Taking International Soft Law Seriously: Its Implications for Global Convergence in Corporate Governance*

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Abstract

The normative power of international "soft law" has constantly increased through the activities of various international organizations and the reliance that state practice places on the new form of international legal prescription. The recent unprecedented pace of such development has been seen in such financially-troubled East Asian countries as Korea. This article describes the changes and developments within the Korean economy and industries since the end of 1997 with particular emphasis on corporate governance and regulation of financial markets, directly and indirectly mandated by various international soft law rules. This article suggests that the national law principles developed in capital exporting (and providing) countries will serve as the predominant model for the convergence of national institutions and regulations, particularly corporate governance institutions and regulation of financial markets, which inevitably supports the convergence-from-competition hypothesis. The Korean case also clearly shows how a particular group of international soft law rules can fundamentally change a nation's economic system. This article argues that the Korean case shows the legitimacy of the normative power of international soft laws in its ability to shape and fulfill the regulatory needs of a globalizing market.

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I. Introduction

The role and significance of international "soft law" in modern international law-making in the second half of the 20th century is now well recognized amongst international law scholars.[1] Its normative power has constantly increased through the activities of various international organizations and the reliance that state practice places on the new form of international legal prescription.[2]

The recent unprecedented pace of such development has been seen in such financially-troubled East Asian countries as Korea. The interesting events that have taken place in Korea since the end of 1997 have clearly shown that, in certain circumstances, the normative power of international soft law may be quite substantial. These events also suggest that international soft laws can be promptly transformed into or implemented under domestic laws, and that the scope of international soft law's impact on a country's economic and social development may be far reaching. As a result of the "conditionality" imposed by the stand-by-arrangements between the Korean government and the International Monetary Fund ("IMF"), Korea's various domestic laws and regulations have gone through substantial reform as mandated by

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1) The non-treaty international soft law regularly takes the form of codes of conduct, guidelines, recommendations, declarations, and resolutions of international organizations, conferences, and NGOs, which are not a source of international law in the sense of Article 38 Para. 1 of the Statute of the International Court of Justice. *See generally* Alfred Verdross & Bruno Simma, Universelles Völkerrecht: Theorie und Praxis 419-422 (3rd ed. 1984). The literature on this topic is vast, and impossible to list all of them. *See, e.g.,* Hartmut Hillgenberg, *A Fresh Look at Soft Law,* 10 Eur. J. Int'l L. 499, 513 (1999) (characterizing non-treaty agreements as "fact," not as "source"); Christoph Schreuer, *Recommendations and the Traditional Sources of International Law,* 20 German Yrbk. Int'l L. 77, 105 (1977) (observing that "the effectiveness of some recommendations does not fall short of certain treaty provisions or customary rules"); Joseph Gold, *Strengthening the Soft International Law of Exchange Arrangements,* 77 Am. J. Int'l L. 443 (1983). It is widely accepted that the non-binding international norms also play an important role in the making of customary international law. *See* Ian Brownlie, Principles of Public International Law 11-15 (5th ed. 1998); Matthias Herdegen, Internationales Wirtschaftsrecht 12-13 (2nd ed. 1995); A.E.Boyle, *Some Reflections on the Relationship of Treaties and Soft Law,* 48 Int'l & Comp. L. Q. 901, 903-904 (1999).

2) For a theoretical account of international soft law's source of normative power, *see* Verdross & Simma, *supra* note 1, at 323-328 (developing and explicating the "consensus theory"). The role of soft law is also expanding on national law level. The most widely quoted example may be the British City Code on Takeovers and Mergers. *See* Peter Frazer, *The Regulation of Takeovers in Great Britain,* in: Knights, Raiders, and Targets ch. 27 (John C. Coffee, Jr., et al. eds. 1988); Deborah A. DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British,* 58 N.Y.U. L. Rev. 945 (1983). For an example of the voluntary Insider Trading Code in Germany, *see* Joseph Blum, *The*

the capital adequacy rules of the Bank for International Settlements ("BIS Rules") and OECD Principles of Corporate Governance ("OECD Principles"), along with basic legal concepts and principles prevailing in the major sponsor countries of the international lending agencies. These laws and regulations, which include such basic laws as the Commercial Code, Securities and Exchange Act and Banking Act, and the regulatory reforms affecting these laws, have brought about fundamental changes in Korean corporate governance and financial markets.

Such major reform implies that some international soft law rules, if coupled with the active involvement of international lending agencies in domestic implementation, may effectively, and in a short period of time, change the economic and industrial landscape of developing countries. The international economic policy-makers within international organizations and national governments, which are in charge of redesigning the international financial system, must carefully take notice of the implications of these developments. The financial institutions and markets can be effectively and sufficiently ruled and regulated by international soft laws, which are, by nature, flexible and adaptable. When these laws are supported by the legitimate and urgent regulatory needs of the market, these laws can be even more effectively applied.[3]

This article describes the changes and developments within the Korean economy and industries since the end of 1997 with particular emphasis on corporate governance and regulation of financial markets, directly and indirectly mandated by various international soft law rules. The article analyzes the conditions leading to such changes and developments, and identifies the implications for global convergence in corporate governance and of financial market laws.[4] This article suggests that the national law

Regulation of Insider Trading in Germany: Who's Afraid of Self-Restraint?, 7 Nw. J. Int'l L. & Bus. 507 (1986); Klaus J. Hopt, *The German Insider Trading Guidelines: Spring-Gun or Scarecrow?,* 8 J. Comp. Bus. & Cap. Mkt. L. 381 (1986). For the Japanese administrative guidance, *see* Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law,* 37 Harv. Int'l L. J. 3, 28-30 (1996); Michael K. Young, *Judicial Review of Administrative Guidance: Governmentally Encouraged Consensual Dispute Resolution in Japan,* 84 Colum. L. Rev. 923 (1984).

3) *Cf.* Philip R. Wood, Comparative Financial Law 35 (1995): Wood suggests that (domestic) soft laws "do have a compelling force if the society concerned is disposed to abide by them or if the guidance emanates from an authority which has the sanction of revocation of a license or other unpleasant consequences." He also points out that "[the] participants may choose to comply by reason of a culture of sociability, mutual forbearance, a recognition that the individual advantage requires common restraint, and a desire not to incur the disapproval of one's peers..."

4) This article tries to consolidate, from a different perspective, my views on convergence in corporate governance,

principles developed in capital exporting (and providing) countries will serve as the predominant model for the convergence of national institutions and regulations, particularly corporate governance institutions and regulation of financial markets.[5] Such principles appear more often in international soft law rules with their expanded application through the activities of international organizations. Countries under financial trouble, in particular, have been under the power of this process.

Part II briefly discusses the state of convergence in corporate governance and of financial market laws in the age of globalization. Part III explains how the BIS Rules have been introduced and implemented in Korea, with accompanying background information necessary for understanding such recent developments. Part IV describes the IMF-conditioned financial restructuring, which was carried out under the mandate of the BIS Rules. This section also describes the various capital market laws and regulations newly promulgated in Korea since the 1997 crisis. For the sake of delivering a clear image to international readers, certain aspects of laws are described at some length to show how international standards are currently shaping the Korean capital markets' regulatory environment. Part V explains and analyzes Korea's newly-enacted corporate governance system, providing a comprehensive introduction to the IMF-conditioned corporate governance regulatory reforms as mandated by such international soft law rules as the OECD Principles. Part VI discusses the implications

expressed in my previous studies: Hwa-Jin Kim, *Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea,* 17 Berk. J. Int'l L. 61 (1999) [hereinafter Kim, *Living with the IMF*]; Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives from Germany,* 26 Law & Pol'y Int'l Bus. 371 (1995); Hwa-Jin Kim, [M&A and Corporate Control] (Korean) (3rd ed. 1999); Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance,* forthcoming in 5 Yrbk. L. & Legal Practice in East Asia (2001). *See also* Hwa-Jin Kim, [*Global Convergence in Corporate Governance and International Law*] (Korean), 1 Kor. J. Sec. L. 261 (2000); Hwa-Jin Kim, [*The Regulation of Mutual Fund Industry in Korea: Developments by Global Standards*] (Korean), 23 Korean Civil Law Case Studies 757 (2001).

5) Such trends are clearly visible even amongst industrialized nations, as evidenced from the efforts of reputable non-US enterprises to access the US capital markets. The compliance of such non-US enterprises with the rules of US markets have a certain impact not only on their own operation and structure, but also on the national regulatory environments of their own countries such as those laws governing capital markets. *See* John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications,* 93 Nw. U. L. Rev. 641 (1999) [hereinafter Coffee, *The Future as History*]. *Cf.* Jeffrey N. Gordon, *Pathways to Corporate Convergence?: Two Steps on the Road to Shareholder Capitalism in Germany: Deutsche Telekom and Daimler Chrysler,* 5 Colum. J. Eur. L. 219 (1999).

of developments in Korea on the global convergence in corporate governance. It claims that recent developments in Korea support the case for convergence by international law. It also briefly discusses the relevance of the globalization to the contemporary perspectives on international law.

II. Globalization and Convergence

The impacts of globalization and convergence[6] on emerging economies are diverse and significant. Through the development of the "global standards", larger areas of their national law and life are now under the strong influences of the values, concepts and standards prevailing in the international investment community largely comprised of the countries of North America and Europe. The globalization is "the result of technology more than of politics", because it came about with "the universalization of markets, the spread of the consumer society values and the advance of technology".[7] However, the globalization means an external mandate for legal, political and cultural changes and reforms for many emerging market economies such as Korea. For the emerging market economies, the domestic consequences of globalization and convergence include the imperatives for vertical upgrading of the economic, legal and political system by the global standards.[8]

In response to the widespread notion in the age of globalization that the efficiency and stability of each individual nation's corporate and financial systems are of the utmost importance for the operation of the international economy, the reforms in the emerging economies focus primarily on the improvement of the regulatory environment for corporate and financial market sectors by undertaking the process of convergence on an international scale. The on-going academic discussions and

6) *See* Henry Laurence, *Spawning the SEC,* 6 Indiana J. Global Leg. Stud. 647, 649 (1999) (defining the convergence as "the process by which the rules, regulations, or political institutions governing economic activity in different countries become more similar").

7) Pierre-Marie Dupuy, *International Law: Torn Between Coexistence, Cooperation and Globalization,* 9 Eur. J. Int'l L. 278, 283 (1998). *See also* Alex Y. Seita, *Globalization and the Convergence of Values,* 30 Cornell Int'l L. J. 429 (1997).

8) For this reason, many people raise concern about the potential leveling of regulatory standards by the U.S. neoliberal norms. *But see* Gregory Shaffer, *Globalization and Social Protection: The Impact of EU and International Rules in the Ratcheting Up of U.S. Privacy Standards,* 25 Yale J. Int'l L. 1 (2000) (showing that the EU data protection policy leads to a ratcheting up of U.S. privacy standards).

practical developments in these areas in the more advanced economies and on the international level provide the policy-makers and scholars in Korea with helpful guidance for institutional reforms and improvements as elsewhere. The state of convergence in corporate governance and of financial market laws is particularly relevant to the subject of this article.

A. Convergence in Corporate Governance

The results produced by the convergence in corporate governance to a high standard, including such factors as efficient disclosure system and the attendant social and political consequences for society, are well recognized.[9] The European Union's financial market integration and company law harmonization[10] programs also support this fact. In this respect, it has recently been discussed whether increased global competition will force the convergence in corporate governance on an international scale.[11]

In line with the view developed by neoclassical economists, some scholars claim that the globalization of the world economy will produce a strong tendency toward such convergence.[12] Other scholars, on the contrary, argue that the path dependency will constrain the competitive forces pushing towards convergence in corporate governance.[13] Further, those espousing the intermediate view claim that "shareholder dispersion depends on the ability of the legal system to protect minority

9) *See* Coffee, *The Future as History, supra* note 5, at 705-706; Uri Geiger, *The Case for the Harmonization of Securities Disclosure Rules in the Global Market,* 1997 Colum. Bus. L. Rev. 241; Joel P. Trachtman, *International Regulation Competition, Externalization and Jurisdiction,* 34 Harv. Int'l L. J. 47 (1993).

10) *See* Alfred F. Conard, *The European Alternative to Uniformity in Corporation Laws,* 89 Mich. L. Rev. 2150 (1991). *Cf. also* Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment,* 61 Fordham L. Rev. 161 (1992).

11) For the earliest prediction that increased global competition will force the convergence in corporate governance on an international scale, *see* Roberta S. Karmel, *Is it Time for a Federal Corporation Law?,* 57 Brook. L. Rev. 55, 90 (1991).

12) This is called the 'convergence-from-competition hypothesis'. For the traditional theme that efficiency considerations determine corporate structure, *see, e.g.,* Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law (1991); Harold Demsetz, *The Structure of Ownership and the Theory of the Firm,* 26 J. L. & Econ. 375 (1983).

13) *See* Lucian A. Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership,* 52 Stan. L. Rev. 127 (1999) (developing a theory of the path dependence of corporate structure, and

shareholders,"[14] and that functional convergence can be facilitated by liquid international securities markets that develop an alternative monitoring force.[15]

These discussions on global convergence in corporate governance ultimately lead toward the policy questions as to whether regulators should attempt to facilitate the transition from concentrated ownership to dispersed ownership.[16] The answer to this question may have significant policy implications, particularly for such emerging economies as Korea, in its development of an industrial and economic structure. In any emerging economy, there may be a strong systematic temptation to promote concentrated ownership in firms for, arguably, the sake of efficiency.[17] The answer will also provide national and international decision-makers with insights into the role of law in fostering the growth of corporations and financial markets.[18] The outcome of the discussion will determine the desirable limits of developing industrial policy through the use of legal measures, especially as it pertains to the development of the industrial and economic structure of emerging economies.

B. Convergence of Financial Market Laws

As the activities of financial institutions around the world take on an increasingly

suggesting that some important differences in corporate structures might persist); Mark J. Roe, *A Political Theory of American Corporate Finance,* 91 Colum. L. Rev. 10 (1991) (the seminal work); Curtis J. Milhaupt, *Property Rights in Firms,* 84 Va. L. Rev. 1145, 1148 (1998) (claiming that "the convergence of national corporate governance systems will be slow, sporadic, and uncertain"); Milhaupt, *supra* note 2, at 64 (concluding that the Japanese example confirms path dependence of corporate governance mechanisms and shows marginal convergence); John Pound, *The Rise of the Political Model of Corporate Governance and Corporate Control,* 68 N.Y.U. L. Rev. 103 (1993); Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?,* 74 Wash. U. L. Q. 327 (1996); Mark J. Roe, *Chaos and Evolution in Law and Economics,* 109 Harv. L. Rev. 641, 668 (1996) ("What [economic institution] survives depends not just on efficiency but on initial, often accidental conditions (chaos theory); on the history of problems that had to be solved in the past but that may be irrelevant today (path dependence); and on evolutionary accidents what might do best today might have met its evolutionary demise in the past").

