Chambers AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Equity Finance 2024

Definitive global law guides offering comparative analysis from top-ranked lawyers

Contributing Editor
Peter Memminger
King & Spalding

Chambers

Global Practice Guides

Equity Finance

Contributing Editor

Peter Memminger

King & Spalding

2024

Chambers Global Practice Guides

For more than 20 years, Chambers Global Guides have ranked lawyers and law firms across the world. Chambers now offer clients a new series of Global Practice Guides, which contain practical guidance on doing legal business in key jurisdictions. We use our knowledge of the world's best lawyers to select leading law firms in each jurisdiction to write the 'Law & Practice' sections. In addition, the 'Trends & Developments' sections analyse trends and developments in local legal markets.

GPG Director Katie Burrington
Content Management Director Claire Oxborrow
Content Manager Jonathan Mendelowitz
Senior Content Reviewer Sally McGonigal, Ethne Withers
Content Reviewers Vivienne Button, Lawrence Garrett, Sean Marshall, Marianne Page, Heather Palomino, Deborah Sinclair, Stephen Dinkeldein and Adrian Ciechacki
Content Coordination Manager Nancy Laidler
Senior Content Coordinator Carla Cagnina
Content Coordinators Hannah McDowell and Delicia Tasinda
Head of Production Jasper John
Production Coordinator Genevieve Sibayan

Published by
Chambers and Partners
165 Fleet Street
London
EC4A 2AE
Tel +44 20 7606 8844
Fax +44 20 7831 5662
Web www.chambers.com

SOUTH KOREA

Law and Practice

Contributed by:
Haeng-Gyu Lee, Ki Il Ban, Yujin Lee and Seokwon Han
Jipyong

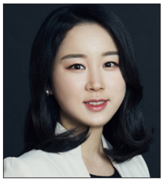
Contents

Jipyong is widely recognised as one of the premier Korean law firms, with more than 300 lawyers and specialists in offices across Asia. Renowned for its deep expertise and strategic acumen, the firm's capital markets group handles a broad spectrum of market-leading transactions extending across borders, from advising on initial public offerings and secondary listings to facilitating global depository receipt (GDR) issuance and the listing of foreign companies on the Korean Exchange and international markets, such as the Cambodia Securities Exchange. With a strong reputation for navigating intricate regulatory landscapes, and through regular collaboration with key Korean financial regulators including the Financial Supervisory Service, the Korea Exchange and the Korea Securities Depository, the firm is positioned as a trusted advisor for clients seeking sophisticated and effective capital markets solutions.

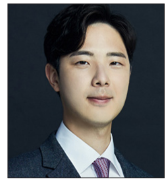
Authors

Haeng-Gyu Lee heads the Capital Markets Group of Jipyong LLC. As a leading lawyer in capital markets and private equity renowned for his strategic insight and meticulous approach, Haeng-Gyu has spearheaded some of the most notable capital markets transactions in recent years, including the listing of SK Biopharmaceuticals on the Korea Exchange, assisting issuers, sponsors and underwriters, financial institutions and private equity clients. Haeng-Gyu has consistently been honoured as the "Leading Lawyer" and "No 1 IPO Legal Advisory" by both domestic and international publications. Fluent in both Korean and English, Haeng-Gyu combines in-depth local knowledge with a global perspective to deliver innovative and tailored legal solutions that drive successful outcomes.

Ki Il Ban is a partner at Jipyong LLC. He is a regional legal expert with many years of experience in South-East Asia, advising Korean conglomerates and financial institutions on M&A, joint ventures, project financing and regulatory compliance. He played a key role in pioneering Cambodia's securities market, advising the lead manager in the IPOs of Phnom Penh Water Supply Authority, Phnom Penh Autonomous Port and ACLEDA Bank. He also leads Jipyong's Thailand, Lao PDR, Singapore, Malaysia, Hong Kong, Australia and New Zealand practice teams. Ki Il holds an LLB from Victoria University of Wellington and an LLM from Sydney Law School.



Yujin Lee is a senior associate at Jipyong LLC specialising in capital markets, M&A, corporate governance, shareholder activism, management rights disputes, private equity and financial regulation. With a comprehensive academic background and a proven track record in both legal practice and academia, Yujin brings a wealth of experience and expertise to the legal landscape. Her exceptional contributions to the legal field have been recognised with accolades including the "Leading Lawyer/Rising Star in Capital Markets/Equity" from an international publication. Yujin holds an LLM from Columbia Law School and a JD from Korea University Law School.



Seokwon Han is a senior associate at Jipyong LLC specialising in corporate finance and corporate matters, with a particular focus on transactions involving private equity. Seokwon has successfully handled numerous cases related to private equity investments and management buyouts, gaining extensive experience in these areas. Seokwon is well-versed in navigating the complexities of corporate transactions, providing clients with strategic advice tailored to their specific needs. Seokwon received a JD from Seoul National University School of Law.

