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THE CURRENT STATE OF EQUITY INVESTMENTS BY FOREIGN FUNDS [IN SOUTH KOREA] AND RELATED LEGAL ISSUES

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I. INTRODUCTION

On September 15, 2004, the South Korean press gave extensive news coverage to a series of private individual "Question & Answer" session meetings which the Capital Group Companies Fund ("Capital Group") held with many of the top chief executive officers ("CEOs") of major Korean corporations.[1] Known worldwide as a top U.S. private equity management company, the Capital Group is currently the largest institutional investor in South Korea. As a major shareholder of large corporations such as Samsung Electronics, the Shin Han Financial Group, SK Group, and Hyundai Motors, the U.S. investment firm invited their CEOs to address questions and seek answers concerning the corporations' overall performance and business trends. The fact that the CEOs readily accepted the Capital Group's invitation reveals just how great of an influence foreign investment funds exert on corporate management and governance of major corporations in South Korea.

News of Sovereign Asset Management ("Sovereign")'s clash with SK Corporation ("SK") in early 2004 has also been well publicized, highlighting foreign funds' willingness to participate in company management in South Korea. After having acquired 14.99% of SK Corp. shares, the European private equity fund took a hostile turn against SK Corp.'s management and controlling shareholders. At SK Corp.'s annual shareholders meeting held in March 2004, Sovereign submitted a shareholder proposal seeking to elect

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[1] *See, e.g.*, *The U.S.'s Mighty Capital Group Visits . . . Initial Interviews with Korean CEOs*, MAEIL ECONOMY NEWS, Sep. 15, 2004, at A24.

new candidates for the board of directors and to amend the company's articles of incorporation, culminating in a bitter proxy contest between Sovereign and SK Corp.[2]

Moreover, in recent years, large foreign funds investing in South Korea have either acquired or attempted to acquire management control rights of some of the country's largest companies and financial institutions. Notable examples include Newbridge Capital, the Carlyle Group, and Lone Star, which purchased controlling stakes in Korea First Bank, KorAm Bank,[3] and Korea Exchange Bank, respectively.

As a result of this wave of foreign acquisitions, there has been much public discussion about whether domestic private equity funds should be encouraged to compete more effectively with foreign funds operating on Korean soil. In response, the South Korean government recently amended the Act on Business of Operating Indirect Investment and Assets ("Indirect Asset Management Act" or "IAMA").[4] The amended IAMA went into effect on December 6, 2004, and is poised to establish a new framework for the establishment and promotion of domestic private equity funds[5] in South Korea.[6]

It should come as no surprise that foreign funds have been able to establish a successful presence in the Korean market, wielding considerable influence over South Korea's domestic industries and securities market. The very existence of foreign funds and their overall activities in South Korea has become a major social and economic concern. In particular, public attention has been increasingly focused on so-called foreign private equity funds and hedge funds.

This Article explores the current state of investments by foreign funds in South Korea and examines related legal issues. Part I briefly summarizes

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[2] *Translator's Note*: In July 2005, Sovereign Asset Management ("Sovereign") sold its remaining shares in SK Corp., reaping a staggering profit of U.S. $900 million.

[3] KorAm [Hanmi] Bank was later sold by the Carlyle Group to Citigroup Inc. in February 2004.

[4] *Translator's Note*: The Act on Business of Operating Indirect Investment and Assets ("Indirect Asset Management Act" or "IAMA"), formerly referred to as the Indirect Investment Asset Management Business Act, was originally enacted on January 4, 2004. The IAMA is an integration of two major laws previously known as the Securities Investment Trust Business Act and the Securities Investment Company Act.

[5] In South Korea, the phrase "private equity fund" has been translated in various ways to refer alternatively to private securities funds, private securities investment funds, and private company acquisition funds. The IAMA has also recently introduced a legal investment vehicle known as a "specialized private equity investment company" ("SPEIC") which is virtually synonymous with "private equity fund." This Article uses the term "private equity fund" to refer to such entities for purposes of clarity and consistency. *Translator's Note*: A more detailed discussion of private equity funds is given *infra* Part II.

[6] The latest amendment to the IAMA was promulgated on October 5, 2004, through the passage of Act No. 7221, and became effective December 6, 2004.

the basic concepts and types of investment funds. Part II examines the current status of securities investments made by foreign funds in South Korea. Part III examines several key legal issues in connection with such investments.

With respect to foreign investments in general, there are other major issues which this Article does not cover. For example, discussions relating to domestic sales of beneficiary certificates of foreign funds (especially mutual funds) and domestic registration of foreign asset management companies are excluded. Furthermore, while certain foreign funds (e.g., Lone Star Korea and Lend Lease Global Properties) continue to play an important role as major investors in the South Korean real estate and insolvent credit bond markets, this Article limits its discussion to securities investments made by foreign funds.

II. THE CONCEPT OF A FUND AND CLASSIFICATION OF FOREIGN FUNDS

A. The Fund Concept and Its Classification

The general meaning of the term "fund" is "a pool of capital established for purposes of achieving particular objectives or conducting particular activities." The term is used in this Article to mean an "investment fund" in line with its traditional economic definition. In other words, a fund can be defined as a pool of assets generated by multiple investors with shared interests. It is a shared investment vehicle and, as if it were a living being, it is recognized as having the ability to bring together investments on behalf of its investors.[7] In theory, a fund is virtually synonymous with the so-called "collective investment scheme," an indirect collective investment arrangement which pools capital investments from numerous investors. A specialized professional oversees and manages the pooled investments and distributes income profits to the investors. In South Korea, both the fund concept and the IAMA's definition of an indirect investment scheme share almost the same meaning.

Funds are generally classified as either agreement-type investment trusts or entity-type investment companies based on their legal structure. They can be further categorized as: (1) either open-end investments or closed-end investments depending on investment pooling methods and limitations; (2) either unit-type investments or open-type investments based on the fluctuating or fixed nature of the principal investment; (3) bond-type, stock-type, or mixed-type funds depending on the tax treatment of investors;

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[7] Sam Chul Park, Commentary on Investment Vehicles 40 (Sam Woo Sa 2001).

and (4) either public funds or private funds based on methods used in attracting investors to the fund.[8]

Article 27 of the IAMA classifies indirect investment vehicles (i.e., funds) based on the type of capital investment. They can fall under any of the following: (1) securities indirect investment funds; (2) derivative indirect investment funds; (3) real estate indirect investment funds; (4) actual indirect investment funds; (5) short-term financial indirect investment funds; (6) re-indirect investment funds; or (7) special assets indirect investment funds. Because of the special nature of direct investment vehicles, Chapter 5 of the IAMA also provides for: (1) exchange traded indirect investment funds; (2) class-type indirect investment funds; (3) transfer-type indirect investment funds; (4) mother-child-type indirect investment funds; (5) securities investment companies for purposes of corporate restructuring; and (6) securities investment companies for purposes of company acquisition/takeover.