14) Coffee, *The Future as History, supra* note 5, at 647.

15) *See id.* at 650. *See also* Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance,* 85 Cal. L. Rev. 1 (1997).

16) *See* Coffee, *The Future as History, supra* note 5, at 647.

17) For a study arguing that highly concentrated ownership of firms improves corporate operations, *see* Karen H. Wruck, *Equity Ownership Concentration and Firm Value,* 23 J. Fin. Econ. 3 (1989). *See also* George J. Stigler & Claire Friedland, *The Literature of Economics: The Case of Berle and Means,* 26 J. L. & Econ. 237, 254-59 (1983).

18) *See* John C. Coffee, Jr., *Privatization and Corporate Governance: The Lessons from Securities Market*

international array, the prudential regulation of such activities and other financial services is also converging.[19] It has been even claimed, that "[i]n some respects, the banking sector is approaching a situation in which it makes sense to talk about the existence of a single international regulatory framework."[20] The regulatory convergence in such areas may proceed more rapidly due to the nature of the regulatory object and purposes. Those laws are less path-dependent as they are public laws that take on more universal character in their regulatory purposes. In fact, it is suggested, that "convergence at the level of securities regulation will outpace convergence at the level of corporate law."[21] The European Union's successful program for the integration of financial markets is a clear evidence of this view.[22]

The convergence of financial market laws is promoted not only through works of various international organizations, including the World Bank, the IMF, the Organisation for Economic Co-operation and Development ("OECD") and the World Trade Organization ("WTO"), but also through consultation amongst national

Failure, 25 J. Corp. L. 1, 38 (1999) ("[B]ecause civil law systems of corporate governance implicitly contemplate concentrated ownership, they have disdained disclosure to the market for disclosure to the supervisory board. In consequence, the civil law tends to inhibit the development of securities markets, whose growth depends upon the breaking down of informational asymmetries.")

19) *See generally* Joseph J. Norton, *"International Financial Law," An Increasingly Important Component of "International Economic Law": A Tribute to Professor John H. Jackson,* 20 Mich. J. Int'l L. 133 (1999).

20) David E. Van Zandt, *The Regulatory and Institutional Conditions for an International Securities Market,* 32 Va. J. Int'l L. 47, 76 (1991).

21) Coffee, *The Future as History, supra* note 5, at 700. *See also* Laurence, *supra* note 6, at 683 (claiming that "globalization made the SEC the regulatory model of choice").

22) For the integration of financial markets and liberalization of financial services in the EU, *see generally* Hal S. Scott & Philip A. Wellons, International Finance: Transactions, Policy, and Regulation 324-379 (5th ed. 1998). For the harmonization of securities regulation and disclosure rules of the EU, *see* Manning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities,* 31 Harv. Int'l L. J. 185 (1990); David Reid & Andrew Ballheimer, *The Legal Framework of the Securities Industry in the European Community Under the 1992 Program,* 29 Colum. J. Transnat'l L. 103 (1991); Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market-A Proposal,* 66 Fordham L. Rev. 1785 (1998); Roberta S. Karmel, *The Case for a European Securities Commission,* 38 Colum. J. Transnat'l L. 9 (1999). For the integration of the financial services industry, *see* Michael J. Levitin, *The Treatment of United States Financial Services Firms in Post-1992 Europe,* 31 Harv. Int'l L. J. 507 (1990); Manning Gilbert Warren III, *The European Union's Investment Services Directive,* 15 U. Pa. J. Int'l Bus. L. 181 (1994). For the integration of banking industry, *see* Michael Gruson & Werner Nikowitz, *The Second Banking Directive of the European Economic Community and Its Importance for Non-EEC Banks,* 12 Fordham Int'l L. J. 205 (1989).

supervisory authorities through such international forums as the Basle Committee, the International Organization of Securities Commissions ("IOSCO"), and the International Association of Insurance Supervisors ("IAIS"). In the securities regulation sector, the increasing role of the IOSCO is particularly noted. The IOSCO has passed various resolutions since 1986 to harmonize the national disclosure standards.[23] The Basle Committee's efforts to harmonize the national prudential regulations are illustrated below. The standards developed through consultation amongst members, whether they are either national governments or supervisory authorities, are regularly expressed in the form of international soft laws like guidelines, principles and resolutions.

The global convergence in the areas of the financial laws may facilitate the convergence in corporate governance.[24] It is well recognized that the prudential regulation of financial institutions may improve not only the governance of the financial institutions, but also provide their lender corporations with means for such improvement. The national regulations' adoption of more internationally unified prudential rules will promote the convergence in corporate governance of financial institutions and general corporations. The same logic may apply to the role of the securities regulations. The ever-converging national laws of securities require the corporations of the world a practice of disclosure by more unified rules and standards, which ultimately leads to the convergence in corporate governance. Also, it should be

23) One such resolution is 'A Resolution of the Presidents' Committee on IOSCO Endorsement of Disclosure Standards to Facilitate Cross-Border Offerings and Listings by Multinational Issuers' of Sep. 1998, available in <http://www.iosco.org/resolutions/resolutions-document18.html> (emphasizing the importance of developing "a generally accepted body of non-financial statement disclosure standards that could be addressed in a single disclosure document to be used by foreign issuers in cross-border offerings and initial listings, subject to the host country review or approval processes"). For IOSCO's efforts at harmonization, *see* Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity,* 20 Mich. J. Int'l L. 207, 238-246 (1999). *See also id.* at 266 ("[I]OSCO, while enjoying increasing acceptance by the global securities community, is still held back by its lack of authority to impose its mandates and the diversity among its members which often leads to disagreements concerning standards"). For SEC mandatory disclosure of foreign corporate governance, *see* James A. Fanto, *The Absence of Cross-Cultural Communication: SEC Mandatory Disclosure and Foreign Corporate Governance,* 17 Nw. J. Int'l L. & Bus. 119, 205 (1996) (arguing that "SEC mandatory disclosure does not now encourage foreign issuers to explain adequately and meaningfully their corporate governance practices to U.S. investors").

24) *See* Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence,* 20 Cardozo L. Rev. 227 (1998).

noted that, in theory, *de facto* global convergence in corporate governance may be achieved through an expansive extraterritorial application of the U.S. disclosure rules.[25] The extensive use of the Internet in securities offerings and trading can significantly increase the number of occasions in which the U.S. securities law applies outside the U.S.[26]

III. Implementation of the International Prudential Rules in Korea

A. Korea's Adoption of the BIS Rules in 1995

Bank supervisory authorities around the world, since the Basle Committee on Banking Supervision's adoption of the BIS Rules[27] in July of 1988, have widely endorsed and implemented the BIS Rules through national regulations. The Rules

25) For discussions on the potential benefits from regulatory competition, *see* Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation,* 71 S. Cal. L. Rev. 903, 914-18 (1998) (arguing that regulatory competition among different regimes will lead to a race-to-the-top); Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law,* 17 Nw. J. Int'l L. & Bus. 207 (1996); Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom,* 95 Mich. L. Rev. 2498, 2503 n. 5 (1997) (raising concern that the regulatory competition would lead to a "race-to-the-bottom in the content of national disclosure regimes"); Merritt B. Fox, *The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities,* 97 Mich. L. Rev. 696 (1998); Joel P. Trachtman, *Recent Initiatives in International Financial Regulation and Goals of Competitiveness, Effectiveness, Consistency and Cooperation,* 12 Nw. J. Int'l L. & Bus. 241, 292 (1991) (suggesting that the regulatory convergence will facilitate competition in international financial markets). *Cf.* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation,* 107 Yale L. J. 2359, 2383-88 (1998) (providing substantial evidence that there is a race-to-the-top in U.S. state corporate law competition for corporate charters); Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets,* 38 Va. J. Int'l L. 563 (1998) (arguing that "the globalization of stock markets also entails legal interdependence, particularly in what concerns securities regulation and corporate governance regimes"). For the extraterritoriality issue in securities law, *see generally* Gunnar Schuster, Die internationale Anwendung des Börsenrechts (1996) (a comprehensive comparative study of German, British and the U.S. laws).

26) For the SEC's position on the jurisdiction over foreign offers made on the Internet that is transmitted to the U.S., *see* John C. Coffee, Jr., *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation,* 52 Bus. Law. 1195, 1227-32 (1997); Richard Cameron Blake, *Advising Clients on Using the Internet to Make Offers of Securities in Offshore Offerings,* 55 Bus. Law. 177 (1999).

27) In this article, the "BIS Rules" collectively refer to the "Basle Accord" of 1988 and its amendments subsequently adopted by the Basle Committee on Banking Supervision: International Convergence of Capital Measurement and Capital Standards (July 1988); Amendment to the Capital Accord to Incorporate Market Risks (Jan.

envisage that banks maintain the minimum capital-to-assets ratio of eight percent of total capital.[28] It is widely believed that the BIS Rules have largely been successful in achieving its fundamental goal, i.e., securing international convergence of supervisory regulations that govern the capital adequacy of international banking institutions. The Rules "strengthen the soundness and stability of the international banking system" and "diminish an existing source of competitive inequality among international banks." [29]

Although Korea is not a part of the Basle Committee on Banking Supervision, the Korean government, through promulgation of the Bank of Korea's ("BOK") relevant supervisory regulations, introduced the BIS Rules in July of 1992 to ensure the capital adequacy of Korean banks. The BOK recognized at least three compelling reasons for the voluntary adoption of the Rules. First, it was anticipated that the supervisory authorities of the G-10 countries[30] and Luxembourg would enforce the Rules against foreign banks when such foreign banks were involved in business with their international banks. Second, the adoption of the Rules would enhance the credibility of Korean banks in international financial markets, and help in efficiently managing risks. It also would contribute to the development of a co-operative relationship between the supervisory authorities of Korea and other countries. Third, the

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1996) <http://www.bis.org/publ/pub_list.htm>. The BIS Rules are implemented in the European Union through its directives on own funds and on solvency ratios. *Cf.* Council Directive 89/299 of 17 April 1989 on The Own Funds of Credit Institutions, 1989 O. J. (L 124) 16 <http://europa.eu.int/eur-lex/en/lif/dat/1989/en_389L0299. html>; Council Directive 89/647 of 18 December 1989 on a Solvency Ratio for Credit Institutions, 1989 O. J. (L 386) 14 <http://europa.eu.int/eur-lex/en/lif/dat/1989/en_389L0647.html>. Further, the BIS Rules can also be understood as the general principles for effective banking supervision. *See* Basle Committee on Banking Supervision, Core Principles for Effective Banking Supervision (Sept. 1997) <http://www.bis.org/publ/pub_list.htm>. *See also* Supervisory Lessons to be Drawn from the Asian Crisis (Basle Committee on Banking Supervision Working Paper, June 1999) <http://www. bis.org/publ/pub_list.htm>.

28) *See* Scott & Wellons, *supra* note 22, ch. 4; Lawrence L. C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision,* 39 Va. J. Int'l L. 1 (1998); Camille M. Caesar, *Capital-Based Regulation and U.S. Banking Reform,* 101 Yale L. J. 1525 (1992); Duncan E. Alford, *Basle Committee International Capital Adequacy Standards: Analysis and Implications for the Banking Industry,* 10 Dickinson J. Int'l L. 189 (1992); David Fairlamb, *Beyond Capital Adequacy,* Institutional Investor (International Edition), Aug. 1997, at 22-35.

29) International Convergence of Capital Measurement and Capital Standards, *supra* note 27, at 1. For empirical studies, *see, e.g.,* Capital Requirements and Bank Behaviour: The Impact of the Basle Accord (Basle Committee on Banking Supervision Working Paper, April 1999) <http://www. bis.org/publ/pub_list.htm>.

30) Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, United Kingdom, and United States.

introduction of the Rules may help Korean banks maintain soundness even in the midst of implementation of new strategies mandated by the domestic financial market's deregulation, such as aggressive asset management and increasing off-balance sheet transactions.[31] By the end of 1995, all Korean banks were required to maintain an equity capital position equivalent to at least eight percent as suggested by the BIS Rules.[32]

Despite these efforts, however, the soundness of Korean banks, due to various difficulties, has deteriorated over time. The Korean government's direct influence over banking and other financial institutions has prevented the management of such institutions under market-driven principles. The so-called practice of "directed lending" became common practice, with prudence giving way to, in practice, highly lax supervision. The effect of the BIS Rules turned out to be literally "soft" while the Korean government pursued other agendas with the banks. By BIS standards, the average equity capital position of Korean commercial banks was 7.04 percent at the end of 1997.[33] The equity capital position of such banks as Korea First Bank and Seoul Bank at the end of 1997 were below zero and 0.97 percent, respectively.[34] Korean financial institutions, with poor corporate governance as regular practice, failed in risk management and were, as a result, severely hit by the financial failures of their borrowers during the 1997 crisis.[35]

B. The 1997 Crisis

The foreign exchange crisis that started amongst the Southeast Asian countries during the summer of 1997 was the direct cause that triggered the Korea's own financial crisis in late 1997.[36] It is widely believed, however, that the Korean economy

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31) *See* BOK, [Understanding Major Issues of the BIS and Basle Committee on Banking Supervision] (Korean) (Aug. 1996) at 39.

32) *See id.* at 40.

33) *See* Han-guk Kyongje Shinmun, Feb. 27, 1998, at 1.

34) *Id.*

35) *See* Korea Financial Supervisory Service Monthly Review (Feb. 2000) at 2.

36) For discussions on the Asian economic crisis started in 1997, *see generally* Scott & Wellons, *supra* note 22, at 32-36 & ch. 21; IMF, The IMF's Response to the Asian Crisis (Jan. 17, 1999) <http://www.imf.org/external/np/exr/facts/asia.htm>; Timothy Lane et al., IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment (1999) <http://www.imf.org/external/pubs/ft/op/op178/index. htm>; Il

had a structural problem prior to 1997.[37] Such factors as poor corporate governance, moral hazard (endemic through Korean financial institutions and general corporations, and even amongst the general public), government-controlled market, inefficient administrative infrastructure, primitive market for corporate control, weak political leadership all contributed to the international investment community's loss of confidence in the Korean market, which feared being caught in a repeat of the Thai, Indonesian and Malaysian trouble.

