring techniques, such as the merger of target and acquisition companies, may be employed depending on the facts underlying a financing. However, Korean laws relating to financial assistance are generally strictly applied, and a careful consideration of the overall circumstances of the financing is necessary in using any structuring technique.



Hyun Ju Helen Pak
Senior Foreign Attorney, Shin & Kim

Seoul, South Korea
T: +82 2 316 4212
F: +82 2 756 6226
E: hpak@shinkim.com
W: www.shinkim.com

About the author

Hyun Ju Helen Pak is a partner and a senior foreign attorney of Shin & Kim. She has extensive experience in international project and corporate finance transactions and has advised major financial institutions and corporations in a wide range of banking and corporate transactions. Her clients have included JP Morgan Chase, Citigroup, Standard Chartered First Bank Korea, the National Pension Service of Korea, the Korea Export-Import Bank, the Korea Trade Insurance Corporation, the Korea Development Bank, POSCO Engineering & Construction and POSCO Energy.

Pak began her practice at the New York offices of Simpson Thatcher & Bartlett in 1987 and joined Shin & Kim in 1992. From 1996 to 2001, she was with Simpson Thacher & Bartlett in Hong Kong. She returned to Korea in 2003 and became a partner with Horizon Law Group, rejoining Shin & Kim's finance department in 2007.



Tae-Sung Jeong
Partner, Shin & Kim

Seoul, South Korea
T: +82 2 316 4228
F: +82 2 756 6226
E: tsjeong@shinkim.com
W: www.shinkim.com

About the author

Tae-Sung Jeong is a partner at Shin & Kim in the finance department. He advises clients in all areas of banking and corporate finance transactions, including acquisition financing and domestic and cross-border securities offerings. Jeong also has extensive experience in advising on mergers and acquisitions involving financial institutions. He has been with Shin & Kim since 2006.