B. General Classification of Foreign Funds

Rather than relying on legal classifications, foreign funds investing in Korean companies can generally be divided into three main categories: private equity funds, hedge funds, and mutual funds.[9] In this Section, this Article briefly examines the concept behind each of the three fund categories.[10]

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[8] Private equity funds are distinguishable from public offerings, which must comply with various strict regulations set forth in the Korean Securities and Exchange Act. Public offerings raise funds from numerous unspecified investors in the form of sale of securities of listed companies to the general public. By contrast, private equity funds acquire funds from qualified institutional investors or a small number of unspecified accredited investors. Such investors are generally sophisticated, financially savvy individuals or entities that have a special association with, or intimate knowledge of, the securities offered by private equity funds. Whereas the need to protect investors is obvious in public offerings of securities, it is much less evident in the case of private equity funds. In fact, government regulation in the private equity fund industry is very low or virtually nonexistent.

[9] One representative type of fund frequently discussed is a public pension fund in which government entities operate as investors. Examples include the Hermes Group pension funds of the United Kingdom and the California Public Employees' Retirement System (CalPERS). Another representative type is the so-called corporate governance improvement fund. The main purpose of such funds is to improve or reform the corporate governance standards of the companies in which they invest in order to increase the overall valuation of these companies. Notable examples of corporate governance improvement funds include the Oppenheimer Funds and CalPERS (as well as Sovereign, which claims to be an institutional fund aimed at improving corporate governance).

[10] The discussion in Part II has been prepared in reliance of the foregoing materials. *See generally* Hyung Tae Kim, *Promoting and Improving the Infrastructure Private Equity Funds: The Importance of Buyout Funds* (Korean Securities Research Center 2004) (unpublished seminar materials); Hee Jin Noh, *Regulation and Characteristics of Hedge Funds* (Korean Securities Research Center 1998); The Korean Association of Investment Vehicles, *Hedge Funds* (2002); Erik J. Greupner, Comment, *Hedge Funds are Headed Down-Market: A Call for Increased Regulation?*, 40 SAN DIEGO L. REV. 1555 (2003); Michael

1. Private Equity Funds

"Private equity fund" is not a legal term. It generally refers to a pool of private investments raised by investment experts from a relatively small number of investors (*e.g.*, institutional investors or investment-savvy individuals).[11] Such investments are considered mid- or long-term investments in the form of equity securities that are not generally tradable in the public marketplace. A private equity fund typically takes the form of a limited partnership in which a fund manager makes a substantial investment and becomes a general partner with unlimited liability. On the other hand, investors in the fund become limited partners with limited liability.[12] In the United States, private equity funds are not subject to regulation under the Investment Company Act of 1940. Furthermore, virtually no U.S. law exists to protect investors participating in such funds. Many foreign funds that have recently become well known in South Korea for their active investments on Korean soil—such as the Carlyle Group, Lend Lease, and Newbridge Capital —are private equity funds.

Private equity funds are similar to hedge funds (as discussed below) in that no legal regulations exist with respect to investor protection. Significant differences exist, however, between the two in terms of their investment objectives, methods and strategies, investment period, and types of investors. For example, private equity funds invest mainly in securities or other related equities of privately-held corporations (or in the case of public companies, liquid securities with voting management rights), while hedge funds invest in various financial market instruments including bonds, financial derivatives, or currencies in addition to corporate securities. Furthermore, private equity funds in most cases participate in the management affairs of their invested companies, whereas hedge funds do not. In addition, private equity funds aim to reap mid- or long-term investment profits, while hedge funds focus on short-term profits.

Klausner, *Institutional Shareholders, Private Equity, and Antitakeover Protection at the IPO Stage*, 152 UNIV. PENN. L. REV. 755 (2003); Joseph W. Barlett & Eric Swan, *Private Equity Funds: What Counts and What Doesn't*, 26 J. CORP. L. 393 (2001); DANIEL A. STRACHMAN, HEDGE FUNDS (2002); Dion Friedland, Magnum Funds, The Hedge Fund Ass'n, *About Hedge Funds*, 2001, http://www.thehfa.org//aboutus.cfm.

[11] The Investment Company Act of 1940 of the United States classifies investment funds into two basic categories: (1) private funds, which gather investors by private and confidential means, place no restrictions on investor eligibility criteria, and involve fewer than 100 investors; and (2) qualified purchaser funds, which gather investors by private and confidential means, but place limitations on investors by classifying them as either private investors, who invest more than U.S. $5 million, or general corporations, which invest more than U.S. $25 million.

[12] While it is legally possible to organize an investment vehicle in the form of a limited liability companies ("LLC"), most vehicles are structured in the form of a limited partnership ("LP") due to tax concerns and investor liability issues.

Private equity funds in South Korea have frequently been associated with buyout funds. Buyout funds usually seek to acquire management rights of companies with undervalued assets to increase overall valuation of such companies through corporate restructuring. When higher valuation is achieved, the funds sell their securities to other strategic investors to recoup their investment and reap profits. Buyout funds, however, are just one representative type of private equity funds. Other types of private equity funds exist as well. For example, venture capital funds are funds which primarily invest in early-stage or startup companies. Mezzanine funds invest mainly in convertible bonds and bonds with stock warrants. In 2003 alone, approximately U.S. $1.9 billion was invested in the Asian region through various forms of private equity funds.

2. Hedge Funds

Hedge funds are funds in which investment experts raise private equity assets from a small number of investors. They employ various speculative and leveraged techniques and use financial derivative instruments to maximize short-term profits in accordance with certain overall investment strategies. These funds are usually created in tax-haven jurisdictions. The Quantum Fund run by George Soros is one example of a hedge fund. Similar to private equity funds, these funds are exempt from regulation under the U.S. Investment Company Act of 1940.[13]

The advantages associated with hedge fund investments include absolute profits and efficient portfolio composition. The disadvantages, on the other hand, are low levels of transparency, high risk (i.e., speculation), high fees, and limited liquidity. Similar to private equity funds, hedge funds invest in shares of non-listed corporations. As of 2004, there were approximately 8,350 hedge funds operating worldwide, with a global gross working capital totaling U.S. $875 billion.