On the other hand, the business and financing activities of Korean firms were significantly internationalized and already subject to the discipline of the international financial market.[38] As of the end of June 1997, BIS reporting banks' outstanding loans to Korea amounted to 116.8 billion US dollars, and the amount of outstanding international debt securities issued by Korean companies totaled 48.9 billion US dollars.[39] The international investment community's loss of confidence in Korea's credibility was fatal to many Korean banks and firms. Unfortunately, however, Korea only came to realize its vulnerability through the severity of the 1997 crisis.

The efforts of the Korean government, financial industry, corporate sector and the general public to restore credibility to the economy were painful, but successful so far. The Korean government and government officials, in particular, have heroically performed the implementation of comprehensive reform programs in various sectors while also endeavoring to achieving national political consensus on such reforms and acquiring international recognition on the seriousness and permanency of the reforms.[40]

As explained below, the effect of the 1997 crisis in Korea was also significant. The general public, not necessarily investors in the financial markets, were made aware of the abusive and irresponsible practices of some Korean entrepreneurs and financiers. The investors realized that they were not given a fair share of the nation's economic

Chong Nam et al., Comparative Corporate Governance Trends in Asia (OECD Conference Paper, March 1999) <http://www.oecd.org/daf/corporate-affairs/governance/in-Asia.htm>; World Bank, East Asia: The Road to Recovery (1998).

37) *See generally* Kim, *Living with the IMF, supra* note 4.

38) *See id.* at 89-91.

39) *See* Scott & Wellons, *supra note* 22, at 34. The total amount of Korea's foreign debts was 156.9 billion US dollars at the end of November 1997. *See Korea's Foreign Debts Total $156.9 bil. by IMF Standards,* Korea Herald, Dec. 31, 1997, at 1.

40) *See* Korea Financial Supervisory Service Monthly Review, *supra* note 35, at 3.

growth because of the illegitimate wealth transfers and the failures in business judgment of some corporate managers. In particular, corporate governance and regulation of financial institutions have become an actively discussed and highly contentious issue for almost all market participants in Korea, including general households, who have all felt the direct effects of the problems during the financial crisis.

C. Korea-IMF Stand-by-Arrangements

On November 21, 1997, Korea applied to the IMF for the 58 billion US dollar in bailout funds by submitting the Letter of Intent to the IMF.[41] The Korea-IMF Memorandum on the Economic Program ("Korea-IMF Memorandum") was signed on December 3, 1997.[42] It provided for a wide range of corrective measures related to macroeconomic policy, fiscal policy, and financial and corporate sector restructuring, and was supplemented by subsequent agreements with the IMF.[43]

The program qualifies as a conditionality which international lending agencies like

41) *See* Michael Duffy, *The Rubin Rescue,* Time, Jan. 12, 1998, at 12-15; Bob Davis, *Bitter Medicine: Korea Plays Adverse Patient to IMF's Rescue Team,* Asian Wall St. J., March 3, 1998, at 1, 9; Michael Hirsh et al., *Seoul Calls for Help,* Newsweek, Dec. 1, 1997, at 34 - 37; Mark L. Clifford, *Korea's Crisis,* Bus. Wk. (Asian Edition), Nov. 24, 1997, at 18-21.

42) The Korean translation of its full text was published in major Korean daily newspapers. For the full text of the Korean government's Letter of Intent with the Korea-IMF Memorandum submitted to the IMF, *see* Chosun Ilbo, Dec. 6, 1997, at 12. For the full text of the second and third packages submitted to the IMF by the Korean government, *see* Joong-Ang Ilbo, Dec. 26, 1997, at 5 and Maeil Kyongje, Feb. 18, 1998, at 3, respectively. The English texts of the Letters of Intent and Memorandums of Economic Policies are available in <http://www.imf.org/external/country/kor/index.htm>.

43) For various discussions and opinions on the Korea-IMF deal, *see Korea's IMF Negotiations,* Wall St. J. Europe, Dec. 3, 1997, at 8; Michael Schuman & Namju Cho, *Is Korean Bailout the Right Medicine?,* Wall St. J. Europe, Dec. 8, 1997, at 5; Editorial, *Hurdles Ahead for South Korea,* N. Y. Times, Jan. 2, 1998, at 16; Ajay Kapur, *Bad Medicine from the IMF,* Asian Wall St. J., Jan. 15, 1998, at 6. *See also* George P. Shultz, William E. Simon & Walter B. Wriston, *Who Needs the IMF?,* Asian Wall St. J., Feb. 4, 1998, at 8; David Sacks & Peter Thiel, *The IMF's Big Wealth Transfer,* Asian Wall St. J., March 12, 1998, at 6; Lawrence Summers, *The IMF: Good for Donors Too,* Asian Wall St. J., March 30, 1998, at 10; *What's an IMF For?,* Asian Wall St. J., April 7, 1998, at 10; *The IMF Crisis,* Asian Wall St. J., April 16, 1998, at 8; David Rockefeller, *Why We Need the IMF,* Wall St. J. Europe, May 11, 1998, at 10. *Cf.* Stephen Zamora, *Regulating the Global Banking Network: What Role (if Any) for the IMF?,* 62 Fordham L. Rev. 1953 (1994).

the IMF and World Bank regularly use when extending loans.[44] As the Korean government's submission of its Letter of Intent to the IMF did not in and of itself constitute an expression of intent to be bound by an international agreement, a breach of the stand-by-arrangement *per se* would not have triggered any state responsibility on the part of Korea.[45] However, any default in implementation of the program will limit further borrowing and lower Korea's credit rating, which would exert a far greater detrimental impact on the economy and diplomacy than any legal cause of action. Indeed, Korea has thus far been very successful in keeping up with the IMF-imposed time schedule as agreed for implementation of the program.

The Korean government's efforts to steer the nation's economy toward recovery have focused on implementation of the IMF-program and its supplementary agreements. In particular, the IMF has approved the periodic Article IV (of the IMF's Articles of Agreement) consultations that have been consolidated into several memoranda, and transformed into various statutory amendments. For instance, the latest Korea Memorandum on Economic Policies of the IMF dated November 24, 1999 ("1999 Memorandum")[46] has transformed into, as of January 2000, numerous changes affecting the regulation of financial institutions.

The Korean economy is recovering at a far faster rate than anticipated. The IMF completed the consultations and reviews under the stand-by credit for Korea in August 2000. Due to the speed of recovery it is now not so easy to argue that the legal changes and institutional reforms have significantly contributed to the rebound of the Korean economy. It typically takes some time while newly enacted laws are actually implemented and applied in practice, and the practical effect of such improvement in economic efficiency may be realized more slowly and gradually. The legal changes and institutional reforms may have important signaling functions with positive impacts on investors and the market. The successful and timely implementation of the IMF-program may have induced the international investment community to feel safe to go back to the Korean market. However, it may be questioned whether the crisis was really due to the structural problems and deficiencies in the traditional Korean

44) *See generally* Manuel Guitian, Fund Conditionality: Evolution of Principles and Practices (IMF Pamphlet Series No. 38, 1981). *See also* Harold James, International Monetary Cooperation Since Bretton Woods 322-35 (1996); William A. McCleary, *The Design and Implementation of Conditionality,* in: Restructuring Economies in Distress: Policy Reform and the World Bank ch. 10 (Vinod Thomas et al. eds. 1992).

45) *See* Herdegen, *supra* note 1, at 229.

46) *See* <http://www.imf.org/external/np/loi/1999/112499.htm>.

institution. The difficult issue as to whether the legal changes have achieved something beyond the signaling will be discussed below in this article.

D. BIS Rules at Work

Ever since the Korea-IMF Memorandum was adopted in December of 1997, the magic number of "8" percent has played a dominant role in Korea's financial industry. The BIS Rules have been used as an important policy tool for the Korean government in its efforts towards restructuring the troubled Korean industry and in putting the wounded Korean economy back on track.[47]

The Korea-IMF Memorandum provided that "[a] timetable will be set for all banks to meet or exceed Basle standards."[48] It then made revocation of merchant banking licenses contingent upon fulfillment of the standards under the BIS Rules and provided for such severe disciplinary measures on commercial banks as liquidation, withholding of dividend distributions and/or management payroll freezes, also contingent upon rehabilitation plans meeting standards under BIS Rules.[49] In January 1998, the Korean government nationalized by recapitalizing, for eventual sale to international investors, two Korean commercial banks in eminent danger of insolvency, namely Korea First Bank and Seoul Bank.[50] As already mentioned, the equity capital position of Korea First Bank and Seoul Bank at the end of 1997 were below zero and 0.97 percent, respectively.

Five out of the twelve weak banks failing to meet the capital adequacy ratio set by the BIS Rules were ordered to suspend operations under the Korea Financial Supervisory Commission's ("KFSC") issuance of the June 29, 1998 Contract Transfer Order issued pursuant to the Law Concerning the Improvement of the Structure of the Financial Industry. The assets and liabilities of these five financially-troubled banks were purchased, pursuant to a purchase and assumption ("P&A") formula, by five financially-sound banks. The KFSC granted the remaining seven banks a period of up to two years to improve their financial position to the satisfaction of the KFSC. If the

47) Also, it was interesting and surprising to recognize that even the general public, including school children and housewives, became familiar with such words as "BIS" and "equity-capital-ratio." That explains that their households were also directly impacted by the economic crisis.

48) *See* No. 17 of the Korea-IMF Memorandum.

49) *See id.* Nos. 22-25.

50) Korea First Bank was sold to Newbridge Capital in December of 1999.

banks fail to meet the KFSC's requirements within the given period, such banks may also be subject to a shut-down.

Sixteen merchant banks were also shut down in 1998. It was inevitable that a great number of white collar workers would lose their jobs. Managers responsible for these failed institutions were subsequently brought to the courtroom. In December of 1999, the Korea Deposit Insurance Corporation ("KDIC") announced plans to commence legal actions against 764 ex-managers of 86 failed financial institutions, which amounted to a total of 5.4 trillion won in damages.[51] Consequently, Korean commercial banks and other financial institutions have become very conscientious of the BIS Rules and have tried their best to satisfy the requirements mandated by the KFSC.[52] Sometimes their efforts have resulted in sudden bankruptcies of affected borrowers.

The Korean government's efforts to reform the financial sector will continue in close collaboration with the IMF as stipulated in the latest 1999 Memorandum. The 1999 Memorandum, which places great emphasis on implementing prudential regulations and supervision,[53] required all Korean banks to meet at least the minimum capital ratio of 8 percent, and encouraged an increase in capital ratio to 10 percent by December 2000. If a bank fails to meet the minimum 8 percent requirement, the KFSC shall invoke the prompt corrective action procedures under the Law Concerning the Improvement of the Structure of the Financial Industry.[54] Korean commercial bank's average equity capital position increased to 8.23 percent by the end of 1998[55], and again to 9.84 percent by the end of June 1999.[56] The Korean government has concluded that such increase is a clear sign of economic recovery and improvement of

51) *See* Seoul Kyongje, Dec. 31, 1999, at 5. *See also* KDIC's Press Release dated Dec. 30, 1999 <http://www.kdic.or.kr/news/frame1.htm>. Such actions are based upon Art. 21-2 of the Korean Depositor Protection Act. The purchase of director's liability insurance has become widespread in Korea since the 1997 crisis. According to the KFSC, the major Korean corporate groups paid in 1998 a total of 22.5 billion won in D&O insurance premiums. *See* KFSC's Press Release dated Jan. 28, 1999 <http://210.95.55.199>.

52) *See* Joong-Ang Ilbo, Nov. 6, 1999, at 10 (reporting Korean banks' efforts in fulfilling the 8% requirement). *See also* Han-guk Kyongje Shinmun, July 13, 2000, at 4 (talking about the "Devil's BIS 8%").

53) The 1999 Memorandum requires the KFSC to update its regulations and procedures and to bring them closer to international best practice as expressed in the Basle Committee's Core Principles, *supra* note 27.

54) *See* Lee, *supra* note 28, at 36-39 (emphasizing the potential role of the IMF in strengthening the influence of the BIS Rules).

55) *See* KFSC's Press Release dated March 26, 1999.

56) *See* KFSC's Press Release dated Sept. 30, 1999.

the financial system.[57]

In February of 1999, the BIS Rules were finally adopted as a statutory concept in Korea. The Korean Banking Act[58] and Law on Merchant Banking Companies[59] uniformly define "own capital" as the sum of "the core capital and supplementary capital under the standards of the Bank for International Settlement". Further, Korean banks must now disclose own capital in accordance with the BIS Rules in registration statements for issuance of securities, which are to be filed with the KFSC, to "assist investors in their decision making." In March of 2000, the Korean government announced plans to adopt the Amendment to the Capital Accord to Incorporate Market Risks[60] which was promulgated by the Basle Committee on Banking Supervision in January of 1996.[61]

It is quite interesting that Korea adopted the EU approach that extended the capital adequacy rules to all banks located in the member countries. The BIS Rules do mandate only those banks that engage in transnational activities to comply with these standards. In fact, for some local banks in Korea the compliance maybe very difficult for an uncertain guarantee of safety.[62] It should be noted that the new Korean laws adopting the standards of the BIS Rules do not necessarily imply that they are better laws for every purpose. However, the surprising silence in Korea as to the adequacy of the BIS Rules for all Korean financial institutions is a clear evidence that the trend of convergence in financial market laws, which is mandated by the discipline of the international markets, is very, maybe too, strong.

IV. The Restructuring of the Korean Financial Industry[63]

A. Addressing the Problem of Troubled Financial Institutions

The Korea-IMF Memorandum required the Korean government to establish "a

57) *Id.*

58) *See* Art. 2 (1) No. 5 of the Act.

59) *See* Art. 2 No. 3 of the Law.

60) Amendment to the Capital Accord to Incorporate Market Risks (Jan. 1996) <http://www.bis.org/publ/pub_list.htm>.

61) *See* KFSC's Press Release dated March 4, 2000.

62) For an account of problems with the BIS Rules, *see* Caesar, *supra* note 28, at 1537-43.