Jipyong

26F, Grand Central A
14 Sejong-daero
Jung-gu
Seoul 04527
Republic of Korea

Tel: +82 2 6200 1600
Fax: +82 2 6200 0800
Email: master@jipyong.com
Web: www.jipyong.com

JIPYONG JIPYONG LLC

1. Equity Finance Techniques and Structures

1.1 Early-Stage and Venture Capital Financing

In the Republic of Korea ("South Korea"), various types of early-stage and venture capital (VC) investments are being made, particularly in sectors such as AI, semiconductors, rechargeable batteries and pharmaceuticals/biotech. These investments often occur in multiple rounds. As early-stage and VC investments take place before the financial performance of the investee company is attained, they are mostly in the form of mezzanine investments such as redeemable convertible preference shares (RCPSs), bonds with warrants (BWs) or convertible bonds (CBs). Convertible loans are not allowed under Korean law, so CBs are often used instead.

1.2 Growth and Private Equity Financing

There is a wide range of growth and private equity (PE) financing in Korea. Compared to early-stage and venture financing, growth/PE financing generally involves larger investment amounts and fewer investors. These investments are often made at a stage when the investee company has already achieved some level of financial performance, and the number of investors tends to be smaller as investors often want to be involved in the management of the investee company, such as by having the right to appoint one of its directors.

1.3 Public Equity Markets

In Korea, in order for a company to go public, it must appoint a securities firm, apply for listing eligibility review by the Korea Exchange, obtain approval for listing eligibility and submit a securities statement to the Financial Supervisory Service of Korea (FSS). Upon FSS' acceptance of the securities statement, the company is allowed to conduct a public offering process through demand forecasting and then list its shares and start trading on the Korea Exchange. In Korea, the public offering market is very important for companies in need of financing, and it serves as an important exit vehicle for private equity funds (PEFs) that have invested in start-ups or venture companies. In the Korean capital market, companies in sectors such as pharmaceuticals and biotech, rechargeable batteries, semiconductors, and K-beauty frequently pursue IPOs. IPOs are mainly driven by the company's need to raise capital and for the purpose of providing exit opportunities to pre-IPO investors.

1.4 Equity Restructurings

CBs and RCPSs, which are the main types of mezzanine investments used in the Korean capital market, are recognised as liabilities under Korean International Financial Reporting Standards (K-IFRS) and are often converted to common stock to improve the financial soundness of a company, especially in preparation for IPOs. In such investments, the largest shareholder may be asked to refrain from exiting as a means of protecting investors in case where the IPO is unsuccessful after the conversion into common stock. If the target company needs to raise additional funds in the event that the IPO is not completed or the company is valued lower than the unit price of the existing investors' investment, it is often difficult to obtain the consent of existing investors if the unit price of new investors' investment is lower than that of the existing investors' investment. In this case, the existing largest shareholder may sell their shares to existing investors at a reduced price to secure additional investment.

1.5 Corporate Governance

The typical corporate governance structure of a company under the Korean Commercial Act consists of a general meeting of shareholders and a board of directors. The general meeting of shareholders, which consists of multiple shareholders, appoints directors, and such directors form the board of directors to make decisions on important matters relating to the company. Major organisational changes, such as mergers or business transfer, must be approved at the shareholders' meeting. If there are multiple shareholders, the matters relating to the general meeting of the shareholders, and the composition and the powers of the board of directors, are often determined through a shareholders' agreement and reflected in the company's articles of incorporation.

In unlisted companies, certain shareholders may have additional rights, as set forth in the shareholders' agreements, including the right to have access to company information and the requirement to obtain such shareholders' consent on important decisions relating to the company. Although these rights are generally recognised in the case of unlisted companies, when a company goes public through an IPO, many of these rights under the shareholders' agreement rights are often restricted from the perspective of the principle of shareholder equality and compliance with fair disclosure.

1.6 Mix of Debt and Equity Financing

Investing in both equity and debt in the same company is not common in the Korean capital market, though it is legally permissible. However, there may be legal reasons to invest in both equity and debt simultaneously, as equity investors may suffer a greater loss in the event that the investee company becomes bankrupt. Also, in M&A transactions, acquisition financing is frequently used, in which case there is often a distinction between the investors who invest in equity and those who invest in debt. The method of investment would depend upon the investors' investment style (aggressive vs conversative approach) and characteristics.

2. The Equity Finance Market

2.1 Types of Equity Finance

The Korean capital market features various types of equity finance options. Hybrid financing methods, such as CB, BW and RCPS, are also widely used. Many PE managers make investment using VC, growth equity, and PE strategies. Recently, the credit solution business, which uses a pure loan strategy permitted under the amendments to the Capital Markets Act, has also been growing. On the other hand, companies seeking investment are actively pursuing fundraising through IPOs and post-listing markets in addition to PE investment, which requires a high level of management involvement and oversight.

2.2 Equity Finance Providers and Potential Restrictions on Them

Equity financing is mostly provided by PE or VC. Due to high interest rates and a sluggish IPO market, VC investments in start-ups or venture companies have decreased somewhat, making it challenging to exit through IPOs. However, PE houses are increasingly investing in large corporations to support their restructuring process. The recent amendments to the Capital Markets Act have removed the restriction that used to require PEs to invest at least 10% in the investee company, and such amendments have led to more diversified investment by PEs. While Korea generally imposes no restrictions on foreign investors, there are limitations on foreign shareholding in sectors like broadcasting and national strategic industries, which means that the acquisition of significant stakes in companies in such industries requires approval from the relevant authorities. In the financial sector, any investor, whether domestic or foreign, who wishes to become a majority shareholder of a financial institution must pass the eligibility test required by the financial supervisory authorities.