In the United States, both investment banks and traditional banks have recently substantially increased their investments in hedge funds. *The Asian Wall Street Journal* reported in October 2004 that Lehman Brothers was negotiating the acquisition of GLG Partners, a large U.K. hedge fund, and that JP Chase & Co. had acquired more than half the shares of Highbridge Capital Management, a New York hedge fund with U.S. $7 billion in assets. In addition, according to a recent report by Citicorp, the total amount of investment assets held by hedge funds amounted to U.S. $500 billion in

[13] Recent discussion in the U.S. has centered on the issue of desirability of federal regulation of hedge funds by the U.S. Securities and Exchange Commission. *See generally* Greupner, *supra* note 10.

2000, with 20% owned by institutional investors such as pension funds. It is expected that hedge fund assets will rise to several trillion dollars by 2010, with 80% of assets held by institutional investors.[14]

3. Mutual Funds

Mutual funds are associated with the concept of open-end/public-offering indirect investment companies under the IAMA.[15] They are distinguishable from private equity funds or hedge funds in that mutual funds raise funds publicly from investors. Mutual funds usually invest in securities or bonds with high liquidity, such as shares of publicly-held corporations. To protect the public investor, mutual funds in the United States are subject to stringent regulations including federal securities laws and the Investment Company Act of 1940. For instance, all mutual funds must register with the U.S. Securities and Exchange Commission. Complete disclosure to the public must also be made with respect to their operation, fees, costs, and benefits. In the United States, where the mutual fund industry is most developed, there were 8,126 mutual funds in operation in 2003, with a total net asset value of U.S. $741.5 billion.

4. Comparison by Type of Fund

The three types of funds are compared and summarized in Table I.

Table I
Comparison by Fund Type

	PRIVATE EQUITY FUND	HEDGE FUND	MUTUAL FUND
ENROLLMENT OF INVESTORS	Private	Private	Public
PROTECTION OF INVESTORS	Relaxed	Relaxed	Stringent
CONTRIBUTION BY FUND MANAGER	Permitted	Permitted	Not Permitted
INVESTMENT TYPE	Equity Securities	Various Instruments	Various Instruments
INVESTMENT TIMEFRAME	Mid- or Long-Term	Short-Term	Mid- or Long-Term
REGULATION	Absence of Regulation	Absence of Regulation	Regulation
INFORMATION DISCLOSURE TO THE PUBLIC	No Disclosure	No Disclosure	Disclosure
FUND MANAGER TYPE	Any Person	Expert/Professional	Expert/Professional
FUND MANAGER COMPENSATION	Incentives	Incentives	Management Fees

[14] ASIAN WALL STREET JOURNAL, [No title given by author], Oct. 1, 2004, at M6.

[15] In comparison to investment trusts and companies operating on South Korea soil, far more numerous, complex contract-type and company-type fund structures are used in the United Kingdom and the United States, respectively.

III. CURRENT STATE OF INVESTMENTS BY FOREIGN FUNDS [IN SOUTH KOREA]

According to the Korea Stock Exchange, the total value of listed securities investments made by foreigners is approximately U.S. $147 trillion as of August 6, 2004. This amount represents 43.6% of the total aggregate market capital of the Korean securities market.[16]

According to Table II,[17] the amount of investment made by investment companies represents approximately 44.0% of the total amount of foreign securities investments. It is safe to say that investment companies fall into the category of funds. Because pension funds qualify as funds, and securities holdings by securities houses are likely held in the form of funds, one can then conclude that about 50 to 55% of total foreign investments are made by means of investing through funds.

Table II
Securities Investments by Non-Koreans in South Korea

INVESTMENTS MADE BY	1997	1998	1999	2000	2001	2002	2003	REPRESENTATION BY PERCENTAGE
INDIVIDUALS	1,995	3,151	3,869	4,535	4,794	5,024	5,243	34.2%
INSTITUTIONS	4,519	5,329	6,085	7,213	8,066	9,104	10,092	65.8%
—INVESTMENT FUNDS	3,198	3,763	4,239	4,966	5,503	6,190	6,751	44.0%
—PENSION FUNDS	476	522	598	686	766	874	991	6.5%
—SECURITIES FIRMS	250	285	310	336	369	388	421	2.7%
—BANKS	243	282	322	357	361	387	412	2.7%
—INSURANCE COMPANIES	144	159	180	207	228	250	268	1.7%
—OTHERS	208	318	436	661	839	1,015	1,249	8.1%

Based on data gathered from the Korea Securities Exchange, Table III shows the number of investments in listed Korean companies (two or greater) made by each non-Korean entity holding more than five percent of

[16] The Korea Securities Exchange, *Foreign Ownership Figures and Trends in the Aftermath of KOSPI Peak*, Aug. 10, 2004, *available at* http://www.krx.co.kr/webeng/index.jsp.

[17] *See* The Korea Securities Exchange, *Share Ownership (of Five Percent or Greater) by Foreigners*, Apr. 27, 2004, *available at* http://www.krx.co.kr/webeng/index.jsp.

shares, as of April 24, 2004.[18] The author's independent review of substantial shareholding (change) reports reveals that the share ownership figures have been reported in most cases by either an asset management firm or investment trust consulting firm that manages funds. It seems therefore that funds are the actual share owners. In particular, it appears that most of them are firms managing public mutual funds. Table III, however, only shows information analyzed based on number of investments made by foreign funds. Although private equity funds make fewer investments relative to other types of funds, their share investments in companies are often large enough to give them management rights. It is therefore difficult to simply conclude that private equity funds' investments in South Korea constitute only a small portion of total foreign fund investments as a whole.

Table III
Number of Investments by Foreign Funds in South Korea
(as of April 24, 2004)

NAME OF FOREIGN FUND	NUMBER OF INVESTMENTS MADE
Capital Research Management Companies	15
Capital Group II	13
JF Asset Management Limited	12
Templeton Asset Management	11
Morgan Stanley DW Inc.	9
Deutsche Bank Aktiengesellschaft	8
Arnold & S Blake Advisors LLC	5
Fidelity Fund	5
Neuberger & B LLC	5
The Korea Fund	5
ARIS AIG	4
Hermes Pension Mgt. Ltd.	4
SIMIL	4
Mitsubishi Corp.	3
The Bow Post Group, LLC	2
Deutsche Bank London	2
Sumitomo Corp.	2
Wellington Management Company LLP	2
Deutsche Investment Management Americas, Inc.	2
Genesis Asset Managers	2
Goldman Sachs International	2
IFC	2
Joho Fund Ltd.	2
OCM Emerging Markets FL	2
Platinum Asset Management Trusts	2
TOTAL NUMBER OF INVESTMENTS BY FOREIGN FUNDS	**125**

[18] Data was obtained from both the Korea Securities Exchange and the Korean Securities Dealers Automated Quotation System ("KOSDAQ").

Table IV shows a specific breakdown of share ownership in listed Korean companies by each of several foreign investors (i.e., an investment management company or a trust investment consulting firm that manages funds) holding more than five percent of shares.