63) For an overview, *see* KFSC and KFSS (Korea Financial Supervisory Service), Financial Reform and

comprehensive strategy to restructure and recapitalize the financial sector.”[64] It also advised the Korean government to take “bold and decisive action to address the problem of troubled financial institutions and to open the financial sector to foreign investment.”[65]

By April 1998, twelve weak Korean banks that, as of the end of 1997, had failed to meet the capital adequacy ratio set by the BIS Rules submitted restructuring plans to the KFSC. The Korea-IMF Memorandum provided that “[t]he rehabilitation plans submitted to supervisory authorities by financial institutions will specify the sources and amounts of new capital, a clear schedule to meet Basle capital adequacy standards.”[66] After careful review of the plans for a period of two months, the KFSC revealed its restructuring plan for the banking industry at the end of June 1998.[67] Surprisingly, the KFSC did not approve the restructuring plans submitted by five banks. According to the KFSC, these banks would not fulfill the requirement set by the BIS Rules even after a successful recapitalization. As a consequence, these banks were to be shut down through P&A transactions with five other financially-sound banks.[68] This was the first time for the Korean public to learn that the banks do also fail. After a number of demobilizing events and occurrences during the two or three days following the shut down, the failed banks prepared to enter into bankruptcy. Seven of the twelve banks surviving the restructuring were required to provide the KFSC with further plans for restructuring and management improvement by September 1998. Among the banks so requested, the Commercial Bank of Korea and Hanil Bank were merged in January of 1999.[69] Cho Hung Bank, Chung Buk Bank and Kangwon Bank completed a two-tiered merger in September of 1999.

Supervision in Korea 2000 (April 2000), <http://210.95.55.198/eintro/final.pdf>; Samsung Economic Research Institute, [The Unfinished Reform: Financial and Corporate Restructuring] (2000) (Korean).

64) *See* No. 8 of the Korea-IMF Memorandum.

65) *See id.* No. 15.

66) *See id.* No. 25.

67) *See* Chosun Ilbo, June 30, 1998, at 31.

68) It is quite striking that the fate of Korean banks depends almost exclusively upon the indicators measured by the BIS standards. As discussed earlier, many experts have questioned the adequacy of the BIS Rules for developing economies. The performance of banks that have actually complied with the BIS Rules may be disappointing according to other indicators. In fact, the closed banks were shut down not only because they were unsound by the BIS standards, but also they could not present convincing evidence of their potential for overall recovery.

69) *See Forced Friendship in South Korea,* The Economist, Aug. 8, 1998, at 66.

The other twelve banks that had met the capital adequacy ratio set by the BIS Rules as of the end of 1997 were also put under extensive supervisory review in August 1998. Some of these banks were advised to improve their management performance. Among them, Hana Bank and Boram Bank merged in January of 1999, with Kookmin Bank and Korea Long-Term Credit Bank also merging in January of 1999. Bank mergers, previously viewed as events occurring only in foreign countries, became a reality in Korea.

Other financial institutions’ situations looked even worse. Sixteen merchant banks, six securities companies and two investment trust companies were shut down or suspended in 1998. The IMF’s 1999 Memorandum requires the Korean government to privatize Korea Investment Trust and Daehan Investment Trust, the two largest securities investment trust companies in Korea. The Korean government was to retain shares in these companies, but only for ensuring a sound, commercially-based management and the prevention of future failures in asset management.

B. NPLs and the New ABS Market

The problem of non-performing loans (“NPLs”) of Korean financial institutions prompted the Korean government to set up the Korea Asset Management Corporation (“KAMCO”) modeled after the U.S. Resolution Trust Corporation.[70] At the same time, the Non-Performing Asset Resolution Fund was created to clear bad loans from the books of financial institutions. As of the end of August 2000, KAMCO has bought the bad loans of banking and other financial institutions totaling 75.7 trillion won in exchange for a payment of 29.5 trillion won.[71]

In order to facilitate the disposition of NPLs of troubled Korean financial institutions, asset-backed securitization was introduced into Korea as part of the Law Concerning Asset-Backed Securitization (“LABS”), in effect since September 16,

70) KAMCO was re-established on November 24, 1997 by the Law on the Efficient Management of Non-Performing Assets of Financial Institutions and Establishment of KAMCO.

71) *See* <http://www.kamco.or.kr/kor/ma/main1.htm> (visited Sept. 22, 2000). *See also* <http://www.kamco.or.kr/eng/business/business3.htm> (visited Jan. 7, 2000) (showing KAMCO’s NPLs disposition records totaling 20.8 trillion won as of the end of Nov. 1999). As of the end of 1998, non-performing loans at Korean financial institutions amounted to 60.2 trillion won. *See* KFSC’s Press Release dated March 5, 1999, Total NPLs at Korean Financial Institutions in Dec., 1998 (visited Jan. 21, 2000) <http://210.95.55.198/data/brd/11/Epr_0305.htm>.

1998.[72] As of the end of December 1998, total NPLs (loans classified as either substandard, doubtful or estimated loss) of 22 Korean commercial banks stood at 22.22 trillion won.[73] As of the end of 1999, asset-backed securities backed by NPLs, automobile installment payment loans, credit card loans and home mortgage loans, etc., worth a total of 6.7 trillion won have been issued in Korea.[74] Asset-backed securities issued through public offerings totaled 4.4 trillion won, and amounted to 16.9 percent of the total volume of corporate bonds issued in 1999, thus showing an impressive growth in the market within a relatively short period of time.[75]

As of the end of 1999, thirty-two asset-backed securitization plans were registered with the KFSC. The successful start of the asset-backed securities market in Korea is due to financial institutions' need for liquidity enhancement, as well as in the search for alternative long-term financing options of financial and general companies after the 1997 crisis. Banking institutions, in particular, were able to greatly increase their capital adequacy ratio under the BIS Rules through asset-backed securitization.[76]

Asset-backed securities are issued regularly by Securitization Companies. Out of 32 securitization plans filed with the KFSC thus far, 30 have been filed by Securitization Companies. They are new instruments in the Korean financial market introduced by the LABS. They are special purpose paper companies ("SPCs") which were previously unknown in Korea. As paper companies, SPCs cannot establish branches or employ officers and staff. SPCs, therefore, must entrust all business matters to asset holders termed "Originators" and other third parties. These third parties then transfer the securitization assets to the SPCs in accordance with the asset-

72) The latest amendment to the LABS went into effect on January 21, 2000.

73) *See* KFSC, Bank Nonperforming Loans at end-December, 1998 (visited March 5, 1999) <http://www.fsc.go.kr/kfsc/board/11/pr_0303.htm>.

74) *See* KFSC's Press Release dated Feb. 16, 2000.

75) *See id.* There are no restrictions as to which assets may be subject to securitization under the Law Concerning Asset-Backed Securitization. However, assets that generate statistically easy-to-predict cash flows are generally more likely to undergo asset-backed securitization. Among qualifying assets, and those that are presently subject to such securitization, are loans and real estate. Among all loans, usually those that are adaptable to collective statistical management and disposition are subject to asset-backed securitization. Examples of such loans are home mortgage loans, automobile installment payment loans, and credit card loans. In the United States, securities backed by credit card loans accounted for 42 percent of all asset-backed securities issued in 1994, totaling 75 billion US dollars. Securities backed by automobile installment payment loans and home mortgage loans accounted for 24 percent and 13 percent, respectively. *See* Scott & Wellons, *supra* note 22, at 762-764.

76) *See* Han-guk Kyongje Shinmun, Feb. 9, 2000, at 4 (prospect for further growth).

backed securitization plan registered with the KFSC. They must also entrust management of the assets to an Originator or a credit information agency. The SPC is established as a limited liability company (Yuhan Hoesa) under the Korean Commercial Code and is subject to related code regulations. However, certain regulations may be altered if they conflict with those stipulated in the LABS. According to the law, therefore, the SPC's minimum capital allowed is 10 million won.

Home Mortgage Loan Securitization Companies have also been introduced by enactment of the Home Mortgage Loan Securitization Company Law on January 29, 1999 and effective beginning April 30, 1999. The latest amendment to this law went into effect on January 21, 2000. The companies established under this law specialize in acquiring and securitizing home mortgage loans transferred from financial institutions. Home Mortgage Loan Securitization Companies also specialize in the issuance of guarantees for home mortgage loan backed securities that either they or other companies issue, as well as specializing in the borrowing and issuing of corporate bonds. Unlike SPCs established under the LABS, these companies are not paper companies but rather stock corporations under the Korean Commercial Code, with a minimum capital requirement of 25 billion won. In addition, the fund ratios of Home Mortgage Loan Securitization Companies are regulated much like financial institutions. Korea Mortgage Corporation is the first Home Mortgage Loan Securitization Company licensed by the KFSC under the Home Mortgage Loan Securitization Company Law.

C. The New Rules for Asset Management

Several Article IV consultations between the Korean government and the IMF led to substantial statutory changes in the regulation of the operations and asset management of Korean financial institutions. In implementation of the IMF's 1999 Memorandum, the most significant statutory amendments to various financial institution laws, including the Securities and Exchange Act ("KSEA"), Securities Investment Trust Business Law and Insurance Business Law, were enacted in January of 2000. Above all, these amendments focus on regulations that require sound asset management and the adoption of an internal compliance system of various financial institutions.[77]

Pursuant to these changes, securities companies, securities investment trust

companies, insurance companies and merchant banks must all appoint compliance officers to ensure management's fulfillment of responsibilities to investors. The compliance officers are to report to an audit committee or statutory auditor on management's compliance with internal asset management rules.[78] Furthermore, the KSEA was newly-enacted[79] to introduce and apply capital adequacy rules to securities operations.[80]

D. The KOSDAQ

Probably one of the most remarkable changes in Korean capital markets of recent years is the rise of the secondary segment of the Korean securities market. The Korea Securities Dealers Automated Quotation System Stock Market ("KOSDAQ") was launched on July 1, 1996, and modeled after the Nasdaq Stock Market ("Nasdaq") in the United States. This secondary market was established primarily to support small businesses and venture firms specializing in the high-tech and biotechnology areas. KOSDAQ has grown rapidly since 1998 as a result of the restructuring of conventional big businesses traded on the Korea Stock Exchange ("KSE").

Korean investors realized during the financial crisis the limited growth prospects of established firms. Korean investors were significantly affected by the 1997 crisis and subsequent events in that investors were made aware of the abusive practices of some major KSE-listed companies and their controlling shareholder-managers. Such frustration also resulted from KSE-listed firms' general tendency to not take seriously the interests and expectation of their investors. The most often-raised complaint may have been that KSE-listed firms were not providing investors with their fair share of

77) The new provisions mandated by the IMF (and World Bank) on corporate governance of financial institutions are separately described in Part IV below.

78) *See* Art. 54-4 of the KSEA; Art. 14-2 of the Securities Investment Trust Business Law; Art. 6-5 of the Insurance Business Law; Art. 5-3 of the Law on Merchant Banking Companies. *See also* Art. 35-3 of the Securities Investment Company Act.

79) *See* Art. 54-2 of the KSEA. External audit of unit trust funds that are under the management of securities investment trust companies shall be carried out on an annual basis, and audited accounts may be made available to unit trust fund investors. Art. 26-2 of the Securities Investment Trust Business Law. Securities investment trust companies are required to disclose to investors the investment guidelines and strategies under which specific funds are managed. *Id.* Art. 27. The advertising and sales materials provided by securities investment companies shall contain material information on investment in funds. *Id.* Art. 27-2. *See also* Art. 41-2 of the Securities Investment Company Act.

80) *See generally* Scott & Wellons, *supra* note 22, at 291-323. After the 1992 failure of the International

business growth and adequate managerial information.[81] It is widely recognized that the KOSDAQ-listed firms, usually small and medium-sized start-up ventures, are generally more conscientious of investor interests especially as related to their efforts at inducing capital.

The Korean government has also realized the political importance of cultivating an active venture capital industry to promote the international competitiveness of new Korean firms in high-tech and information technology industries. The average daily trading volume on the KOSDAQ has increased from 5.5 billion won in 1998 to 1.8 trillion won as of December of 1999.[82] The aggregate market capitalization of KOSDAQ-listed firms increased substantially during 1999 from 7.9 trillion won at the end of 1998 to 62 trillion won at the end of 1999.[83] The number of registered firms increased from 331 to 569 during 1999.[84]

The Korean government's efforts concentrate on improving the infrastructure and investor protection in KOSDAQ.[85] KOSDAQ has recently adopted more strict ownership dispersion requirements for enrolled firms, and introduced more advanced disclosure and market monitoring systems. Effective as of April 1, 2000, a company that intends to register with KOSDAQ must satisfy the new ownership dispersion requirement:[86] The total number of shares which have been offered to the public by the company on the date of its registration application must be, as of the date of its registration application, (i) at least 30% of the total issued and outstanding shares or (ii)

Organization of Securities Commissions' (IOSCO) efforts to issue common capital standards for securities operations, the Basle Committee on Banking Supervision and IOSCO in 1995 issued a joint proposal for capital standards of derivatives operations. *See* Framework for Supervisory Information about the Derivatives Activities of Banks and Securities Firms (May 1995) <http://www.bis.org/publ/pub-list.htm>. *Cf.* Cynthia C. Lichtenstein, *International Standards for Consolidated Supervision of Financial Conglomerates: Controlling Systemic Risk,* 19 Brooklyn J. Int'l L. 137 (1993).

81) *See, e.g.,* Woon-Youl Choi, [*Management Trusted by Shareholders*] (Korean), Chosun Ilbo, Dec. 27, 1996, at 5 (pointing out the low dividend pay-out ratio of Korean firms).

82) *See* MOFE/KFSC, [A Plan for Sound Development of the KOSDAQ] (Korean) (Dec. 1999) at 1.

83) *Id.* The performance of the KSE has also been remarkable. In 1999, the total market capitalization of the KSE increased 148% from 137.8 trillion won to 341.6 trillion won. *See* Korea Financial Supervisory Service Monthly Review (Feb. 2000) at 3.

84) *See* Han-guk Kyongje Shinmun, Aug. 28, 2000, at 3.

85) *See* Korea Financial Supervisory Service Weekly Newsletter, Jan. 12, 2000, at 2-3.

86) *See* Art. 4 of the KOSDAQ Rules. The full text of the KOSDAQ Rules is available in <http://www.ksda.or.kr>. The KOSDAQ has three market sections: venture business, ordinary and foreign business, and mutual

at least 10% of the total issued and outstanding shares and at least 5 million shares. In addition, the number of the minority shareholders must be 500 or more.