2.3 Equity Finance Seekers

Large companies that seek capital for the purpose of corporate restructuring tend to prefer a small number of large PE firms. Typically, start-ups and venture companies tend to have multiple investors due to the associated risks, and they often want to set a long timeframe to recover the investment, preferably through a qualified IPO. While the investee companies may prefer debt to minimise interference in management, equity investors are less concerned with simple interest margin, so the investee company rarely has a choice. For this reason, mezzanine investments are often made to meet the needs of both the investors and the investee companies at the same time.

2.4 Deal Flow and Size

The Korean capital market has a well-established equity finance market. However, there is no organisation that provides comprehensive statistics on various equity finance deals, and most deals are led by PE firms, making it difficult to track the number and size of those deals due to confidentiality. According to the Korea Venture Business Association, the venture capital investment volume in the first half of 2024 was KRW2.6754 trillion, with 1,228 investee companies, showing a slight increase from the first half of 2023. The PE sector does not have statistics from the PE Managers' Council, but annual figures will be compiled by the Financial Supervisory Service early next year. According to unofficial IPO-related information, a total of 59 companies raised about KRW1.9 trillion through IPOs in the first half of 2024, which represents a slight decrease in the number of IPOs and the amount raised compared to the first half of last year. In 2025, the overall equity finance market is expected to be more active than this year as central banks of influential countries, including the US Federal Reserve, are expected to gradually lower interest rates as part of their monetary policy changes.

2.5 Privately Allocated Equity Versus Public-Raised Equity

Private allocated equity and public-raised equity are both necessary for a company's growth process, and it is difficult to say which of the two is more important. Typically, start-ups, venture companies and new high-value spin-offs from large companies first seek funding from PE sources such as VCs and PEs. After three to five years, these investors exit through an IPO, and the company raises additional public funds to continue R&D or capital investment. However, when the IPO market shrinks, the pre-IPO market also tends to follow the same path. Recently, the Korean capital market has been experiencing some contraction in the IPO market due to high interest rates and geopolitical uncertainty, leading to a decrease in VC investments.

2.6 Deal Sourcing and Market Players

Start-ups and venture firms often source deals from VC funds, PEFs, accounting firms or law firms. On the other hand, large enterprises often handle deal structuring and sourcing internally through their own strategic planning or finance departments. For large corporate deals, global investment banks or PEFs with large assets under management are actively sourcing deals with full-time client management. For example, SK Group recently reorganised its entire business, and Boston Consulting Group conducted strategic consulting before sourcing specific deals.

2.7 Exit Considerations and Realisations

In the Korean capital market, IPO is the most important exit strategy, and equity finance investors mostly plan for an IPO within three to five years from the time of investment. Therefore, if the IPO market shrinks or there is a decrease in the market valuation of a particular industry, and the IPO pricing is less favourable than the initial investment price, exit may be challenging. To hedge this kind of risk, investors often design many structures that include put options, allowing them to have the right to sell their stakes to the largest shareholder of the investee company in certain cases or drag-along rights if the largest shareholder does not exercise a call option. Recently, in the case of its e-commerce subsidiary, 11th Avenue, SK Group gave up exercising the call option due to the bad market conditions, leading to ongoing negotiations for the PE firm H&Q to exercise drag-along rights. However, exits under such down-side protection clause often result in investment losses and potential disputes.

2.8 Equity Finance Versus Debt Finance

In the case of start-ups and venture companies, equity finance is preferred over debt finance, which increases the debt-to-equity ratio, in order to secure financial soundness for an IPO. On the other hand, large companies often prefer debt finance over equity finance because they are uncomfortable with investors' involvement in management and since the corporate bond market is well-developed. As for investors, aggressive PEFs prefer equity investments because they can expect upside returns and have influence over the investee company's management, while stability-oriented pension funds are more likely to consider debt investments. Mezzanine investments, which combines both, are also commonly used.

2.9 Time Required for Equity Finance

For an unlisted company, going through the process of negotiating the initial key investment terms, conducting due diligence, drafting and negotiating contracts and closing the deal usually takes three to five months. The process may be delayed for several months if material issues are spotted during the due diligence. On the other hand, if the financing is time-bound, equity finance can sometimes be raised through a public tender offer, which can be managed on a tighter timeline and may be closed within two to three months. Critical issues during the deal process includes valuation, exit plans, downside protection, and the timing and scope of damages.

3. Regulation and Related Legal Issues

3.1 Investment Restrictions

In Korea, there are specific foreign investment restrictions in certain sectors. For instance, there is a limitation on foreign investment in the broadcasting and electricity industries. In the financial industry, both domestic and foreign investors must undergo an eligibility test required by the supervisory authorities if they wish to acquire more than a certain number of shares. Companies involved in industries designated as national core technologies (such as semiconductors) must be approved by the relevant authorities before equity investment can be made. Also, investments (including the establishment of joint ventures) from countries against or to which the USA has imposed sanctions or export restrictions, such as Russia, China and Iran, may be restricted. Violation of Korean laws or US sanctions would give rise to severe damages, so most companies respond by changing the counterparty rather than considering measures to overcome such violation.

3.2 Repatriation of Money and Limitations on Capital Flows

In Korea, foreign investors are free to repatriate dividends from Korea to abroad as long as they comply with the statutory reserve requirements and pay all applicable taxes in Korea. In addition to dividends, foreign investors may also recoup their investment through capital reduction. Foreign financial institutions with large public functions may be criticised by the National Assembly or the media for excessive dividends, especially if they have minimal corporate social responsibility (CSR) activities. However, there are no legal prohibitions against such practices.