Statistical information shows that from 2001 onward, many foreign funds (such as Capital Group International, Inc., Capital Research and Management Company,[19] JF Asset Management Limited,[20] Templeton Asset Management Limited,[21] and Morgan Stanley DW Inc.[22]) have steadily increased their investments in many Korean companies. As of June 24, 2004,[23] CGII holds a total average of U.S. $2.427 billion in 13 investments while CRMC holds U.S. $2.286 billion in 17 investments. Both CGII and CRMC are the two largest foreign fund investors in South Korea in terms of investment amount. Ranked third is Momenta (Cayman) Ltd.,[24] an indirect investment company located in the Cayman Islands that holds 5,117,550 shares of SK Telecom, valued at U.S. $972 million. It is also the largest single investment made in terms of investment amount.

[19] The Capital Group Companies, Inc. is an investment consulting firm with 100% ownership of Capital Group International, Inc. (CGII) and Capital Research and Management Company (CRMC). Neither CGII nor CRMC own securities of their invested companies, but rather manage their investments on behalf of mutual funds that actually invest in such companies.

[20] J.P. Morgan Fleming Asset Management (Asia) Inc. is an investment management company which fully owns JF Asset Management Limited. The latter also manages investment funds administered by JPMorgan Chase.

[21] This firm manages mutual funds administered by Franklin Templeton Investments.

[22] Morgan Stanley DW Inc., an affiliate company of Morgan Stanley Dean Witter, manages various mutual funds and trusts.

[23] The Korea Securities Exchange, *Reporting of Five Percent or Greater Share Ownership by Foreigners*, Jun. 24, 2004, *available at* http://www.krx.co.kr/webeng/index.jsp.

[24] According to the substantial share ownership report filed by Momenta (Cayman) with the Korean Securities and Exchange Commission, the investment firm holds American Depository Receipts ("ADRs") of SK Telecom Co., Ltd. ("SK Telecom") for purposes of purchasing bonds that have been issued as part of SK Telecom's exchangeable bonds issuance program. SK Telecom's shares are purchased as original shares, and the exchangeable bonds are issued based on the purchase of original shares. In this regard, they should be distinguished from ordinary investment funds.

Table IV
Securities Investments (5% or Greater) by Foreign Funds in Korean Companies (as of April 24, 2004)

NAME OF FOREIGN FUND	NAME OF INVESTED COMPANY	NUMBER OF SHARES OWNED	TOTAL NUMBER OF OUTSTANDING SHARES	OWNERSHIP PERCENTAGE
CAPITAL RESEARCH AND MANAGEMENT COMPANIES (CRMC)	Keum Kang Koryo Chemicals	555,500	10,520,000	5.28%
	Dae-Gu Bank	6,636,650	132,125,000	5.02%
	Dae-lim Commercial, Inc.	3,327,740	35,800,000	9.30%
	Pusan Bank	15,147,500	146,683,650	10.33%
	Bing G-rae	541,380	9,951,241	5.44%
	Samsung Electronic Co.	6,066,870	74,693,696	8.12%
	Shinhan Financial Investment Co.	26,487,620	294,401,300	9.00%
	KET	14,372,430	284,849,400	5.05%
	Korea Electric	407,040	8,073,375	5.04%
	Han-il Cement	611,030	6,883,087	8.88%
	Hyundai Commercial Development	5,449,960	75,384,180	7.23%
	Hyosung	2,495,000	32,818,752	7.60%
	KEC	583,710	8,054,797	7.25%
	LG Construction Co.	3,676,400	51,000,000	7.21%
	LG Fire Insurance Co.	3,218,610	60,000,000	5.36%
	Total: 15	**89,577,440**		
CAPITAL GROUP INTERNATIONAL, INC. (CGII)	Kookmin Bank	20,154,700	336,379,116	5.99%
	Samsung Fire Insurance Co.	4,685,758	48,874,837	9.59%
	Shinhan Financial Co.	24,370,204	294,401,300	8.28%
	Cheil	391,670	4,601,649	8.51%
	Pulmu Wom	316,470	5,159,568	6.13%
	Korea Gas Construction	3,955,520	77,284,510	5.12%
	Korea Tire	9,338,240	150,189,929	6.22%
	Hyundai Commercial Development	8,325,868	75,384,180	11.04%
	Hyundai Motors Co.	12,282,139	219,518,502	5.60%
	Hyundai Fire Insurance Co.	681,210	8,940,000	7.62%
	INI Steel	6,009,170	98,897,919	6.08%
	LG Construction	4,417,670	51,000,000	8.66%
	LG Cable	1,640,040	32,200,000	5.09%
	Total: 13	**96,568,659**		

[Table IV continues on next page]

Table IV (continued)

JF ASSET MANAGEMENT LIMITED	Gwang Ju Shin Segae Dept. Store	80,370	1,600,000	5.02%
	Keum Kang Koryo Chemicals	638,652	10,520,000	6.07%
	Dae Shin Securities	3,643,500	48,586,400	7.50%
	Samsung Tech One	5,168,800	77,000,000	6.71%
	Sam Yang Gennex	190,950	2,985,917	6.40%
	Sam Hwa Crown	226,070	3,736,455	6.05%
	Sung Shin Co.	1,564,990	19,142,775	8.18%
	Shin Do Ri Co.	507,690	10,080,029	5.04%
	NC Soft	1,149,597	18,908,454	6.08%
	Korea Export Packaging Co.	260,040	4,000,000	6.50%
	LC Cable	1,777,990	32,200,000	5.52%
	STX	1,628,779	21,239,063	7.67%
	Total: 12	**16,837,428**		
TEMPLETON ASSET MANAGEMENT	Dong-Ah Chemicals	813,410	9,514,000	8.55%
	Samsung Micro Chemicals	4,684,460	25,800,000	18.16%
	Samsung Mid	23,163,673	230,865,031	10.03%
	Young Won Export	6,403,150	51,014,336	12.55%
	Woong-Jin Co Way	1,859,430	23,959,690	7.76%
	Poong San	2,785,630	32,000,000	8.65%
	Hite Beer	962,190	19,197,208	5.01%
	Hyundai Commercial Dev. Co.	14,770,370	75,384,180	19.59%
	Cheil Jedang (CJ)	1,844,570	23,972,727	7.69%
	LG Health Co.	1,648,230	15,618,197	10.55%
	SK Corp.	6,394,390	126,977,822	5.04%
	Total: 11	**62,329,503**		

Tables V and VI show a list of representative transactions in which foreign funds made investments in listed Korean financial institutions and Korean companies, respectively, with an intent to either acquire management rights or participate in management affairs.[25]

[25] Tables V and VI have been selectively prepared using data compiled by Hyung Tae Kim. *See supra* note 10.