As abusive practices by controlling shareholders are also on the rise along with the boom in KOSDAQ, some safety mechanisms have been introduced through the KOSDAQ Rules. After an IPO is made, the controlling shareholders of the company cannot sell the shares for six months following the IPO.[87] Improving corporate governance is also a focus of regulatory reform. The changes in corporate governance under the new Korean Commercial Code, including the option to introduce an audit committee, also apply to the KOSDAQ firms. Furthermore, investors of KOSDAQ-listed firms enjoy the same level of minority shareholders rights as those of KSE-listed firms. Also, KOSDAQ firms are now subject to the same disclosure obligations as those of KSE-listed firms.[88]

Successful establishment of some key complimentary institutions will determine the future development of the Korean venture capital market. The trends in labor mobility and risk tolerances are already visible in the venture industry in Korea.[89] Foreign investors' participation in the Korean capital market has resulted in the increased presence and activities of international investment bankers in Korea. As a result, Korean entrepreneurs are on the rebound in the new market of opportunities. The successful institutional adaptation of KOSDAQ to that of the U.S system will play a crucial role not only for the future of the secondary segment of the Korean capital market, but also for the future of the entire Korean economic system.[90]

E. The New Tools for Financing and Restructuring

1. Mutual Funds

The IMF-mandated reform programs contained other general prescriptions for the

fund sections. The listing requirements for the venture business section are less stringent than those for the ordinary and foreign business section. For a good summary, *see* <http://www.ksda.or.kr/Portfoliokorea/stock/stocksub3_1.htm>.

87) *See* Art. 6 of the KOSDAQ Rules.

88) *See* Arts. 43 through 49 of the KOSDAQ Rules.

89) *See* Maeil Kyongje, Feb. 28, 2000, at 13 (reporting huge movement of professionals from reputable consulting firms to venture businesses).

90) *See* Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the*

functional improvement of the Korean financial markets. In line with the IMF programs, among other things, mutual fund industry was launched in 1998, which substantially expanded the scope of financing and investment options in Korea.[91]

Mutual funds[92] are a new means of securities investment and were designated and introduced in Korea as Securities Investment Companies under the Securities Investment Company Act, enacted and effected as of September 16, 1998.[93] The mutual fund could not be organized under the Korean Commercial Code because ordinary stock corporations in Korea cannot repurchase their shares on a regular basis. Furthermore, ordinary stock corporations in Korea cannot reduce capital unless done in compliance with the conditions prescribed by the statute.

The major motivation behind the introduction of Securities Investment Companies through enactment of the Securities Investment Company Act was due to the need for boosting and cultivating the Korean securities market. Korea's introduction of the Securities Investment Companies has led to a mass movement of funds from investment trust companies, commercial banks, insurance companies and merchant banks to Securities Investment Companies.[94] It was reported that as of September

Comparative Corporate Governance Debate, 91 Nw. U. L. Rev. 865, 879-94 (1997) (singling out five traits of the institutional environment that contribute to the success of the U.S. venture capital market: "the existence of large, independent sources of venture capital funding; liquidity; highly developed legal and contractual incentive structures; labor mobility; and risk tolerance").

91) For a detailed account, *see* Hwa-Jin Kim, *New Special Purpose Companies in Korean Financial Markets,* in: Recent Transformations in Korean Society and Law 171 (2000); Kim, [*The Regulation of Mutual Fund Industry in Korea: Developments by Global Standards*], *supra* note 4.

92) According to a recent report, there were, as of the end of 1998, a total of 7,314 mutual funds in the United States with a total net asset volume amounting to a startling 5,525.2 billion US dollars. (There were a total of 31,570 mutual funds worldwide as of the end of September 1998 with a total asset volume amounting to 7,651.6 billion US dollars.) *See* Investment Company Institute, Mutual Fund Fact Book (May 1999) <http://www.ici.org/facts-figures/factbook99_toc.htm>. For a historical overview of the United States mutual fund industry, *see* Mark J. Roe, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance ch. 8 (1994); SEC, Protecting Investors: A Half Century of Investment Company Regulation (1992); Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry,* 139 U. Pa. L. Rev. 1469 (1991). For an introduction to the US Investment Company Act of 1940, *see* Howell E. Jackson & Edward L. Symons, Jr., Regulation of Financial Institutions chs. 12 & 13 (1999); Thomas Lee Hazen, The Law of Securities Regulation ch. 17 (3rd ed. 1996). *See also* Tamar Frankel, The Regulation of Money Managers (4 vols. 1978 & 1980), with 2000 Supplement (4 vols.) (an exhaustive commentary). The web site of the Investment Company Institute <http://www.ici.org> provides comprehensive information and data on mutual funds in the United States.

93) The latest amendment to the law went into effect on April 1, 2000.

94) Shareholders of Securities Investment Companies may, in principle, ask the sales and promotion company to

1999, a total of 60 Securities Investment Companies, including Corporate Restructuring Securities Investment Companies,[95] were registered at the KFSC, with a total volume of 4,562 billion won.[96] As of September 2000, a total of 138 Securities Investment Companies were registered with the KFSC.[97]

In Korea, securities investment trusts managed by investment specialists and professional money managers are one of the chief investment vehicles used for indirect investment in securities. A Korean investment trust is regulated under the Securities Investment Trust Business Law and the Trust Law. Securities investment trusts distribute profits to investors that hold certificates of beneficiary interest. Profits are obtained from the investment of trust assets that are established with investor funds. Thus, in principle, the management of trust assets and the distribution of profits are done according to each unit of trust as stipulated in the Securities Investment Trust

redeem their shares. These are referred to as open-end Securities Investment Companies. However, the Securities Investment Company Act does not allow the registration of open-end Securities Investment Companies for a period of up to five years from the date of the law's enactment. Accordingly, only closed-end Securities Investment Companies, where the shareholders of the Securities Investment Companies cannot ask the sales and promotion company for redemption of their shares, are presently allowed in Korea. The closed-end Securities Investment Companies can increase their stocks' liquidity by listing them with the KSE or KOSDAQ. Before listing on the KSE, the Securities Investment Companies must meet the criteria of having minimum of 80 billion won in capital backed by over 1,000 shareholders. Securities Investment Companies not meeting the above criteria can be listed and traded on the KOSDAQ.

95) Corporate Restructuring Securities Investment Companies are closed-end Securities Investment Companies which have been in existence for more than three years, and that have invested more than 50 percent of their assets into certain securities. Those securities may be issued by companies other than large scale-conglomerates (i.e. the 30 largest companies in Korea) as defined by the Korean Anti-monopoly and Fair Trade Act. The various restrictions on the previously-discussed asset management of general Securities Investment Companies do not apply to Corporate Restructuring Securities Investment Companies. There are four Corporate Restructuring Securities Investment Companies in Korea, which include Seoul Debt Restructuring Fund, Han River Restructuring Fund, Arirang Restructuring Fund and Moogoonghwa Restructuring Fund. These companies were established by the combined investment of 1.6 trillion won by 25 financial institutions including the Korea Development Bank, and were registered with the KFSC in October and November of 1998. These four companies' assets are managed by Rothschild, Scudder Kemper Investments, State Street Bank & Trust and Templeton Asset Management, respectively. *See* Chosun Ilbo, Jan. 10, 2000, at 11 (performance records). With respect to the tax privileges for the Corporate Restructuring Securities Investment Companies, *see* Art. 54 of the Law on the Restriction of Tax Privileges.

96) *See* Basic Guide to Investment Funds in Korea (visited January 3, 2000) <http://www.kitca.or.kr/home/english/guide.asp> (showing also that as of September 1999 total assets under the management of securities investment trust companies in Korea totaled 224 trillion won).

97) <http://www.kitca.or.kr/sp_batch/display/n_fund_list.asp> (visited Sept. 22, 2000).

Business Law.[98] Until now, however, Korean unit trust funds established and operated by an investment trust management company, in certain cases, were operated without any substantial distinction. This frequently lead to problems in the transfer of profits and the movement of fund assets between funds and the property of investment trust companies and fund assets. The most common example of this is the transfer of a part of the property of a fund recording high returns to one with falling returns so that the suggested rate of returns could be balanced ("alias watering the rate of returns"). This practice ignores the fundamental principle of distributing profits in accordance with performance. One of the reasons behind the introduction of the corporate investment trust form was the expectation that if each fund was to have a legal personality, such problems would arise less frequently and transparency in the management of funds would improve.[99]

The facilitation of Securities Investment Companies may not only change the face of the Korean financial market,[100] but may also bring many changes to the practice of corporate governance in Korea. The Securities Investment Companies distribute the profits generated by its invested assets to shareholders in the form of dividends. These assets are managed in an aggressive manner, thereby affecting the attitudes of corporate management through asset managers' active participation in the market for

98) *See* Art. 33 (1) No. 7 of the Law.

99) *See, however,* Kon Sik Kim, [*The Structure of Securities Investment Trusts*] (Korean), 278 Human Rights and Justice 8 (1999) (skeptical view). For patterns of abusive practice, *see* Maeil Kyongje, Dec. 25, 1999, at 3; Chosun Ilbo, Jan. 19, 2000, at 49 & 50 (reporting also that Korean money managers currently manage a total number of 14,103 securities investment funds). Under the Korean Securities Investment Trust Business Law, it is the trustee (usually commercial banks) who enters into legal transactions involving trust assets. Under the Law, investment managers are merely responsible for issuing instructions to the trustees with respect to their investment activities. However, over time, it has become widespread practice in the Korean securities investment trust industry for investment managers to be directly involved in the legal transactions involving trust assets, at times completely excluding trustees from such transactions. On the other hand, the trustees themselves often assume rather passive positions. Accordingly, the legal effect or validity of the transactions directly conducted by the investment managers without involvement of the trustees could be questioned. As a result, a gap exists between the laws and regulations on the one hand and the actual practice on the other, which may cause legal uncertainties in a number of situations, particularly in litigation. This situation has also contributed to distorted practices in the management of trust assets by investment managers. For the law and practice of unit investment trusts, *see generally* Macfarlanes, Collective Investment Schemes: The Law and Practice (Looseleaf 1999); Kam Fan Sin, The Legal Nature of the Unit Trust (1997); Siegfried Kümpel, Bank-und Kapitalmarktrecht ch. 10 (1995).

100) Art. 80 of the Act allows foreign securities investment companies (mutual funds) to sell their shares in Korea.

corporate control.[101] Moreover, in the event that the level of liquidity falls due to an increase in the volume of invested assets, there is always the possibility that the shareholders will become "activists", keen on actively participating in the management of the company.[102] For this reason, Securities Investment Companies will assume a role as one of the most important institutional investors in Korea.[103]

2. Holding Companies and Vulture Funds

Along with corporate governance reform and financial market restructuring, acquisition activities by foreign investors in Korea have been increasing. Korean firms have also begun to seek strategic alliances with foreign or local firms to survive in the more rationalized and internationalized market.[104] The restructuring itself has

101) Securities Investment Companies generally cannot manage assets by investing more than 10 percent of total assets in one security, or by investing in more than 10 percent of the total number of issued and outstanding shares of one company. The latter is a regulation which is especially designed to prevent Securities Investment Companies from engaging in unfair trade practices related to M&As by holding large volumes of shares of small and medium sized companies. Securities Investment Companies may not acquire securities issued by their major shareholders in excess of 10 percent of the total volume of its assets. Such restrictions are to prevent Securities Investment Companies from engaging in using unfair trade and other manipulative practices in the stock market. Furthermore, Securities Investment Companies may not acquire certificates of beneficiary interest issued by securities investment trust companies or stocks issued by other Securities Investment Companies in an amount exceeding 5 percent of its total volume of assets. In addition, Securities Investment Companies, in principle, may not borrow funds, issue guarantees, or provide any collateral.

102) Securities Investment Companies can, in principle, exercise their voting rights directly or through asset management companies. However, there are a few restrictions: Securities Investment Companies may actively participate in corporate control contests and exercise their voting rights for the benefit of investors. Securities Investment Companies are not, however, allowed to exercise their vote for the purpose of ultimately acquiring corporate control. The motivation behind exercising certain voting rights is officially evaluated and judged upon by the Korea Fair Trade Commission. This is parallel in content to the restriction on the exercise of voting rights concerning unit trust assets of securities investment trust companies under the Securities Investment Trust Business Law. In light of this similarity, Securities Investment Companies will play a substantially important role in the future M&A market in Korea. In particular, corporations with low shareholder rates will concentrate their efforts on bringing neutral Securities Investment Companies aboard as allies. Hence, their relationships with asset management companies will emerge as an important factor.

103) For an overview of institutional investors in Korea, *see* Yu-Kyung Kim, *The Growing Financial Market Importance of Institutional Investors: The Case of Korea,* in: Institutional Investors in the New Financial Landscape 159 (OECD 1998).

104) For Korean banks' alliances with foreign giant banks, *see* Maeil Kyongje, Feb. 29, 2000, at 4 (reporting that

produced, since 1997, a high level of mergers and acquisitions activity in Korea, which include the so-called "Big Deals" encouraged by the Korean government, although contested acquisitions have become dormant since 1997.[105] Because the Korean government recognized that an active market for corporate control facilitates the improvement of corporate governance, several regulatory reforms have been completed to promote hostile takeovers and open the market up to foreign investors.[106] When the economy revives, it is anticipated that the market for corporate control in Korea may become active. Foreign institutional investors may especially find the restructured Korean market lucrative in terms of mergers and acquisitions.

Two new instruments related to the mergers and acquisitions market in Korea are worth mentioning: Holding Companies and Corporate Restructuring Companies. The Korean government has introduced these two types of entities to help ease the structural changes of Korean firms in 1999.

(a) Holding Companies

The 1999 amendment to the Korean Anti-monopoly and Fair Trade Act was promulgated on February 5, 1999, and took effect on April 1, 1999. It contains the provisions concerning Holding Companies.

Prior to the amendment, the Anti-monopoly and Fair Trade Act prohibited the establishment of, or the conversion of a company into, a Holding Company whose main purpose was to control the management of a domestic company through the ownership of such company's shares. As referred to here, a Holding Company means a company which owns, for the purposes of controlling the business management of another company, the shares of that company, provided that the total book value of those shares on the balance sheet is 50 percent or more of the amount of the total assets

German Allianz Group would take 12.5% of Hana Bank's equity, thus become the biggest shareholder).

105) By far, the largest M&A transaction in Korea was SK Telecom's (the largest mobile telephone operator in Korea) $3 billion acquisition of a controlling stake in Shinsegi Telecomm from Pohang Iron and Steel (POSCO) in 1999/2000. The second-largest M&A transaction in Korea was Hyundai Electronics' $ 2.5 billion acquisition in 1999 of a controlling stake in LG Semicon and the subsequent merger of the two companies. The latter was one of the highly publicized "Big Deals" guided by the Korean government.