3.3 AML and Sanctions Regulation

In Korea, the deal process has not yet been rigorously tested for anti-money laundering or know-your-customer rules in equity financing transactions. When issues arise during due diligence, they are often addressed through more detailed representations and warranties.

3.4 Choice of Law and Jurisdictions

In deals involving foreign investors, it is common to agree on a dispute resolution clause with international arbitration. In particular, Korean deals often prefer arbitration through the Singapore International Arbitration Center (SIAC) due to its geographic proximity and lower costs compared to arbitration in New York or London. Arbitration at the Korea Commercial Arbitration Board (KCAB) is often chosen if the Korean party has a strong bargaining position. Meanwhile, Korean courts have a reputation for providing fair procedures and opportunities to foreign investors. However, unlike arbitration, it is a three-tiered system, which can be time-consuming and costly, making it a less preferred method than international arbitration for resolving disputes in international transactions.

3.5 Noteworthy Regulatory Trends

The government of Korea and the Korean capital market are actively working to attract foreign investment, so there are no new regulations or burdens that foreign investors need to be particularly concerned about. In particular, the current government's pro-business stance makes it easier for foreign investors to invest in Korea. However, as mentioned previously, the level of regulation may increase in countries or areas that are subject to US sanctions or export controls.

4. Tax

4.1 Withholding/Capital Gains Tax

Disclaimer

The contents set forth in the following are simply based on Korean law. If there is a tax treaty between Korea and the country of residence of the foreign investor in question, the contents that follow may need to be revised accordingly.

Tax on Dividend Income

Under the Korean Tax Act, dividend income from domestic sources for non-residents refers to the following:

- dividends or distributions of profits or surplus received from a domestic corporation;
- dividends or distributions from entities that are considered a legal person; and
- deemed dividends.

Under Korean tax laws (Corporate Income Tax Act and Income Tax Act), the rate of withholding tax for dividend income received by foreign corporations and non-residents is 20%, excluding local income tax. If a domestic company in Korea pays a dividend income to a shareholder who is a non-resident or foreign corporation, the amount of withholding tax on the dividend income must be declared and paid by the 10th day of the month following the payment date.

Tax on Capital Gains on Share Transfer

Tax on capital gains on share transfer

When a foreign corporation or non-resident shareholder of a domestic company in Korea transfers shares in that domestic company, the capital gains generated from the transfer of shares are taxable under the Korea tax laws (the Corporate Income Tax Act and Income Tax Act). However, the capital gain from the transfer of shares of a listed corporation is not taxable if the transferor continues to hold less than 25% of the shares during the year in which the transfer date falls and the five-year period immediately preceding the transfer date.

The person responsible for withholding the withholding tax (ie, the person who pays the capital gains on the share transfer, or the securities company if the transfer is made through a securities company) withholds and pays the lesser of (i) 10% of the share transfer price and (ii) 20% of the margin on the share transfer (transfer price minus acquisition price and transfer costs) on the taxable capital gains on share transfer.

Securities transaction tax

Securities transaction tax needs to be paid by the transferor of shares; however, if the transferor is a non-resident of Korea or a foreign corporation without a place of business in Korea, the securities transaction tax needs to be paid by the transferee. In the case of listed stocks, the securities transaction tax is paid by the securities firm.

The tax rates vary depending on whether the stock is listed or unlisted. For unlisted stocks, the securities transaction tax is 0.35%. For listed stocks, the tax rates differ by market, as follows:

- for Korea Composite Stock Price Index (KOSPI)-listed stocks, the tax rate is 0.05% plus an additional 0.15% Special Tax for Rural and Fishing Villages, bringing the total to 0.20%;
- for Korean Securities Dealers Automated Quotations (KOSDAQ)-listed stocks, the total tax rate is 0.20%; and
- for Korea New Exchange (KONEX)-listed stocks, the total tax rate is 0.10%.

Thus, the overall tax rate is 0.35% for unlisted stocks, 0.20% for KOSPI-listed stocks, 0.20% for KOSDAQ-listed stocks and 0.10% for KONEX-listed stocks.

4.2 Other Taxes, Duties, Charges or Tax Considerations

Korean tax law provides for a variety of tax credits – and reduction and exemption systems – for various tax policy reasons. The key measures are as follows.

- Corporate tax reduction and exemption for small and medium-sized enterprises (SMEs): reduction of 50% to 100% of the corporate tax payable each year, for five years, from the year of income generation after establishment for SMEs founded before 31 December 2024.
- Special tax reduction for SMEs: reduction of 5% to 30% of corporate tax for SMEs operating in tax-exempt industries, such as manufacturing, until 31 December 2025.
- Integrated investment tax credit: when an SME or a middle-standing enterprise invests in tangible assets for business, such as machinery and equipment, a certain amount

of the investment amount is tax-deductible from corporate tax.