Table V
Acquisitions by Foreign Funds of Korean Financial Institutions

ACQUIRED FINANCIAL INSTITUTION	FOREIGN FUND	INVESTMENT DATE	INVESTMENT AMOUNT (U.S. MILLIONS)	INVESTMENT PURPOSE
Good Morning Securities	H&Q, Lombard	May 1998	$82	Acquisition (48%)
Korea Exchange Bank	Lone Star	August 2003	$1,060	Acquisition (55%)
Hamni Bank	Carlyle Group	September 1998	$385	Acquisition (40%)
Korea First Bank	Newbridge Capital	December 1998	$427	Acquisition (50%)
Kookmin Bank	Goldman Sachs	May 1999	$500	Share Purchase (11%)
Korea Exchange Card	Olympus Capital	December 1999	$118	Acquisition (54%)
Hana Bank	Allianz AG	April 2000	$150	Share Purchase (12%)
LG Card	Warburg Pincus	October 2000	$370	Share Purchase (19%)

Table VI
Acquisitions by Foreign Funds of Korean Companies

ACQUIRED COMPANY	FOREIGN FUND	INVESTMENT DATE	INVESTMENT AMOUNT (U.S. MILLIONS)	INVESTMENT PURPOSE
Winnia Mando	UBS Capital Consortium	November 1999	$201	Asset Purchase
Mando Inc.	JP Morgan Partners Consortium	January 2000	$470	Asset Purchase
Hae Tae	UBS Capital Consortium	July 2001	$410	Asset Purchase
Hanaro Communications	Newbridge-AIG	October 2003	$1,100	Stock Transfer

In the above transactions, all of the investments which led to acquisition of management rights were made by private equity funds. Unlike public mutual funds, private equity funds have invested enough to acquire management rights or at least participate in management. As illustrated above, foreign private equity funds have invested in Korean financial institutions for the specific purpose of acquiring management

rights.[26] It is this fact which may have sparked such intense discussion about encouraging the creation of domestic private equity funds in South Korea.

In many cases, foreign funds have become increasingly proactive shareholders. Not only have they exercised their shareholder rights at the annual shareholders meeting, but they have also demanded that the controlling shareholders and management improve corporate governance, enhance management transparency, and give priority to shareholders' interests.

For example, the Capital Group demanded that Samsung Electronics appoint outside directors in 2000 and 2001 and move its principal place of business to New York in 2003. Moreover, in 2004 the fund requested that Samsung's CEO and CFO participate in one of their board of directors meetings.[27] Although such exhibits of shareholder activism by foreign funds may be perceived as management interference, one cannot deny the fact that foreign funds have contributed significantly to the overall improvement of corporate governance and management transparency of major Korean companies. Accordingly, one would expect that foreign funds will make use of their shareholders rights in an active and decisive manner, either in their individual capacity or in cooperation with other foreign investors.

Until now, foreign funds that have sought to acquire management rights of Korean companies have done so through friendly purchases of shares from other majority shareholders, by means of open competition or negotiation. However, recently there has been much discussion about the possibility of hostile takeovers in South Korea by foreign investors. In reality, hostile takeovers in the form of foreign fund investments remain a rare phenomenon to this day. One notable exception has been Sovereign's acquisition of SK Corp. shares in early 2004. Hostile takeovers initiated by foreigners are unlikely to become more common because they are not encouraged by the current Korean business climate. Furthermore, labor unions and company employees tend to show considerable opposition to the prospect of job loss resulting from corporate restructuring. However, as illustrated by Kumkang Korea Chemical's recent hostile takeover attempt of Hyundai Elevator Inc., if domestic firms are likely to increasingly engage in

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[26] Although the Carlyle Group did not achieve the status of first-priority negotiators, they not only actively participated in the bidding process for the contemplated sale of Daehan Investment & Securities, Ltd. and the Korea Investment Securities Co., Ltd., but they were also heavily involved in the actual sale of Daewoo Heavy Industries & Machinery Ltd.

[27] Foreign Assault – Preparing for the Worst Case Scenario: Emergency M&A Agenda for Samsung Electronics, KOREA ECONOMY NEWS, Oct. 6, 2004, at P1.

hostile takeover attempts in the near future, one cannot disregard the possibility of such attempts by foreign funds, especially private equity funds.

IV. PROBLEMS ARISING FROM INVESTMENTS BY FOREIGN FUNDS

The following is a list of general problems with respect to investments by foreign funds in domestic Korean companies:[28]

1. The possibility of acquiring management rights;
2. Issues relating to large dividend payouts to securities held by foreigners;
3. The reduction in floating stocks;
4. The possibility of withdrawal of foreign capital from the Korean securities market; and
5. The risk of harm to the Korean financial system resulting from use of financial derivatives.

It is safe to say that these matters can typically arise in the case of investments by foreign funds. Nevertheless, they become much more severe when investments are made by so-called financial investors, relative to investments made by industrial investors.

Because this Article focuses on exploring legal issues, it stops short of examining the above matters in detail. The purpose of this Part is to merely illustrate a set of more general problems associated with investments by foreign funds in South Korea.

V. RELATED LEGAL ISSUES

This Part reviews several key legal issues concerned with domestic investments by foreign funds. In the aftermath of the heated dispute over management control rights of SK Corp. between Sovereign and controlling shareholders, many discussions[29] have focused on the belief that South Korea lacks appropriate legal defensive measures against potential hostile

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[28] For a further discussion of problematic issues, see Je-Chul Kim et al., *Discussion of Problematic Issues in Connection with Comparative Share Ownership by Foreigners*, Korean Securities Research Center (Jun. 2004). *See also* Hyun Soo Park, *Acquisition Strategies and Takeover Defenses of [Korean] Companies by Foreign Investors*, 50 SANG-JANG HYUP 83 (2004).

[29] In this regard, overseas anti-takeover measures, such as the so-called "poison pill" and the voting rights system (golden shares versus ordinary shares) have been discussed as alternative defensive strategies. Most measures, however, have not been tested as valid under existing Korean law. Introducing them as part of legislation in South Korea would require overcoming numerous obstacles.

takeovers or undue management interference by foreign companies, including foreign funds.

However, foreign funds' efforts to participate in management are, by and large, carried out within legally permissible procedures and methods in accordance with relevant domestic laws, such as the Securities Exchange Act or the Commercial Code. In many cases, they make legitimate claims for corporate action (e.g., initiating corporate governance reform measures) by actively exercising their shareholder rights.

Moreover, the issue of whether a hostile M&A should be accepted or tolerated is a matter of national government policy. In many circumstances, it becomes irrelevant to consider the nationality of entities or persons initiating hostile takeovers.