106) *See* Kim, *Living with the IMF, supra* note 4, at 76-81. For mergers and acquisitions in Korea, *see generally* Kim, [M&A and Corporate Control], *supra* note 4.

of the former. The definition excludes any company whose main business is not considered by the Korea Fair Trade Commission to be the management control of another company, with reference to the volume, purpose and proportion of investment of the company. The underlying rationale behind the prohibition against Holding Companies was to deter such entities from being used as a means of forming conglomerates, which may lead to the concentration of economic power through a multiplicative expansion of capital. As an exception to this prohibition, foreign investors in Korea, under limited circumstances, have been allowed to form Holding Companies.

However, the Korean business community has continuously demanded that it be allowed to establish Holding Companies, claiming their usefulness in corporate restructuring and in preventing domestic companies from foreign managerial control. The Korean government has, with certain restrictions and to a limited extent, allowed for Holding Companies to be formed, in principle, under the amended Anti-monopoly and Fair Trade Act.[107] As of September 2000, a total of 8 Holding Companies were reported to the Korea Fair Trade Commission.[108]

(b) Vulture Funds

The Law on the Promotion of Industrial Development, promulgated on February 8, 1999 and effective from May 9, 1999, introduced Corporate Restructuring Companies. Corporate Restructuring Companies are organized by the so-called vulture funds that acquire insolvent companies at a low price and then dispose of such companies at a

107) Those Holding Companies whose domestic subsidiaries handle only financial or insurance businesses are called Financial Holding Companies, and all other Holding Companies are called General Holding Companies. General Holding Companies may not have any subsidiary companies running financial or insurance businesses. Furthermore, subsidiaries of General Holding Companies may not own shares in any other domestic company for the purposes of controlling the management of that other company. *See* Maeil Kyongje, Dec. 2, 1999, at 7; Maeil Kyongje, Jan. 5, 2000, at 2 & 7 (reporting that large companies and commercial banks are establishing Financial Holding Companies). The Korean government planed to introduce a separate legal regime for Financial Holding Companies by the second half of 2000. See Korea Financial Supervisory Service Monthly Review (Feb. 2000) at 11. For the regulation of financial holding companies in the U.S., *see generally,* Robert C. Clark, *The Regulation of Financial Holding Companies,* 92 Harv. L. Rev. 787 (1979); Howell E. Jackson, *The Expanding Obligations of Financial Holding Companies,* 107 Harv. L. Rev. 507 (1994); Pauline B. Heller, Federal Bank Holding Company Law (1999).

108) *See* Han-guk Kyongje Shinmun, Sept. 14, 2000, at 3.

higher price after normalization.[109] Corporate Restructuring Companies must register at the Ministry of Commerce, Industry and Energy("MOCIE"), and may engage in various kinds of businesses including: investment in companies to be restructured; the acquisition, normalization and disposition of companies to be restructured; the purchase of the business or assets of companies to be restructured; the purchase of insolvent assets held by KAMCO; the carrying out of procedures of compulsory composition, liquidation or bankruptcy on behalf of companies to be restructured; and the brokerage of mergers and acquisitions. As of February 2000, a total of 27 Corporate Restructuring Companies were registered at MOCIE.[110]

V. Institutional Changes and Corporate Governance

A. OECD Principles at Work

OECD has finalized and adopted the Principles of Corporate Governance[111] in May of 1999. The adoption of the OECD Principles was widely supported by the G-7 countries, OECD Member governments, international organizations and the private

109) As of the end of September 1999, 79 companies in Korea were under a private restructuring (workout) agreement guided by the KFSC. The amount of their debts to financial institutions totaled 34.9 trillion won. For the restructuring in bankruptcy, *see generally* Patrick A. Gaughan, Mergers, Acquisitions, and Corporate Restructurings ch. 11 (2nd ed. 1999); Philip R. Wood, Principles of International Insolvency chs. 18, 19 & 20 (1995).

110) *See* MOCIE's Press Release dated May 8, 2000. Corporate Restructuring Companies are entitled to the subsidy provided by the Law on the Promotion of Industrial Development. Here, companies to be restructured include: (i) those companies against which a suspension order has been issued by the clearing houses more than once within the latest 3 years; (ii) those companies that have applied to the court for commencement of compulsory composition, corporate reorganization or liquidation procedures; and (iii) those companies that are under the management trust of creditor financial institutions, and that are engaged in businesses other than financial or insurance businesses. *See Art.* 14 (4) of the Law.

111) The text is available in <http://www.oecd.org/daf/governance/principles.htm>. For OECD's corporate governance-related works, *see generally* <http://www.oecd.org/daf/corporate-affairs/governance>. For various other guidelines and codes of conduct developed and adopted by OECD, *see, e.g.,* The OECD Guidelines for Multinational Enterprises <http://www.oecd.org//daf/investment/guidelines/mnetext.htm>. OECD Members accept some codes legally binding obligations. *See, e.g.,* The OECD Code of Liberalisation of Capital Movements <http://www.oecd.org//daf/investment/legal-instruments/clcmart.htm>. For an overview of international codes of conduct developed by various international organizations, *see* Saleem Sheikh & SK Chatterjee, *Codes of Conduct and Their Impact on Corporate Governance,* in: Corporate Governance and Corporate Control ch. 12 (Saleem Sheikh & William Rees eds. 1995).

sector. As the Principles itself expressly put it, the Principles are non-binding and intended to serve as a reference point.[112]

The OECD Principles have caused many countries to develop and adopt their own codes and guidelines. Some of them are directly incorporated in the relevant domestic laws.[113] In Korea, the Principles were referred to in the Congressional Legislative Review Report of the January 2000 amendments to the KSEA.[114] The January 2000 amendments to the KSEA were actually guided by the Code of Best Practice for Corporate Governance which were adopted by the Korean Committee on Corporate Governance in September of 1999.[115] The Code again had heavily been influenced by the OECD Principles. As the January 2000 amendments to the KSEA will not apply to all listed Korean firms, the Korean government plans to mandate listed Korean firms to disclose whether they voluntarily comply with the Code.[116]

The international lending agencies do not keep any ready-made set of corporate governance rules that can be imposed on the counterpart of the stand-by-arrangement. The OECD Principles have practically served as important reference for the conditionality and its implementation in the Korean case as elsewhere. Co-operation between the OECD and the World Bank in promoting an improved corporate governance system exemplifies the necessity for such collaborations.[117]

112) It states in its Preamble: "The Principles are non-binding and do not aim at detailed prescriptions for national legislation. Their purpose is to serve as a reference point. They can be used by policy makers, as they examine and develop their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices."

113) National corporate governance codes and guidelines are made easily available through <http://www.oecd.org/daf/corporate-affairs/governance/other-links.htm>. *See also* <http://www.ecgn.ulb.ac.be/ecgn/codes.htm> (web-page provided by the European Corporate Governance Network) and <http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm> (World Bank's collection of full text of codes, principles and reform proposals of corporate governance).

114) *See* [Congressional Legislative Review Report of the Amendments to the Securities and Exchange Act] (Korean) (Dec. 1999) at 6-7.

115) *See* <http://www.worldbank.org/html/fpd/privatesector/cg/docs/kor.code.doc>.

116) *See* Joong-Ang Ilbo, Jan. 26, 2000, at 30.

117) *See* the Memorandum of Understanding concluded between the OECD and the World Bank to promote improved corporate governance, in <http://www.oecd.org//daf/corporate-affairs/governance/oecd-wb-mou.htm>. Pararell to the developments of standards in corporate governance on international scale, comparative corporate governance has become an important academic discipline since the 1980s. The literature in comparative corporate governance has also become very rich. For recent works, *see, for example,* Mark Roe, *Comparative Corporate Governance,* in: 1 The New Palgrave Dictionary of Economics and the Law 339 (1998), <http://www.law.columbia.

It may be at least questionable whether the OECD Principles indeed offer guide and help in dealing with the corporate governance problems in Korea. While the OECD Principles have been developed for the classic Berle & Means corporations with dispersed ownership and the separation of ownership and control, most of the Korean firms have concentrated ownership. However, the rules of the Principles have been introduced in Korea not only to regulate the current system of corporate governance, but also to bring about a fundamental change to the existing system. They may have signaling functions with substantial impacts on investors and the market. It cannot be denied that the rules of such soft law may fail to satisfactorily address the traditional corporate governance problems in Korea, i.e., the question of who controls the controlling shareholder-managers, because the existing structure is very different from what the rules are created for. However, the existence of a particular ownership structure different from that of Berle & Means does not necessarily rule out the possibility of changes in the existing structure. In fact, in a country like Korea where the political drive for institutional reforms has traditionally been very strong, the model envisaged in the OECD Principles can change the existing ownership structure to a

edu/law-economic-studies/papers/workp125.pdf>;<http://www.law.columbia.edu/law-economicstudies/abstracts.html> (Columbia Law School Center for Law and Economic Studies Working Paper Abstracts); Comparative Corporate Governance: The State of the Art and Emerging Research (Klaus J. Hopt et al. eds. 1998); Institutional Investors and Corporate Governance (Theodor Baums et al. eds. 1994); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor,* 91 Colum. L. Rev. 1277 (1991); Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation,* 92 Mich. L. Rev. 1997 (1994); G. P. Stapledon, Institutional Shareholders and Corporate Governance (1996); James A. Fanto, *The Transformation of French Corporate Governance and United States Instituional Investors,* 21 Brook. J. Int'l L. 1 (1995); Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization,* 102 Yale L. J. 871 (1993); Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States,* 102 Yale L. J. 1927 (1993); Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective,* 57 Brook. L. Rev. 1 (1991); Ronald J. Gilson & Reinier Kraakman, *Investment Companies as Guardian Shareholders: The Place of the MSIC in the Corporate Governance Debate,* 45 Stan. L. Rev. 985 (1993); Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law,* 109 Harv. L. Rev. 1911 (1996); Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law,* 102 Yale L. J. 2021 (1993); Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance,* 74 Wash. U. L. Q. 367 (1996); Jonathan R. Macey, *Italian Corporate Governance: One American's Perspective,* 1998 Colum. Bus. L. Rev. 121.

118) *See* Enhancing Corporate Governance for Banking Organisations 1 (Basle Committee on Banking Supervision, Sept. 1999) <http://www.bis.org/publ/ pub_list.htm> ("Banking supervision cannot function as well if sound corporate governance is not in place and, consequently, banking supervisors have a strong interest in ensuring

great extent, which is not readily feasible in more advanced and established economies.

B. New Corporate Governance Mandated by the IMF and World Bank

It is widely believed that the poor corporate governance of Korean corporations and financial institutions has caused the failure of many Korean financial institutions and markets.[118] It was also believed that the Korean financial crisis was started in part by the loss of the international investment community's confidence in the governance of large Korean corporations and banks.[119] A recent study showed that foreign institutional investors in Korea were willing to pay a premium of 25 percent for the shares of Korean companies with sound corporate governance.[120]

From the very beginning of their involvement in the restructuring of the Korean economy, the IMF and World Bank have put great emphasis on improving the corporate governance of Korean firms. Consequently, there have been huge changes to Korean laws and regulations regarding corporate managers' accountability, managerial transparency, investor protection, and shareholder democracy since 1997 crisis.[121] To be more specific, the Korean Commercial Code ("KCC"), KSEA, Banking Act, and some other laws are all undergoing important changes to reflect the new corporate governance policy adopted by the Korean government in consultation with the IMF and World Bank.

The Korea-IMF Memorandum includes several measures for improving corporate governance of Korean firms. It provides that the Korean government recognized "the need to improve corporate governance and the corporate structure."[122] Toward that end,

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that there is effective corporate governance at every banking organisation.")

119) *See* Han-guk Kyongje Shinmun, Nov. 6, 1997, at 20 (reporting foreign investors' frustration in Korean firms' ignorance of minority shareholder interest and non-transparent management and accounting practices).

120) *See* Sang Yong Park, Value of Governance of Korean Companies: International Investors Survey (April 1999).

121) This article does not discuss the historical background of the corporate governance problems in Korea and developments before the 1997 crisis. For corporate governance in Korea, *see generally* Kim, *Living with the IMF, supra* note 4; Kim, [M&A and Corporate Control], *supra* note 4; Il Chong Nam et al., Corporate Governance in Korea (OECD 1999) <http://www.oecd.org/daf/corporate-affairs/governance/in-Asia.htm>; Myung Hun Kang, The Korean Business Conglomerate: Chaebol Then and Now (1996); Kon Sik Kim, Chaebol and Corporate Governance in Korea (University of Washington Dissertation 1995).

122) No. 34 of Korea-IMF Memorandum.

the Korean government and the IMF agreed that: "transparency of corporate balance sheets (including profit and loss accounts) will be improved by enforcing accounting standards in line with generally accepted accounting practices, including independent external audits, full disclosure, and provision of consolidated statements for business conglomerates."[123] Subsequent collaboration of the Korean government and international lending agencies has resulted in various statutory amendments related to the corporate governance of Korean firms.

1. The KCC and KSEA

The KCC and KSEA both have gone through two substantial changes since 1998. The October 1998 amendments to the KCC included, *inter alia*, the concept of corporate directors' fiduciary duty of loyalty, *de facto* director, cumulative voting, and shareholder proposal right.[124] The 1998 amendments also introduced corporate division, short-form mergers, and small-scale mergers into the statute. The December 1999 amendments to the KCC included the audit committee[125] together with the concept of outside director, shareholders' resolution by written statements,[126] board meeting by audio-visual instruments,[127] and stock option.[128] The audit committee is not mandatory, and Korean companies may opt for the statutory auditor instead of the audit committee. If they introduce, however, the audit committee by charter provision, such committee must have at least three directors, of which the number of officer-directors may not exceed one-third.[129] The board of directors can resolve to discharge an audit committee member by a majority vote of two-thirds.[130]

The February/May 1998 amendments to the KSEA significantly lessened the shareholding requirements for exercising minority shareholder rights, including the filing of a derivative suit. The January 2000 amendments to the KSEA went further, in

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123) *Id.*

124) For details, *see* Kim, *Living with the IMF, supra* note 4, at 71-74.

125) *See* Art. 415-2 of the KCC.

126) *See* Art. 368-3 of the KCC.

127) *See* Art. 391 (2) of the KCC.

128) *See* Arts. 340-2, 340-3, 340-4, & 340-5 of the KCC.

129) Art. 415-2 (2) of the KCC.