- R&D tax credit: R&D expenses are tax-deductible from corporate tax for the relevant tax year. The deduction rates vary depending on the type of technology. For new growth and source technology, the deduction ranges from 20% to 40%, while for national strategic technology, it ranges from 30% to 50%. For general R&D, the tax credit is the higher of either 25% to 50% of the amount exceeding the R&D expenses of the previous year or 0% to 50% of the R&D expenses for the current year.
- Tax credit for companies that increased labour income: for SMEs and middle-standing enterprises that satisfy the following conditions, 20% (10% for middle-standing enterprises) of the excess wage growth over the average of the three preceding tax years is tax-deductible from corporate income tax.
  (a) The average wage growth rate of full-time workers exceeds the average of the average wage growth rates for the three preceding tax years.
  (b) The number of full-time workers exceeds the number of full-time workers in the preceding tax year.

4.3 (Double) Tax Treaties

Korea has double tax treaties with almost all countries, and these treaties prevent double taxation of capital gains in Korea. However, tax avoidance tactics such as disguising real estate investments as equity investments, and conducting business activities such as having a de facto permanent place of business without having a corporation or branch office in Korea, are subject to taxation, including corporate tax.

5. Bankruptcy and Insolvency

5.1 Impact of Insolvency Processes on Shareholder Rights

When a company commences insolvency proceedings, its investors' equity shares are usually reduced through a capital reduction process, the shareholders' meeting becomes largely procedural and the representative director appointed by the rehabilitation court manages the company under the supervision of the court. In addition, creditors' decisions are more important than the shareholders in approving a rehabilitation plan. Therefore, the commencement of insolvency proceedings has the effect of shifting the centre of the company's management to the court and creditors, whereas the shareholders play a passive role.

5.2 Seniority of Investors in Distributions

In the event of insolvency, the company first distributes to tax creditors, secured creditors and general creditors, and then to shareholders if there are any remaining assets. In Korea, the concept of uncalled capital commitment is not generally recognised for general corporations. Although uncalled capital commitment may exist under a shareholders' agreement, it is not enforceable against the company as it is not a contract with the company. Even if such a contract is entered into with the company, it is unlikely that the insolvency court will enforce the uncalled capital commitment.

5.3 Length of Insolvency Process and Recoveries

In Korea, there are two types of insolvency proceedings: (i) rehabilitation proceedings to revive a company and (ii) bankruptcy proceedings to dissolve the over-indebted company. Rehabilitation proceedings typically take about a year to get the plan approved, and the procedure concluded, depending on the composition of the target company's shareholders and creditors, and the nature of the industry. Bankruptcy proceedings, which involve repayment to creditors and dissolution, often take several years due to the potential lawsuits.

5.4 Rescue or Reorganisation Procedures

In Korea, the primary method of rescuing a company is through a rehabilitation process. Such process is usually initiated by the existing management of the company, which will retain control of the company and prepare a rehabilitation plan with the approval of the rehabilitation court. The plan is prepared based on the decisions of the creditors and finally approved by the court, and the approved plan is implemented over several years and subject to court oversight. In some cases, a company may be granted Autonomous Restructuring Support (ARS), which allows the company and its creditors to negotiate a voluntary restructuring before formal rehabilitation. On the other hand, if the creditors are predominantly financial institutions, they often utilise a workout process, which is a more flexible restructuring process than the court-based rehabilitation process. In this case, creditors, which are often financial institutions, rather than shareholders take the lead in the overall process.

5.5 Risk Areas for Equity Investors

Korea is a country with a well-established limited liability system in which the shareholders of a company are generally only liable for the amount of their investments. Therefore, even if the investee company enters rehabilitation or bankruptcy proceedings, investors are not typically subject to additional liabilities beyond their invested amount. However, it is possible in theory that the directors of a company may be liable for damages if their actions contravened reasonable business judgment rules and contributed to business failure. In addition, if the company has overdue taxes, investors may have secondary tax liabilities if their shareholding ratio exceeds 50%.

Trends and Developments

Contributed by:
Haeng-Gyu Lee, Jin Ha Kim, Min Ah Seo and Yeji Kim
Jipyong

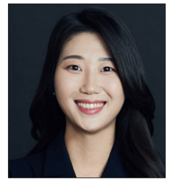
Jipyong is widely recognised as one of the premier Korean law firms, with more than 300 lawyers and specialists in offices across Asia. Renowned for its deep expertise and strategic acumen, the firm's capital markets group handles a broad spectrum of market-leading transactions extending across borders, from advising on initial public offerings and secondary listings to facilitating global depository receipt (GDR) issuance and the listing of foreign companies on the Korean Exchange and international markets, such as the Cambodia Securities Exchange. With a strong reputation for navigating intricate regulatory landscapes, and through regular collaboration with key Korean financial regulators including the Financial Supervisory Service, the Korea Exchange and the Korea Securities Depository, the firm is positioned as a trusted advisor for clients seeking sophisticated and effective capital markets solutions.

Authors

Haeng-Gyu Lee heads the Capital Markets Group of Jipyong LLC. As a leading lawyer in capital markets and private equity renowned for his strategic insight and meticulous approach, Haeng-Gyu has spearheaded some of the most notable capital markets transactions in recent years, including the listing of SK Biopharmaceuticals on the Korea Exchange, assisting issuers, sponsors and underwriters, financial institutions and private equity clients. Haeng-Gyu has consistently been honoured as the "Leading Lawyer" and "No 1 IPO Legal Advisory" by both domestic and international publications. Fluent in both Korean and English, Haeng-Gyu combines in-depth local knowledge with a global perspective to deliver innovative and tailored legal solutions that drive successful outcomes.