Accordingly, instead of discussing legal issues in a general sense, this Article attempts to examine several significant issues[30] that have been uncovered by one attorney in the course of his own legal practice. The Article also suggests the author's opinions on ways to resolve such matters. Much of the following discussion is applicable not only to foreign funds but also to investments made by foreign individuals.

A. The Problem of Reverse Discrimination Faced by Domestic Investors

As revealed in the management rights dispute between Sovereign and incumbent management, as well as in the context of promoting domestic private equity funds [in South Korea], one problematic issue has been that domestic investors face systematic reverse discrimination when compared to foreign investors and their funds.

1. The Monopoly Regulation and Fair Trade Act

Under the Monopoly Regulation and Fair Trade Act ("MRFTA"), domestic companies (especially large conglomerates) are subject to an array of stringent regulations. For example, when conglomerates establish holding companies or conduct activities related to holding companies, they must abide by certain limitations set forth in the MRFTA. In addition, the MRFTA places restrictions on the conglomerates' gross investment amount

[30] There are important tax issues to consider, such as corporate taxation on dividend income for funds and marginal profits in share transfers, and taxation on securities exchanges. This Article does not deal with such issues, however. Further, Citigroup Inc. acquired management rights of KorAm Bank from the Carlyle group in February 2004, and it attempted to delist the Korean bank from the Korea Securities Exchange. Since large amounts of dividends and capital decreases are involved, it is difficult to regard them as merely fund-related matters. This Article does not take into account such matters since relevant activities are pursued through regulation and other legal procedures.

and guarantee of debts for their related subsidiaries. Foreign investors, in contrast, are not subject to such restrictions or limitations. In the case of foreign funds, it is plausible that the funds may be classified as holding companies since their main purpose is investment in other companies. The MRTFA, however, does not currently regulate holding companies incorporated overseas.

Under the MFRTA's extraterritoriality theory, the Korean statute may reach and govern business combinations that produce a large effect on the domestic market even though they occur on foreign soil. Nevertheless, rules that purport to place limitations on holding companies and restrictions on gross investment amount are in theory difficult to apply to companies incorporated in foreign jurisdictions. The Korea Fair Trade Commission presumably has no plans to apply such provisions to foreign funds.

2. Regulation by Finance-Related Laws

Under the Financial Holding Company Act ("FHCA"), non-financial institutions cannot in principle acquire voting shares amounting to more than four percent of the total outstanding shares of a bank holding company (Section 1 of Article 8-2). Under the Banking Act, the same entities cannot acquire voting shares amounting to more than ten percent of the total outstanding shares of a bank without the approval of the Korean Financial Supervisory Commission ("KSFC"). Furthermore, non-financial institutions cannot in principle acquire voting shares amounting to more than four percent of the total outstanding shares of a bank (Article 16-2).

Such restrictions do not apply to foreign funds, however, because they can qualify as financial institutions by merely modifying their investment portfolios.

3. Stringent Regulation of Private Indirect Investment Vehicles Under the IAMA

Private indirect investment vehicles and securities investment company vehicles established to facilitate business takeovers (i.e., private equity M&A funds)[31] were heavily regulated under the IAMA prior to the December 2004 amendment. A substantial number of restrictions (e.g., restrictions on fund operations or exemption from public notice

[31] Where an investment company's indirect investment scheme involves incorporation for the purpose of associating another company as its affiliate company, the voting rights restriction under the IAMA does not apply. *See* IAMA art. 142.

requirements)[32] applicable to general indirect investment vehicles do not apply to private direct invest vehicles that satisfy the following criteria:[33] (1) funds with fewer than 30 investors; (2) indirect investors that are either funds or institutional investors; (3) private individuals that are investing at least U.S. $10 million; or (4) non-individual legal entities corporations that are investing at least U.S. $50 million. Accordingly, unless specifically exempted under Korean law, all such vehicles must adhere to regulations in the IAMA. In particular, Section 2 of Article 89 of the IAMA prohibits investors from: (1) borrowing money to fund their investments; (2) guaranteeing debt repayment; or (3) furnishing security.

Under the December 2004 amendment, the IAMA introduced a new framework for the creation of a specialized private equity investment company ("SPEIC"), in an effort to promote domestic private equity funds that can eventually compete effectively with foreign private equity funds. Similar to U.S. private equity funds, a SPEIC is organized in the form of a limited partnership under the Korean Commercial Code ("KCC"), consisting of a general partner (the management firm which has unlimited liability) and limited partners (the investors who have limited liability). Under certain scenarios, regulatory measures are eased with respect to: (1) restrictions on acquisition of shares in banking and financial holding companies; (2) limitations on gross investment amount; and (3) restrictions regarding holding companies. On its face, reverse discrimination against domestic companies in this matter has been remedied for the most part. When compared to foreign funds, however, SPEICs are disappointing to some extent. First, the legal structure of SPEICs is restricted to the form of a limited partnership under the KCC. Second, investments made must be greater than ten percent of a targeted company's total shares. Third, no clear criteria have been provided in connection with permissible investments by pension funds, as had initially been proposed by the government amendment.

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[32] *See* IAMA art. 175.

[33] Investment trusts and investment companies are generally prohibited from investing in investment securities in excess of 10/100 of the total value of assets of each indirect investment fund, or investing in excess of 10/100 of the total number of shares issued by the same company per the total value of assets of each indirect investment fund. *See* IAMA art. 88, §§ 1-2. This general provision, however, is inapplicable to private equity indirect investment schemes. *See* IAMA art. 88, § 1; IAMA art. 175, § 1.

4. Restricting the Voting Rights of a Majority Shareholder in Appointing a Member of Audit Committee Who Is Neither an Auditor Nor an Outside Director

This matter is dealt with separately in detail below.

5. Issues Pertaining to Statement of Substantial Share Ownership (and Statement of Changes in Substantial Share Ownership)

The issue of fairness has become a subject of debate surrounding the alleged discriminatory sanctions imposed for violations committed in connection with the statement of substantial share ownership requirements (i.e., the five-percent rule) on the part of foreign funds and financial companies. When the violations occurred, domestic companies were criminally indicted by prosecutors, whereas their foreign counterparts were simply given notice or warnings. According to official government reports submitted by the KSFC as of September 2004, violations committed by foreign funds and foreign financial companies numbered 77 in 2002, 122 in 2003, and 61 in 2004. The remedial measures taken by the KSFC were practically ineffective, amounting to a mere slap on the wrist. For domestic companies and individual investors, on the other hand, there have been a total of 1,175 violations from 2002 through the first half of 2004. About 13.7% (161 cases) of the violations resulted in criminal indictments by prosecutors. Additionally, at least seven court orders for liquidation of shares have been issued since 1997.[34] Some believe this constitutes reverse discrimination against domestic companies and investors.