130) Art. 415-2 (3) of the KCC.

favor of shareholders of large securities firms, by lessening such requirements to one half the requirements applicable to regular listed companies.[131] The January 2000 amendments also introduced the outside director system into the statute, which thus far has been required through the listing rules of the Korea Stock Exchange. The board of directors of listed Korean companies must have at least one outside director out of every four directors.[132] Certain large listed companies with total assets in excess of 2 trillion won shall have more outside directors than officer-directors.[133] The number of outside directors in such firms shall be at least three.[134] They must also establish the audit committee under the KCC.[135] The board of directors of large securities firms shall have more outside directors than officer-directors.[136] The number of outside directors in such securities firms must be at least three.[137] They also have to establish the audit committee, of which the number of outside directors shall exceed two-thirds.[138]

2. Corporate Governance of Financial Institutions

Banks and other financial institutions are also subject to the KCC and KSEA depending upon their size or whether or not their stocks are listed on the Korea Stock Exchange. However, because of the importance of this matter, special rules regulate their corporate governance. In such cases, the special rules preempt the rules in the KCC and KSEA.[139]

131) *See* Art. 64 of the KSEA. Shareholders of Securities Investment Companies can exercise their shareholder's rights under the relevant rules of the KSEA without regard to the listing of the stocks on the Korea Stock Exchange or KOSDAQ. In a shareholder derivative suit, the KSEA basically requires a 0.01 percent holding in the total number of issued and outstanding shares of the company. However, in the case of Securities Investment Companies, the requirement is waived, i.e., any shareholder holding one share can bring a derivative suit. *See* Art. 84 (3) of the Securities Investment Companies Act.

132) Art. 191-16 (1) of the KSEA.

133) Art. 84-23 (1) of the Enforcement Decree to the KSEA.

134) *Id.*

135) *See* Art. 191-17 of the KSEA and Art. 84-24 of the Enforcement Decree to the KSEA.

136) Art. 54-5 (1) of the KSEA.

137) *Id.*

138) *See* Art. 54-6 of the KSEA.

139) The Korean government has decided for functional approach to corporate governance of banks. The restrictions on the ownership of bank shares remain unchanged. For corporate governance and banks in Korea, *see* Kim, *Living with the IMF, supra* note 4, at 81-85.

The Korean Banking Act has experienced five substantial and one technical amendment since January of 1998. Most of the changes have been made for improvement of corporate governance of banking institutions. The focus of the latest amendments in January 2000 was on the outside director system again. The Korean Banking Act was the first major Korean statute introducing outside directors in Korea. Now, it mandates that the banks establish the audit committee provided under the new KCC, but with at least two-third outside directors.[140] The January 2000 amendments also lessened the shareholding requirements for minority shareholder to exercise their rights, including the right to file a derivative suit.[141]

To implement the IMF's 1999 Memorandum, various financial institution laws, including the Securities Investment Trust Business Law, have also been amended in terms of corporate governance. Securities investment trust companies managing funds in excess of 2 trillion won must appoint at least three outside directors with the board of directors consisting of more outside directors than officer-directors.[142] Such securities investment trust companies are required to establish the audit committee.[143] The requirement for the minority shareholders of securities investment trust companies to exercise their rights have significantly lessened.[144] The 1999 Memorandum required the KFSC to issue, by March 31, 2000, minimum guidelines regarding corporate governance for insurance companies, including appointment of outside directors, establishment of an audit committee, and establishment of risk management committees. The January 2000 amendments to the Korean Insurance Business Law require certain large insurance companies to establish the audit committee[145] and their board of directors to have more outside directors than officer-directors.[146] The adoption of the audit committee has been made mandatory for merchant banks.[147]

The rationale behind the mandatory adoption of the audit committee for banking institutions and certain large securities companies, securities investment trust

140) *See* Art. 23-2 of the Act.

141) *See* Art. 17 of the Act.

142) *See* Art. 14-4 of the Securities Investment Trust Business Law.

143) *See id.* Art. 14-5.

144) *See id.* Art. 14-3.

145) Art. 12-3 of the Law.

146) Art. 12-2 of the Law.

147) *See* Art. 5-2 of the Law on Merchant Banking Companies.

companies, insurance companies, merchant banks, and listed companies is to guarantee effective management control, which the conventional statutory auditor, although independent, was relatively weak in carrying out in practice. The audit committee is to perform more efficiently in the control function capacity because of its empowerment and familiarity with company affairs. According to the KFSC, the introduction of the audit committee is a natural consequence of adopting board system which consists of a majority of outside directors and, for that very reason, the change does not have any negative effects on corporate governance.[148]

C. Korean Firms' Access to the U.S. Capital Market

Korean firms' access to the U.S. capital market continues.[149] The magnitude of investments and the financial needs of some giant Korean firms such as Samsung Electronics go well beyond the capacity of the Korean securities market. On the other hand, the cost of local financing for Korean companies with high gearing has traditionally been higher than the cost of international financing. Some firms regard having access to the U.S. market as a matter of reputation and credibility. Ever since Samsung Electronics issued GDRs under Regulation S and Rule 144A in December of 1990, many Korean firms issued equity-related securities in the United States.[150] ADRs of such major Korean firms as Pohang Iron & Steel, Korea Electric Power, SK Telecom and Korea Telecom are listed on the NYSE.[151] Ever since two Korean companies were admitted for the first time to the Nasdaq in November of 1999, it has recently become a clear trend for Korean venture businesses to plan on floating stocks or ADRs with contemporaneous listing on Nasdaq.[152]

148) *See* KFSC's Press Release dated Jan. 29, 2000 <http://210.95.55.199>.

149) For foreign firms' access to the U.S. securities market, *see generally,* Roberta S. Karmel and Mary S. Head, *Barriers to Foreign Issuer Entry into U.S. Markets,* 24 Law & Pol'y Int'l Bus. 1207 (1993); William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective,* 17 Fordham Int'l L. J. 10 (1994); Frode Jensen, III, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From a Legal Perspective,* 17 Fordham Int'l L. J. 25 (1994); Richard C. Breeden, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation,* 17 Fordham Int'l L. J. 77 (1994).

150) *See* Kim, *Living with the IMF, supra* note 4, at 89-90.

151) *See* <http://www.nyse.com/international>.

152) *See* Maeil Kyongje, Nov. 19, 1999, at 1 & 15. For non-US companies listed on the NASDAQ, *see*

These developments have substantial influence over corporate governance of Korean firms. The U.S. compliance requirement of on-going disclosure to the U.S. securities markets and to investors requires Korean firms to be more conscientious of investors' interests. It is reported that Korean companies planning IPOs on Nasdaq have become very cautious about disclosing their business performances because of an awareness of the strict requirements under the U.S. Securities Act of 1933.[153] This is a new but positive development, especially in light of the questionable practice in Korea whereby some issuers and underwriters aggressively advertise and forecast on stock prices of IPOs even before the actual offering.[154]

These same companies are also conscientious of corporate governance-related requirements provided under the rules of relevant markets in the United States.[155] Recently, even a turnabout in compliance question has been witnessed. The time schedule for holding a general shareholders meeting once became a crucial issue in a controversy between a NYSE-listed Korean company and local investors. The Korean company relied upon the listing rules of the NYSE in defense of its schedule and successfully argued that the schedule for the general shareholders meeting must be established without violating any of the listing rules of the NYSE. As to such incidents, it is not uncommon for major U.S. law firms to get involved in local controversies related to corporate governance issues on behalf of Korean multinational firms.

In January of 2000, the Korean government disclosed plans to allow Korean firms listed on the KSE or KOSDAQ to list their stocks on foreign exchanges through the elimination of current regulations which prohibit local/foreign cross listing. As "the permission of cross listings will provide an opportunity to promote competition in the era of borderless global financial markets", the Korean government would "revise regulations governing disclosures and illegal stock trading to meet international standards and practices."[156]

<http://www.nasdaq.com/about/listing_information.stm>.

153) *See* Maeil Kyongje, Dec. 9, 1999, at 23.

154) *Id.*

155) For NYSE and Nasdaq listing requirements, *see* <http://www.nyse.com/listed/listed.html> and <http://www.nasdaq.com/listing.stm>, respectively.

156) *See* Korea Financial Supervisory Service Weekly Newsletter, Jan. 12, 2000, at 7.

VI. Convergence in Corporate Governance by International Law?

A. Corporate Governance and Industrial Policy in Korea

The core of traditional Korean government policy as it relates to corporate governance problems has been focused on the dispersion of ownership. The Korean government's continuous efforts at cultivating the securities market since the 1970s lies in the premise that securities market's development will contribute to the policy goal of achieving the dispersed ownership of public companies. The U.S. system, characterized by the separation of ownership and control, was the ideal model for Korean policy-makers and scholars. This basic policy remains unchanged after the 1997 crisis and the subsequent involvement of international lending agencies.

However, the Korean government's policy decision towards "separation of ownership and control" has not necessarily been based upon efficiency, but upon social and political considerations. Such policy was largely related to strong historical and cultural public sentiments against the concentration of power, both political and economic, in a few privileged individuals. Such sentiments have led to the so-called "Chaebol-taming" of recent years. In Korea, corporate governance issues and anti-trust questions were often addressed within the same context, sometimes causing confusion with the policy-making and implementation process.

In fact, the controlling shareholder-managers of some large Korean Chaebols have wielded unchallenged managerial authority while maintaining relatively small shareholding percentages in their respective companies. Abusive practices detrimental to minority investors were not uncommon. Some of them executed fatally-flawed business judgements through a confusion of personal interests or aspirations with sound and sensible business undertakings. However, the making of large conglomerates in itself is a form of adapting and assimilating business organizations into an inefficient market characterized by high transaction costs. The large conglomerates seem to have a unique function within any emerging market economy.[157] The issue of ownership concentration in Korean Chaebols is largely a

157) *See* Byeong-Ho Gong, [*Camdessus' "Reforming the Chaebols"*] (Korean), Han-guk Kyongje Shinmun, Dec. 4, 1997, at 11 (arguing that a group of companies results from the adaptation and evolutionary process in any business environment characterized by high transaction costs).

corporate governance issue. An examination into the issue does not necessarily lead to the conclusion that Chaebols are the ultimate source of all of Korea's problems, and should not prompt a policy decision to dissolve all Chaebols accordingly.[158]

The future of a Chaebol-centered economic structure in Korea must be determined by considerations of industrial organization. It remains to be seen whether the dispersion of ownership in Korean Chaebols will also result in the dispersion of their economic power over the Korean economy. The Kia Motors case[159] clearly exemplified that ownership dispersion in and of itself may not be the ultimate solution to corporate governance problems in Korea. In recent times, fortunately, the Korean government's efforts have focused more on promoting managerial transparency, accountability and protection of minority shareholders. The IMF-mandated reforms also take the same functional approach.

On the other hand, it is clear from the recent changes in the KCC, KSEA and other laws that corporate governance reform in Korea greatly emphasizes the outside director system.[160] However, some have raised concerns over the effectiveness and efficiency of the outside director system for various practical difficulties involving the newly enforced (experimental in a certain sense) institution. It has been reported that 87 percent of the listed Korean firms are opposed to an increase in the number of outside directors on their boards.[161] Some firms complain that outside directors' may

158) *See* Byeong-Ho Gong, [*The New Industrial Policy and Elitism*] (Korean), Maeil Kyongje, May 29, 1996, at 10 (pointing out the emotional prejudice of policy-makers against the actions of controlling shareholders of Chaebols).

159) Kia Motors was the most widely dispersed major public firm in Korea before the 1997 crisis. It is believed that the professional management's entrenchment in collaboration with the labor union in Kia Motors caused the firm's failure in 1997. Kia Motors was taken over by Hyundai Group, and graduated from court receivership within a record period of time in early of 2000. *See* Han-guk Kyongje Shinmun, Feb. 17, 2000, at 1.

160) For an attempt to provide empirical evidence for the proposition that a board with the majority of outside directors increases efficiency and value of the firm, *see* Ira M. Millstein & Paul W. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation,* 98 Colum. L. Rev. 1283 (1998). *See also* John W. Byrd & Kent A. Hickman, *Do Outside Directors Monitor Managers?: Evidence from Tender Offer Bids,* 32 J. Fin. Econ. 195, 201-05 (1992) (recognizing outside directors' role in improving managerial performance); Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with the Barbarians Inside the Gates,* 45 Stan. L. Rev. 857, 880-900 (1993) (expounding on some positive and practical cases); Laura Lin, *The Effectiveness of Outside Directors as a Corporate Governance Mechanism: Theories and Evidence,* 90 Nw. U. L. Rev. 898 (1996); Jill E. Fisch, *Corporate Governance: Taking Boards Seriously,* 19 Cardozo L. Rev. 265 (1997). *But see* Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance,* 54 Bus. Law. 921 (1999) (finding no evidence that greater board independence correlates with greater firm performance).

161) *See* Han-guk Kyongje Shinmun, Feb. 21, 2000, at 10.

have mistaken ideas about their roles by focusing on certain public interests or interests of specific shareholder groups, rather than focusing on the interests of the corporation and investors as a whole. Again, this shows that political considerations are still a very strong factor in the reform process as it relates to Korean corporate governance.

B. Implications of the Korean Case

The Korean case appears to lend credence to the convergence-from-competition hypothesis in regards to recent academic discussions on the issue of convergence in corporate governance. It may be anecdotal[162] from a global perspective, but is strongly indicative. To be sure, future developments in Korea may end up giving credence to the idea that inertial political forces remain strong in preserving the less efficient *status quo*. In fact, Korea would have very likely been kept in the traditional system if there were no extraordinary intervention of international lending agencies during the 1997 crisis. At least by now, however, what has happened in Korea since 1997 clearly supports the thesis that globalization of financial markets promote and facilitate the functional convergence of corporate governance institutions.[163] The events in Korea also suggest that the primary driving force behind such convergence will be the markets, and not the states themselves. The discipline of international financial markets may be realized via international soft law rules, and particularly through the prudential regulation of international financial institutions, exercised by international organizations. Such laws evolve from and rely upon market mechanism, not from and upon direct political decision of international community.[164]

As international organizations do not keep a ready-made set of corporate governance principles by certain standards, it is highly likely that such organizations

162) *See, e.g.,* Milhaupt, *supra* note 13, at 1187.

163) *But see* Bebchuk & Roe, *supra* note 13, at 152 ("Global capital markets cannot generally be relied on to press managers to move to the most efficient ownership structure.") and 161 ("Globalized capital and product markets impose costs on firms laboring under inefficient legal rules, but if a country is prepared to bear those costs, or if positionally powerful players inside the firm can make those costs be borne by outsiders, even outmoded and costly rules can persist.").