Jin Ha Kim is a partner in the Capital Markets Group of Jipyong LLC specialising in equity capital market transactions (with a particular focus on initial public offerings) and M&A, assisting private and public companies, securities firms, investment banks and private equity/venture capital firms. Jin Ha's commitment to excellence and proactive approach have earned him recognition as a "Rising Star" by both domestic and international publications. Drawing upon his graduate studies at the National University of Singapore, Jin Ha is well-equipped to address both domestic and international client needs, contributing to the firm's reputation for delivering cutting-edge legal services in the capital markets arena.

Min Ah Seo is a senior associate in the Capital Markets Group of Jipyong LLC specialising in equity capital market transactions (with a particular focus on initial public offerings), private placements, financial regulations and corporate governance. Min Ah brings a unique blend of legal acumen and financial expertise and provides comprehensive, multifaceted guidance that integrates financial and legal perspectives, bolstered by her CPA background. Min Ah's strategic insight and ability to integrate financial and legal perspectives to deliver exceptional results has earned her "Rising Star" recognition by an international publication in 2021.



Yeji Kim is a senior foreign attorney in the Global Practice Group, Finance Group and Capital Markets Group of Jipyong LLC and a member of the New Zealand, New South Wales and New York Bars. Specialising in cross-border financing, private equity and equity capital market transactions, Yeji regularly advises pension funds, financial institutions and multinational issuers, sponsors and underwriters on transactional, regulatory and corporate matters. Recognised for her adept handling of international transactions and compliance issues, Yeji combines a deep understanding of local and global market dynamics with a proven track record of delivering exceptional results.

Jipyong

26F, Grand Central A
14 Sejong-daero
Jung-gu
Seoul 04527
Republic of Korea

Tel: +82 2 6200 1600
Fax: +82 2 6200 0800
Email: master@jipyong.com
Web: www.jipyong.com

JIPYONG JIPYONG LLC

Market Overview

The year 2023 has been a tough one for capital markets in the Republic of Korea ("South Korea") owing to escalating geopolitical risks, conflicts in Ukraine and the Middle East, aggressive interest rate hikes by global central banks including the Federal Reserve and a deepening property sector crisis with waning confidence in China. Despite the number of initial public offerings (IPOs) in 2023 being comparable to 2022, a blow to the Korean capital markets was particularly harsh with a notable absence of mega IPOs coupled with a sharp decline in overall deal volumes. The impact of 2023 has continued into the first half of 2024, and uncertainty persists over the capital markets due to a variety of factors including expectations of interest rate cuts, geopolitical risks, and elections in key countries.

Amid the talk of the lowest global growth forecast in decades, Korean capital markets still remain volatile in 2024. In hopes of winning back investor's trust once lost to internal and external uncertainties, Korean capital markets are rushing to improve investor protection measures and bolster shareholder value by introducing numerous regulatory changes. Recent trends and developments are highlighted in detail below.

Recent Amendments to the Financial Investment Services and Capital Markets Act (FSCMA) – Introduction of a Mandatory Ex Ante Disclosure System for Insider Transactions

Starting from 24 July 2024, insiders (such as major shareholders and executives) of a listed company are obligated to disclose any large trading of shares in the company in advance. The mandatory ex ante disclosure system for insider transactions is one of the investor protection measures put forward by the Financial Services Commission to appease the growing number of disgruntled investors adversely affected by insider transactions involving significant share trading by amending the FSCMA. A particular focus was given to address insiders' ability to easily access and exploit non-public information for personal gain and deter the shifting of damaging consequences, including stock price drops, to the investors.

Prior to the amendments to the FSCMA (the "Amendment"), the use of non-public information by insiders was regulated under the FSCMA by way of (i) direct regulation prohibiting the use of material non-public information and (ii) ex post regulation requiring the return of short-swing profits and ex post disclosure. Nevertheless, ex post disclosure and other regulations proved to be inadequate in effectively preventing insiders from using non-public information and conducting unlawful acts. Prompt sharing of shareholding changes with the investors also proved to be challenging under the FSCMA prior to the Amendment. With the implementation of the Amendment, the ex post disclosure system has now been expanded, encompassing both ex ante and ex post disclosures.

Ex Ante Disclosure

Under the Amendment, any transfer by an insider of securities (including equity securities, convertible bonds and bonds with warrants) issued by a listed company amounting to (i) 1% of the total issued and outstanding securities or (ii) KRW5 billion or more is required to be disclosed no later than 30 days prior to the expected closing date. In this ex ante disclosure, insiders must disclose the purpose, price, quantity, and expected trading period of the subject transaction. To avoid split transactions, (i) the quantities and prices of trading in the immediately preceding 6 months will be aggregated, and (ii) the submission of trading plans with overlapping trading periods will not be permitted under the Amendment.

Further, any breach of the measures, such as failing to disclose trading plans, false disclosures and/or failing to implement trading plans, may result in a penalty of (i) 0.02% of the total market capitalisation of the listed company or (ii) KRW2 billion, whichever is lower. It is also worth noting that such breach can be criminally sanctioned by imprisonment for a maximum period of one year or a maximum fine of KRW30 million.