In many cases, however, violations committed abroad by foreign funds and foreign financial companies resulted from their difficulties with producing and submitting the required documents in a short time frame. In other words, their violations were merely technical in nature. By contrast, most of the violations by their South Korean counterparts which led to an indictment or a share-liquidation order were cases involving intentional violations of relevant laws, including stock price manipulations. Therefore, it is doubtful whether a simple comparison of the number of violations can provide any meaningful information. Other matters regarding the statement of substantial share ownership requirements will be considered in the following section.

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[34] *Foreigners' 5% Rule Violations*, KOREAN ECONOMICS NEWS, Oct. 11, 2004, at P1.

B. Issues Pertaining to the Statement of Substantial Share Ownership (and the Statement of Changes in Substantial Share Ownership)

1. The General Problem

The Korean Securities and Exchange Act ("KSEA") contains an important provision which requires the filing of a statement of substantial share ownership (Article 200-2).[35] When the number of shares held by majority shareholders changes, the KSEA requires this information to be disclosed to the public. This provision is intended to heighten the transparency and fairness of the securities market and to expedite public announcement of hostile acquisitions of shares held by existing majority shareholders or management. The public disclosure system is essential to advance investor protection. It is important to disclose the identity of persons intending to acquire shares and the purpose of their acquisitions because the company stock price can be seriously affected by share acquisitions that lead to disputes over management rights.[36] In addition, the public disclosure system is vital because of the possibility of unfair share purchase transactions.

Foreign funds' legal structure and investment schemes, however, differ from those of domestic funds. In particular, foreign private equity funds are not typically required to furnish investment information to the public. Moreover, even in substantial share acquisitions which cannot be regarded as portfolio investments, the contents of substantial share ownership statements are by themselves less than useful. On the sole basis of such statements, one would have difficulties finding relevant information about the majority shareholders or the management. Ordinary investors would also have a very hard time obtaining the identities of the actual beneficial owners of the funds, let alone information concerning their business organization and true investment purpose.[37]

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[35] Jae-Hyun Im, [Korean] Securities Regulation and Laws 635 (Park Young Sa ed., 2000).

[36] Empirical research has shown that that when an investor's purpose behind holding a large number of securities is publicly disclosed as simply "for investment," the rate of return on his investment is far higher than when the announcement is made as "plans for acquisition of additional shares." *See* RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 935 (2d ed. 1995).

[37] In reality, a question arises as to whether Sovereign properly or adequately stated its purpose for share acquisition in SK Corp., given that it had listed "creating profits" in its filed statement of substantial share ownership. Based on Sovereign's action thus far, there is a high possibility that the SK Corp. investment is not merely a portfolio investment, but an investment geared toward participation in SK Corp.'s management. Some have alleged that Sovereign had this intention at the time of the statement filing. Accordingly, a related issue arises as to whether this action constitutes a materially false statement.

Accordingly, prior to the recent amendment to the IAMA, an electronic notification system had been utilized for the substantial share ownership statements. Investors were required to provide only a very brief statement of investment purpose with respect to their share ownership or changes in existing share ownership. For example, investors had been permitted under the law to state only a few words, such as "management participation," "investment to acquire management rights," or "investment to manage securities products." No rules or provisions existed for submission of other information such as investment type, classification, or contents. In effect, the older version of the IAMA contained no guidance with regard to the detailed disclosure of investment purpose.

On the other hand, when several funds are combined for the purpose of acquiring a substantial amount of shares in a company, it is likely that the funds are not meaningfully related to one another. Even if a relationship does exist, in many cases the funds are probably not familiar with each other and are likely unknown to the public. Accordingly, if several funds are combined to purchase substantial shares in violation of the public disclosure requirement, stock price movements will likely be unpredictable from the perspective of both the company invested in and the market. Especially in cases where large-scale asset management companies operate multiple funds, problems may potentially arise when fund managers are placed under undue pressure from outside influences because (1) communication and decisions are made entirely by fund managers and (2) no investment companies maintain perfectly functioning internal control systems with respect to the public disclosure of funds. This sort of problem could become more serious when the asset management companies involved are incorporated overseas and operate dozens or hundreds of funds.

2. Technical Problems Peculiar to Foreign Funds

Where an asset management company (i.e., a fund manager) operates multiple funds, other concerned parties face the problem of determining who actually constitutes "specially related persons" and whether certain holdings of shares amount to "quasi-ownership" under the Presidential Decree of the KSEA. They also face the problem of determining whether or not filings of substantial share ownership statements have been actually made by the fund manager or company. This is true even when the parties have fully complied with the requirements set forth in the statement of substantial share ownership reports. For this reason, the KSFC implemented a new disclosure system in March 2004. The new disclosure system first considers whether

or not the asset management company in question actually holds shares. It then determines whether or not the investment company and funds are "specially related," and if so, it further classifies them as either "wholly related" or "partially related."[38] The new disclosure system is enormously complex, containing many ambiguous elements. Substantial confusion is therefore likely to result for the time being.

The IAMA requires that substantial share ownership statements be filed within five business days of the date of share acquisition. It is practically impossible, however, for large-scale overseas asset management companies to meet this requirement because most of them invest through dozens of funds and must combine their investment activities. In many cases, therefore, unintentional violations of the disclosure rule occur. This can ultimately lead to internal compliance issues because such violations are deemed to constitute violations of securities laws in their home jurisdictions.[39] Hence where the purpose of investment is neither to participate in management nor to acquire management rights, it seems necessary to adopt measures providing exceptions to existing policy, permitting foreign investors to (1) submit a combined filing on or prior to the tenth day of the following month (as had been applicable to domestic institutional investors) or (2) submit an initial filing which is supplemented afterwards with additional materials.

3. The Need for Adequate Disclosure

For the reasons outlined above, it is necessary to implement additional requirements on investment funds in order to provide more information to the public. Regardless of whether the funds are foreign or domestic, there is a high likelihood that the true identities of actual investors—masked under the fund names—will not be disclosed to the public in an adequate manner. There is no harm involved in demanding information from the actual investors so that their identities may be publicly released. It is also not unreasonable to demand information from them about the funds they actually own as long as there is no undue burden on their part. In the United States, for instance, funds must disclose in detail the nature of any

[38] Korean Financial Supervisory Commission, System Proposals to Improve Public Disclosure of Share Ownership and Clarification of Reporting Methods Associated with Statement of Ownership of Shares of Foreign Mutual Funds (Mar.16, 2004).