164) *But cf.* Heidi Mandanis Schooner & Michael Taylor, *Convergence and Competition: The Case of Bank Regulation in Britain and the United States,* 20 Mich. J. Int'l L. 595 (1999) (arguing that any convergence in the bank regulatory systems of the United States and United Kingdom will not primarily be the result of competitive forces, but be the by-product of negotiation).

will utilize the laws of the most powerful international investors as models for implementation of regulations. The Korean case may be a good test to see whether the path dependence in corporate governance may be mitigated by international law rules along with its attendant enforcement mechanisms. The Korean case also supports the thesis that regulation of financial institutions and markets, due to the internationalized status of the object of regulation, may be more efficient than corporate law as a mechanism for facilitating the convergence in corporate governance not only of financial institutions but also of general corporations. Because the banking and other financial sectors are more globally integrated and moving closer toward a single international regulatory framework, the latest developments may have significant implications for the role of international law. It in turn tends to provide support for the claim that "market integration may itself represent an important form and measure of convergence."[165]

On the other hand, it should be noted that the implementation of the BIS Rules and other international standards in Korea were greatly supported by, and even required by, Western investors and their governments bringing with them the basic legal concepts and principles prevailing in their home countries. Western investors and governments found a very practical "ready-made" tool in the form of international soft law rules which could be used to establish a friendly regulatory environment in Korea for any future, as well as past, investments. The Korean case shows that the national law principles developed by capital providing countries will lend to support to the predominant model that formulates the convergence in national institutions and regulations, particularly the convergence in corporate governance institutions and the regulation of financial institutions, which inevitably supports the convergence-from-competition hypothesis.

It can very well be argued that the practical response to the reform programs mandated by international soft laws in Korea has been a little different from one might expect. For instance, the legalization of the holding structures that may limit competition looks like a softening of the IMF-mandated program, not like its straightforward implementation. This is so especially because the legalization was made possible through continuous requests by the Korean managers. In other words, the response by Korean actors to the imposed reform programs was rather complex.

165) Coffee, *The Future as History, supra* note 5, at 676.

This may lead to the conclusion that not only the contents of the program but also other factors will determine the outcome of the process unleashed by the mandated program. However, it is not certain and may be too early to judge if the "other factors" directly reflect the preexisting conditions, i.e., the path dependency of the Korean institution. In any case, the evidence and indication of path-dependent developments are not substantial in the Korean case and will not change the overall picture of the convergence.

C. The State of Contemporary International Law

The globalization will inevitably bring about changes in the way of making international law rules and their effectiveness. It will expand the areas of national law and life subject to or influenced by the international law.[166] For instance, the national corporate laws and financial market laws have rarely been regarded as requiring direct concern of international law except in the cases of multinational enterprises. The growth of international organizations during the 2nd half of the 20th century was a fortunate trend in terms of the development of the international law-making mechanism necessary in the age of globalization. As the influence of decisions and activities of international organizations expands over the areas of national politics and economics, the national jurisdiction moves under gradual contraction in its scope and exclusiveness.[167]

The international law theory also experienced a substantial change as a consequence of international legal scholarship's efforts to respond to the challenges of globalization. It is now claimed that the classical 'Lotus principle' is giving way to "a more communitarian, more highly institutionalized international law, in which states

166) *See* Henry J. Steiner, Detlev. F. Vagts & Harold Hongju Koh, Transnational Legal Problems: Materials and Text 316-317 (4th ed. 1994).

167) *Cf.* Celia R. Taylor, *A Modest Proposal: Statehood and Sovereignty in a Global Age,* 18 U. Pa J. Int'l Econ. L. 745 (1997); Kanishka Jayasuriya, *Globalization, Law, and the Transformation of Sovereignty: The Emergence of Global Regulatory Governance,* 6 Indiana J. Global Leg. Stud. 425 (1999). For recent discussions on the international regulation of Internet, *see* the symposium articles in 11 Eur. J. Int'l L. (2000) and 5 Indiana J. Global Leg. Stud. (1998), including Jack Goldsmith, *Unilateral Regulation of the Internet: A Modest Defense,* 11 Eur. J. Int'l L. 135 (2000); Joel P. Trachtman, *Cyberspace, Sovereignty, Jurisdiction, and Modernism,* 5 Indiana J. Global Leg. Stud. 561 (1998).

'channel' the pursuit of most of their individual interests through multinational institutions."[168] On what basis is a state obligated to comply with international law, it is argued that the states' compliance with customary international law rules emerges from pursuit of their self-interests, and that most rules of customary international law reflect a purely coincidental convergence of interests.[169]

As is indicated by foregoing discussions on convergence in corporate governance and of financial market laws, the role of international law will be significantly increasing in the age of globalization. Even the areas of corporate governance and regulation of financial institutions are becoming subject to the international law rules, because they bear ultimately upon the economic growth and social development of the entire international community. The international organizations shall assume the great responsibility to channel each nation's pursuit of self-interests and serve the efficient and proper forum for convergence of legitimate interests of individual countries. Such institutional process will ultimately result in global convergence in corporate governance and other areas by international law.

The international law-making bodies must focus on the prospects of economic growth and social progress that can be achieved by improved corporate governance

168) *See* Bruno Simma & Andreas L. Paulus, '*The International Community': Facing the Challenge of Globalization,* 9 Eur. J. Int'l L. 266, 277 (1998). *Cf. also* Bruno Simma & Andreas L. Paulus, *The Responsibility of Individuals for Human Rights Abuses in International Conflicts: A Positivist View,* 93 Am. J. Int'l L. 302 (1999) (advocating a modified positivism).

169) *See* Jack L. Goldsmith & Eric A. Posner, *A Theory of Customary International Law,* 66 U. Chi. L. Rev. 1113 (1999). For the compliance problem, *see generally* Harold Hongju Koh, *Why Do Nations Obey International Law?,* 106 Yale L. J. 2599 (1997). Recently, interest in the theory of international law has remarkably been renewed both in North America and in Europe. The *status quo* of international legal scholarship is being questioned and challenged by various innovative and original approaches to international law. *See* Bruno Simma, *Editorial,* 3 Eur. J. Int'l L. 215 (1992) (introducing the contributions of international law theorists published in the issues of Eur. J. Int'l L.). For such contemporary approaches to international law, *see, e.g.,* Nathaniel Berman, *But the Alternative Is Despair: European Nationalism and the Modernist Renewal of International Law,* 106 Harv. L. Rev. 1792 (1993) (postmodernism); Nigel Purvis, *Critical Legal Studies in Public International Law,* 32 Harv. Int'l L. J. 81 (1991) (critical legal studies); Hilary Charlesworh, Christine Chinkin & Shelley Wright, *Feminist Approaches to International Law,* 85 Am. J. Int'l L. 613 (1991) (feminist view); Kenneth W. Abbott, *Modern International Relations Theory: A Prospectus for International Lawyers,* 14 Yale J. Int'l L. 335 (1989) (trying to bridge the gap between international law and international relations). *See also Symposium on Method in International Law,* 93 Am. J. Int'l L. 291 (1999). For a bibliography, *see* David Kennedy & Chris Tennant, *New Approaches to International Law: A Bibliography,* 35 Harv. Int'l L. J. 417 (1994).

through convergence.[170] In Korea, some raised concerns that the convergence of the standards of the Korean system with that of the U.S. system may unfairly serve the interests of foreign (U.S.) investors. However, it would also be unfair, and impossible, to induce and have access to U.S. capital without committing to the rules that the providers of capital require for protection of their legitimate interests. Rather, the Korean government should diligently contribute to the development of international law rules in relevant sectors through active participation in international organizations and other regulatory forums. Such organizations and forums may be under the dominant influence of industrialized countries, but still provide fair opportunities for emerging economies to present their views and positions in the making of international norms.[171]

Korea joined the mainstream international community within a short period of time due largely in part to the internationalization of its people's lives and its markets, which was mandated by the need for trade and finance, i.e. the need and desire to prosper. It is quite surprising to observe that Korea, a country that has experienced colonial rule, war and poverty, has come to stand at the center of globalization, subscribing to the rules of modern international law.[172] This is evidence that the normative power of the rules of international law will more and more depends on the global market acting as a mechanism. The convergence of national systems in an era of globalization will facilitate the making of a universal international law, as well as its effective enforcement.

170) *See* Coffee, *The Future as History, supra* note 5, at 705 - 706 (presenting the 'social hypothesis').

171) As works of the international organizations are developing the global standards, in the form of international soft law for the most parts, perspectives of emerging market countries on contemporary international law may also become relevant to understanding the whole process of global convergence in corporate governance and financial market laws. For discussions on the impact of globalization upon the development of international law, *see generally* Michael Reisman, *Designing and Managing the Future of the State,* 8 Eur. J. Int'l L. 409 (1997); Serge Sur, *The State Between Fragmentation and Globalization,* 8 Eur. J. Int'l L. 421 (1997); Philip Alston, *The Myopia of the Handmaidens: International Lawyers and Globalization,* 8 Eur. J. Int'l L. 435 (1997); Jost Delbrück, *The Role of the United Nations in Dealing with Global Problems,* 4 Indiana J. Global Leg. Stud. 277 (1997).

172) By way of historical coincidence, Korea's path to political, diplomatic, and economic development corresponds to the development of modern international law. Korea's past view on international law and relations was heavily tainted by its historical experience with the Japanese colonial regime that lasted until 1945. Korea's initial attitude toward international law was characterized by ambivalence and skepticism toward what Korea viewed as essentially a product of the West imported via the Japanese colonial regime. In the 1950s, however, Korea became the place to implement the collective security regime newly-established by the United Nations Charter. As a result, Korea stood at the center of a new era in international legal order, without full integration into the international community of co-operation. Since the beginning of the 1960s, Korean economic development forced it to subscribe to the collective voices of the Third World. Furthermore, its increased economic presence in the international market provided motivation for Korea's active participation in various international organizations. As a result, Korean diplomacy significantly increased in the level of activity. Still, Korean view on international law was one of ambivalence due largely to on-going disputes with Japan. However, universalism prevailed until the end of the 1980s was in full effect on Korea, and the Korean economy enjoyed great benefits from the development of the international community. Korea became a member of the United Nations in September of 1991, ratified the United Nations Convention on the Law of the Sea in January of 1996, and also joined the WTO in January of 1995 and the OECD in December of 1996. Finally, globalization, which was systematically promoted by the Korean government starting in the 1990s, had a profound impact on the Korean view of world order. During the initial stage of globalization, Korea's market became more integrated into the world market, and the robust activities of many Korean companies could be witnessed all over the world. Technological developments in Korea accelerated even more, and the everyday lives of Koreans became substantially subject to developments in the outside global market. The Asian foreign exchange crisis of 1997 was the turning point for Korean economy, society and law. As a result, it is now almost certain that the Korean view on international law will reflect the current developments of a globalizing world.

VII. Conclusion

The Korean case shows the legitimacy of the normative power of international soft laws in its ability to shape and fulfill the regulatory needs of the market. The Korean case also clearly shows how a particular group of international soft law rules can fundamentally change a nation's economic system. International soft laws can effectively regulate the behavior of states, especially when such laws are coupled with the use of institutionalized sanctions.[173] The Korean case also suggests that the more internationalized an economy, the more susceptible it is to international legal prescriptions. The operational and financing activities of the Korean financial institutions and general corporations had already been internationalized to a great extent well before the foreign exchange crisis of 1997. Even if the international investment community had not mandated international legal norms during the 1997 crisis, compliance with such norms would have been inevitable for the Korean government and Korean firms.

173) Verdross & Simma, *supra* note 1, at 421. The market, however, will impose stronger sanctions than international organizations or individual states. Therefore, the mechanism may be designated as the combined system of commonality and what the author would call "collective reciprocity." For the concept of reciprocity and its role in international law-making, *see* Bruno Simma, Das Reziprozitätselement im Zustandekommen völkerrechtlicher Verträge (1972); Bruno Simma, *Reciprocity,* 7 Encyclopedia of Public International Law 400 (1984).

Efficient and democratic governance will play a significant role for corporations throughout the world that stand at the center of the industrial mechanism which creates and distributes wealth and resources. The scale of their operation will increase as they increase in size for the purposes of engaging in large projects and investments within a globalized market. As they become more globalized, the comparative corporate governance shall find the optimal model for harmonized organizational principles. Peace and human rights in the 21st century cannot be accomplished without fair domestic and international distribution of material resources produced by the industrial activities of private corporations worldwide which are, in complement, being supported by efficient and sound financial institutions and markets. The international community has learned during the second half of the 20th century that illegal and illegitimate wealth transfers and inefficient wealth management resulting from poor corporate governance systems of some developing countries may cause functional distortions of financial institutions and markets. This can then lead to serious regional or worldwide financial crises and, as a consequence, jeopardize the balanced development of the world economy and as well as disrupt the worldwide economic and social order.[174)]

International law-making must produce the effect of making financial institutions and multinational corporations more susceptible to international law rules. For decades, territorial boundaries have long been meaningless as applied to financial markets and the activities of multinational corporations. The effective role of international soft laws, such as the BIS Rules and the OECD Principles, in effecting such financial and business activities suggests that international organizations and rule-making bodies will continue to focus on their importance well into the future.

174) A recent empirical study showed that "the weakness of legal institutions for corporate governance had an important effect on the extent of depreciations and stock market declines in the Asian crisis." *See* Simon Johnson, Peter Boone, Alasdair Breach & Eric Friedman, *Corporate Governance in the Asian Financial Crisis*, 58 J. Fin. Econ. 141, 142 (2000). *See also id*. at 184 ("In cross-country regressions, corporate governance variables explain more of the variation in exchange rates and stock market performance during the Asian crisis than do macroeconomic variables.")

Shareholder Activism in Korea: A Review of How PSPD Has Used Legal Measures to Strengthen Korean Corporate Governance

Jooyoung Kim and Joongi Kim***

Abstract

Shareholder activism has recently begun to play a significant role in reshaping the corporate governance of Korean companies. The People's Solidarity for Participatory Democracy (PSPD), a public interest group, has been at the forefront of leading shareholder activism in Korea. It is believed that PSPD's initiatives will have a lasting influence on the Korean legal system governing corporate governance because for the first time, various minority shareholders' rights that had remained dormant for most of Korea's modern history have finally been utilized. This Article examines how those involved in shareholder activism in Korea have been able to use legal measures to improve corporate governance. It will primarily draw upon the experience of PSPD's activities in recent years. This article will also examine the shortcomings that currently exist under the current legal system and will offer some possible regulatory and policy solutions.

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