Exceptions

Notwithstanding the foregoing, there are a number of exceptions to the mandatory ex ante disclosure system for insider transactions to ensure that the Amendment does not place an excessive burden on the interested parties. Financial investors (such as pension funds, collective investment vehicles, banks, insurance companies, financial investment companies and venture capital firms) deemed to have a relatively high level of internal control and low likelihood of using material non-public information, are exempt from the ex ante disclosure obligation. To ensure equal treatment between the investors, the same exemption will apply to foreign investors falling under the category of "financial investor" in Korea.

Further, (i) transactions required by law, (ii) sale and purchase for the purposes of market stablisation or market-making as permitted under the FSCMA, (iii) shares acquired upon inheritance or as dividends, (iv) sale and purchase under M&A transactions, (v) acquisitions or dispositions resulting from split and merger transactions and (vi) reverse trading resulting from a decrease in the collateral value are also exempt from the ex ante disclosure obligation.

The Amendment also allows deviation from the disclosed trading plan so long as such deviation is within the 30% range of the proposed trading value, allowing some level of flexibility to respond to the then-current market conditions. In addition, withdrawal of the trading plan is permitted in the event of the (i) anticipation of excessive losses on grounds of death or bankruptcy of the reporting party, (ii) increased market volatility (whereby the stock price deviates by more than 30% from the closing price of the trading day immediately preceding the trading plan submission date), (iii) inability to close the transaction due to causes attributable to the other party or (iv) material changes in market conditions (such as delisting or suspension of trading).

A note on the Amendment

The Amendment is expected to enhance the transparency and predictability of significant insider transactions, contributing to the prevention of unfair trading and the protection of investors. It is also anticipated that shareholding changes that may materially affect stock prices will be disclosed to help mitigate market volatility caused by unexpected large-scale share sales. It would be fair to say that, for insiders, the mandatory ex ante disclosure obligation will work to lessen any unnecessary misunderstandings related to the use of material non-public information.

Improvement Plans for the Treasury Stock System of Listed Companies

The Commercial Act generally prohibits the acquisition of treasury stock, which is in line with the doctrine of capital maintenance. This approach, however, has gradually evolved into a system allowing listed companies to acquire treasury stock for limited purposes, including shareholder return. Although implemented with good intentions, it became evident that the current treasury stock system has failed to serve its purpose of maximising shareholder returns as companies became increasingly reluctant to repurchase and cancel treasury stock and began to use the treasury stock as a tool for the major shareholders to defend their management control.

Bearing this in mind, the Financial Services Commission proposed a number of amendments to the Enforcement Decree of the FSCMA (the "Enforcement Decree Amendment") and the Regulations on the Issuance and Disclosure of Securities (the "Regulations Amendment", and together with the Enforcement Decree Amendment, the Treasury Stock System Amendments) to improve the treasury stock system of listed companies, which are expected to be implemented in the third quarter of 2024. The Treasury Stock System Amendments look to (i) restrict the allocation of new shares to treasury stock in spin-offs and mergers, (ii) impose enhanced disclosure requirements and (iii) eliminate regulatory arbitrage in the acquisition and disposal of treasury stock.

Prohibition on the allocation of new shares to treasury stock in spin-offs and mergers

Although shareholder rights including voting rights, dividend rights and pre-emptive rights are barred from being exercised with respect to treasury stock under the current law, ambiguous laws and precedents regarding spin-offs and mergers have led to new shares being allocated to treasury stock. This practice has been criticised for serving as an avenue for major shareholders to strengthen their management control – the so-called "magic of treasury stock" – rather than enhancing shareholder value. Some have also voiced their concern regarding differential treatment when it comes to spin-offs and mergers. In light of the foregoing, the Enforcement Decree Amendment now coherently restricts the allocation of new shares to treasury stock in spin-offs and mergers for listed companies.

Enhanced disclosure of the acquisition, holding and disposal of treasury stock

Pursuant to the Enforcement Decree Amendment, a listed company will be required to prepare, and obtain approval from its board of directors for, a report (the "Treasury Stock Report") setting forth the shareholding status, purpose and future plans (such as additional acquisition or disposal) of treasury stock in the event the treasury stock of the listed company exceeds 5% of the total issued and outstanding shares of the listed company. The Regulation Amendment further mandates that the Treasury Stock Report be submitted together with the business report of the listed company as an attachment thereto. The business report is also required to contain the key terms of the Treasury Stock Report. Additionally, the Regulation Amendment requires the purpose of disposal, the counterparty, the reasons for selecting such counterparty and the anticipated dilutive effect on share value to be disclosed to the public to facilitate effective market monitoring of the discretionary disposal of treasury stock by the listed company.

Elimination of regulatory arbitrage in the acquisition and disposal of treasury stock

With a rather relaxed regulatory approach taken with respect to the acquisition of treasury stock in trust compared to that of direct acquisitions, some have expressed concerns over the potential abuse of the system by companies. There also has been a certain level of criticism directed at the lack of disclosure obligations with respect to the disposal of treasury stock during the term of a trust agreement, which works against the ultimate goal of investor protection. Under the Regulation Amendment, listed companies are

(i) required to – in the event the aggregate purchase price of treasury stock acquired in trust is less than the initially planned and disclosed purchase price – submit a statement detailing the reasons therefor and (ii) restricted from entering into new trust agreements prior to the date falling one month after the initially planned and disclosed treasury stock acquisition period. The applicable listed company is also required to disclose to the public the purpose of disposal, the counterparty, the reasons for selecting such counterparty and the anticipated dilutive effect on share value in the event a trust company disposes treasury stock during the term of the trust agreement, as is the case for direct disposals.

