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.
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. 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.

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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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. DaMott, Current Issues in Tender Offer Regulation: Lessons from the British, 58 N.Y.U. Int’l 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 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


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 “[t]he 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.”

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 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”. 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.

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 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. The European Union’s financial market integration and company law harmonization 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.

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. Other scholars, on the contrary, argue that the path dependency will constrain the competitive forces pushing towards convergence in corporate governance. Further, those espousing the intermediate view claim that “shareholder dispersion depends on the ability of the legal system to protect minority rights”.

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”).


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).


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).


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,” and that functional convergence can be facilitated by liquid international securities markets that develop an alternative monitoring force.

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.19) 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.20) 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.21) 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 international array, the prudential regulation of such activities and other financial services is also converging.22) 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.”23) 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.”24) The European Union’s successful program for the integration of financial markets is a clear evidence of this view.25)

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 governments.

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

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.”)

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”).
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. 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. 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.iocso.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 process.”). 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]fIOSCO, 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. Fonto, 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.”)


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 in July of 1988, have widely endorsed and implemented the BIS Rules through national regulations. The Rules


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, It , ’Brute 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.26 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 countries30 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 international risks. It also would contribute to the development of a co-operative relationship between the supervisory authorities of Korea and other countries. Third, the 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
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 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

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the IMF and World Bank regularly use when extending loans. 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. 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”) 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

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.

The Korea-IMF Memorandum provided that “[a] timetable will be set for all banks to meet or exceed Basle standards.” 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. 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. 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.

45) See Herdegen, supra note 1, at 229.
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. 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. 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, 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. Korean commercial bank’s average equity capital position increased to 8.23 percent by the end of 1998, and again to 9.84 percent by the end of June 1999. The Korean government has concluded that such increase is a clear sign of economic recovery and improvement of the financial system.

In February of 1999, the BIS Rules were finally adopted as a statutory concept in Korea. The Korean Banking Act and Law on Merchant Banking Companies 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 which was promulgated by the Basle Committee on Banking Supervision in January of 1996.

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. 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

A. Addressing the Problem of Troubled Financial Institutions

The Korea-IMF Memorandum required the Korean government to establish “a
comprehensive strategy to restructure and recapitalize the financial sector.”

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.”

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.” 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. 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. 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. Cho Hung Bank, Chung Buk Bank and Kangwon Bank completed a two-tiered merger in September of 1999.

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64) See No. 8 of the Korea-IMF Memorandum.
65) See id. at 15.
66) See id. No. 25.
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.
71) 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.
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 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-

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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. Furthermore, the KSE was newly-enacted to introduce and apply capital adequacy rules to securities operations.

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 Korean 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

80) See generally Scott & Wellons, supra note 22, at 291–323. After the 1992 failure of the International business growth and adequate managerial information. 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. 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. The number of registered firms increased from 331 to 569 during 1999.

The Korean government’s efforts concentrate on improving the infrastructure and investor protection in KOSDAQ. 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. 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)

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. 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.90

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. 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.91

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.kosa.or.kr/Portfolio/korea/stock/stocksub3_1.htm>.87 See Art. 6 of the KOSDAQ Rules.

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

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.92 Mutual funds93 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, 1998.94 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.95 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”).

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, were registered at the KFSC, with a total volume of 4,562 billion won. As of September 2000, a total of 138 Securities Investment Companies were registered with the KFSC.

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 Act.

redemption of 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. These 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, Atrirang Restructuring Fund and Moongoebwa 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, Samsung Kemper Investments, State Street Bank & Trust and Templeton Asset Management, respectively. See Chosun Ilbo, Jan. 10, 2000, at 11 (performance record). 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.ktica.or.kr/total/ 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).

corporate control. 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. For this reason, Securities Investment Companies will assume a role as one of the most important institutional investors in Korea.

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. 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.


104) For Korean banks’ alliances with foreign giant banks, see Naed Kyoung, 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. 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. 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 Shinsegic Telecom from Pohang Iron and Steel (POSUM) 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 IMP, supra note 4, at 76–81. For mergers and acquisitions in Korea, see generally Kim, [M&A and Corporate Control J], 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. As of September 2000, a total of 8 Holding Companies were reported to the Korea Fair Trade Commission.

(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 higher price after normalization. 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.

V. Institutional Changes and Corporate Governance

A. OECD Principles at Work

OECD has finalized and adopted the Principles of Corporate Governance 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...
sector. As the Principles itself expressly put it, the Principles are non-binding and intended to serve as a reference point.\textsuperscript{(102)}

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.\textsuperscript{(103)} In Korea, the Principles were referred to in the Congressional Legislative Review Report of the January 2000 amendments to the KSEA.\textsuperscript{(104)} 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.\textsuperscript{(105)} 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.\textsuperscript{(106)}

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 an 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.\textsuperscript{(107)}

\begin{itemize}
\item \textsuperscript{(102)} 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.”
\item \textsuperscript{(106)} See Joong-Ang Ilbo, Jan. 26, 2000, at 30.
\item \textsuperscript{(107)} 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-wh-mou.htm> Parallell 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: \textit{The New Palgrave Dictionary of Economics and the Law} 339 (1998).<http://www.law.columbia.edu/law-economic-studies/papers/workp125.pdf>

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...
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. 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. 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.

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. 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.” Toward that end, 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."

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. 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 together with the concept of outside director, shareholders’ resolution by written statements, board meeting by audio-visual instruments, and stock option. 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. The board of directors can resolve to discharge an audit committee member by a majority vote of two-thirds.

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

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); Kun Sik Kim, Chaebol and Corporate Governance in Korea (University of Washington Dissertation 1995).
122) No. 34 of Korea-IMF Memorandum.
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 preemp 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 - 36 (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.
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)

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

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 turnaround 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)

153) For NYSE and Nasdaq listing requirements, see <http://www.nyse.com/listed/listed.html> and <http://www.nasdaq.com/listing.stm>, respectively.
154) Id.
155) Id.
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 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 case159) 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

157) See Byoung-Ho Gong, “Candecous “ 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).

158) See Byoung-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.


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\(^{165}\) 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 \textit{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.\(^166\) 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.\(^167\)

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.

\(^{163}\) Butt aff Belchik & 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 outdated and costly rules can persist.”).


\(^{165}\) Coffee, \textit{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. 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.

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


‘channel’ the pursuit of most of their individual interests through multinational institutions.” 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.

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

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.172) 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.

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.

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

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 Coffie, The Future at History, supra note 5, at 705-706 (presenting the ‘social hypothesis’).

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 Bruch & Eric Fredman, 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.”)