A note on the Treasury Stock System Amendments

With particular attention given to enhancing corporate value, the acquisition and cancellation of treasury stock by listed companies in the first half of 2024 has significantly increased compared to that in the same period last year. According to the Korea Exchange, in their press release dated 10 July 2024, the aggregate acquisition and cancellation amounts of treasury stock in the Korea Composite Stock Price Index (KOSPI) have increased by KRW2.1 trillion (increase by 25.8%) and KRW6.8 trillion (increase by 193.6%), respectively. Despite this, dividend payouts have seen a slight increase of 3.7% compared to that in the same period last year.

The turmoil caused by the lack of, or ambiguity in, applicable laws and precedents with respect to the allocation of new shares to treasury stock during spin-offs or mergers is expected to be cleared with the Treasury Stock System Amendments. A more demanding disclosure obligation under the Treasury Stock System Amendments will also work as an upgraded investor protection measure, where consideration of the effects the handling of treasury stock has on stock prices was previously lacking. Many are hopeful that the Treasury Stock System Amendments will put a stop to the misuse of treasury stock by major shareholders as a means of illicit personal gains and help enhance shareholder value.

Development of the Corporate Value-Up Plan

Led by the Financial Services Commission and the Korea Exchange, an attempt to tackle the so-called Korea Discount – the tendency for Korean listed companies to trade at lower valuations compared with their global peers – materialised, with an emphasis on the importance of companies autonomously developing and implementing plans to increase their corporate value and fostering a corporate culture with active investor communications, upon the development and introduction of a corporate value enhancement plan (the “Corporate Value-Up Plan”).

With the unveiling of the guidelines for the Corporate Value-Up Plan (the “Guidelines”) on 2 May 2024, it is expected that the Guidelines will work as a beacon for listed companies in their journey towards putting together an effective Corporate Value-Up Plan tailored to their own background and characteristics. The Guidelines provide certain principles and examples of how listed companies can establish their own Corporate Value-Up Plan, as well as ways to communicate with investors regarding the Corporate Value-Up Plan – on a voluntary and self-initiated basis – by including the following contents:

- company overview;
- current status analysis;
- goals;
- plans;
- implementation evaluation; and
- communication.

It is worth noting that the Corporate Value-Up Plan may be voluntarily disclosed on an annual basis through the Korea Exchange.

Benefits for the participating companies

To encourage the active participation of listed companies, the Korean government plans to offer a number of benefits and incentives to enhance corporate value and encourage the return of profits to the shareholders. Every May, the Korean government will conduct a comprehensive evaluation of the appropriateness of goal setting, the thoroughness of the development of the Corporate Value-Up Plan and efforts made with respect to the implementation of the Corporate Value-Up Plan and communication with the shareholders, based on which a "Corporate Value-Up Award" will be awarded. A company awarded with the Corporate Value-Up Award will benefit from the following incentives.

Tax/accounting

Tax/accounting incentives include:

- tax support consisting of (i) preference given in the selection of exemplary taxpayers, (ii) pre-screening for R&D tax credit, (iii) consulting services on the deduction of corporate tax, (iv) tax correction claims reviews and (v) consulting services for family business succession;
- additional points in the periodic review for the designated external audit exemptions; and
- consideration as a mitigating factor in accounting related sanctions.

Listing/disclosure

Listing/disclosure incentives include:

- exemption from the annual fees of the Korea Exchange;
- exemption from additional or modified listing fees of the Korea Exchange; and
- sanction deferral by the Korea Exchange with respect to non-compliance with disclosure requirements.

Promotion/investment

Promotion/investment incentives include:

- priority participation opportunities in joint investor relations (IR) events organised by the Korea Exchange; and
- preferential inclusion in the Korea Value-Up Index.

The Korea Value-Up Index, which is scheduled to be fully developed in the second half of 2024, is an index composed of listed companies expected to achieve corporate value growth through continuous profit generation and shareholder return. The Korea Value-Up Index will include companies selected based on key investment indicators such as the price-to-book ratio (PBR), price-to-earnings ratio (PER), return on equity (ROE), dividend payout ratio, dividend yield and cash flow. The Korea Value-Up Index is intended for use in the launch of financial products such as exchange-traded funds (ETFs) and funds, and it is also expected to serve as a benchmark for institutional investors, including in relation to pension funds.

A note on the corporate value-up plan

Since the introduction of the Corporate Value-Up Plan, four listed companies (three KOSPI-listed companies and one Korean Securities Dealers Automated Quotations (KOSDAQ)-listed company) have disclosed their Corporate Value-Up Plans in the first half of 2024, with six companies (four KOSPI-listed companies and two KOSDAQ-listed companies) showing their intention to disclose the Corporate Value-Up Plan in the second half of 2024.

Although participation in the developing and disclosing of the Corporate Value-Up Plan is voluntary for listed companies, incentives such as tax benefits and the announcement of the Korea Value-Up Index are likely to incentivise companies to actively draw up their own Corporate Value-Up Plans. It is hoped that the Corporate Value-Up Plan will help address the Korea Discount and serve as a catalyst for the advancement of the Korean capital markets.

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com