[39] Foreign investors generally submit substantial share ownership statements with the assistance of a domestic law firm. When foreign investors fail to meet the submission deadline as a result of being unaware of the legal requirements or lack of adequate preparation, the Korean Financial Supervisory Commission issues a warning letter. In some cases, several domestic law firms representing foreign investors have received multiple warning letters on behalf of their clients.

shareholding relationship and information about their employees. Further, Schedule 13-D, a form used in the filing of a statement of substantial share ownership to comply with the U.S. Securities and Exchange Act of 1934, requires a furnisher to provide specific details such as information on each partner in a general partnership or a limited partnership. There are additional requirements under Schedule 13-D. It requires disclosure of information relating to the identities of persons or entities having control or authority of a partner. In cases where the partner is a corporation, additional disclosure must be made with respect to any officer and any other entity which has control of the corporation.[40]

To make public disclosure effective, information relating to "personnel and employees" of a fund should be furnished in detail as well as information relating to specific circumstances that give reasonable inferences of the funds' investment purposes. Accordingly, the KSFC has recently introduced additional requirements in connection with filing of the substantial share ownership statement. When filing, a furnisher is required to choose between two initial categories: either "ordinary investment," or "investment to acquire management rights or to participate in management." In the latter category, the furnisher is required to provide the following disclosures with specificity: (1) current intent to either directly or indirectly engage in management; (2) plans to replace or change management; (3) future plans relating to direct participation in management (including plans to elect the furnisher or other specially-related parties[41] as officers); (4) plans to amend provisions in the articles of incorporation relating to changes in the management structure, including the number of directors; (5) plans relating to any additional share acquisitions; and (6) plans to sell or liquidate shares.[42] These new disclosure requirements set by the KSFC seem to mirror those requirements found in the U.S. disclosure system. The revised disclosure system is regarded as being especially helpful in gathering adequate information on foreign funds' investment objectives.[43]

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[40] For a detailed discussion, see Hwa-Jin Kim, *Recent Trends and Legal Policies in the [Korean] M&A Market*, BFL, Vol. 6, 43-44.

[41] The phrase "specially-related party" or "specially-related person" can be generally defined as either a party that directly or indirectly owns 50% or more of the voting shares of the other party or a party that can *de facto* determine or control the other party's business policy.

[42] Summary Briefing Report, Methods and Contents of Share Ownership Purpose and Announcement of 5% Public Disclosure Requirement, The Korean Financial Supervisory Commission, Oct. 5, 2004.

[43] Other than the enumerated matters that are subject to disclosure, the United States' Schedule 13-D Item 4 also requires the submission of information in connection with any plan for (1) an extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the issuer or any of its subsidiaries; (2) a sale or transfer of substantially all assets of the issuer or any of its subsidiaries; and (3)

C. Restricting the Voting Rights of a Majority Shareholder in Appointing a Member of an Audit Committee Who Is Neither an Auditor Nor an Outside Director

When electing auditors, Section 2 of Article 409 of the KCC places a statutory limit on the amount of voting shares by providing that "any shareholder who holds more than three percent of the total outstanding shares, exclusive of non-voting shares, may not exercise his vote with respect to the shares in excess of the above limit." Under the KSEA, however, majority shareholders' voting rights are limited to three percent in combination of specially-related persons' voting rights. (Section 11(1) of Article 191 of the KSEA and Section 18 of Article 84 of the Presidential Decree of the KSEA).

At the 2004 general shareholder meeting of SK Corp., Sovereign split its main fund into several parts (establishing five separate subsidiaries holding 100% of total shares). Each subsidiary was made to hold less than three percent of the total number of outstanding shares, which effectively meant that Sovereign fully exercised all of its voting share rights. On the other hand, other controlling shareholders were deemed single individual shareholders and exercised no greater than three percent voting share rights. Although Sovereign indicated their reason for the split as "internal risk management" on their change of ownership statement, it is more likely that Sovereign's actions were deliberately taken in view of the above statutory limitations on voting share rights.

The KSEA provision is primarily intended to protect minority shareholders by making it difficult for a majority shareholder of listed companies to appoint non-outside directors who are auditors. In reality, however, the provision helps to serve the interests of majority shareholders who can potentially acquire management rights. In particular, it can give greater protection to foreign funds with enormous financial assets. As illustrated by the Sovereign case, foreign investors in South Korea can freely establish multiple funds by dividing their owned shares into many parts. By contrast, domestic shareholders' voting shares (including the shares of any specially related persons) face the three-percent restrictions under the KSEA provision. Moreover, the possibility of transferring or dispersing domestic

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any material change in the present capitalization or dividend policy of an issuer where the issuer is a closed-end mutual fund.

shareholders' shares to third parties is practically slim because of restrictions placed on gross investment amount and tax burdens on stock transfer profits. This illustrates one instance of reverse discrimination against Korean investors.

Restricting the voting rights of shareholders in appointing a member of the audit committee is intended primarily to protect minority shareholders. Hence within the context of the problem above, no significant differences should exist between a shareholder with the largest number of shares and a majority shareholder. Accordingly, a majority shareholder who holds more than ten percent of the total outstanding shares must meet a separate public disclosure obligation under the KSEA. Because of this additional requirement, it is more reasonable to apply the KSEA provision to majority shareholders as well—to restrict their voting rights in appointing a member of the audit committee who is not an outside director (taking into account the shares of any specially-related persons). This would likely prevent a majority shareholder (having ten percent or more of shares) from exerting undue influence over the audit member-appointing process. Further, this would help strengthen the voting rights of true minority shareholders and can help eliminate the reverse discrimination resulting from some of the MRFTA restrictions levied against domestic companies or shareholders.

D. Application of the Foreign Investment Promotion Act

The Foreign Investment Promotion Act ("FIPA") is intended mainly to promote foreign direct investment. Various benefits are conferred upon those foreign investors whose investments constitute "foreign investment" within the meaning of the FIPA. Under the MRFTA, where a company acquires or owns securities of a foreign-invested company under the FIPA, two things happen. First, the company secures a five-year grace period in which no restrictions are placed on the company with respect to gross investments made from the date of such acquisition or ownership (Section 1(3) of Article 10 of the MRFTA). Furthermore, regulations dealing with securities acquisition and disposition under the Foreign Exchange Transactions Act ("FETA") become applicable. However, if a foreign investor in principal invests greater than U.S. $50,000 and acquires more than ten percent of the total outstanding shares in any invested company, the company is deemed to be a foreign investment company within the meaning of the FIPA.

The FIPA does not target short-term portfolio investments, but instead facilitates long-term investments to promote the development of invested companies in cooperation with majority shareholders and management. Although investments made by foreign private equity funds may qualify as "long-term investments" under the FIPA, they are in many cases mere portfolio investments. Despite this, it is difficult to fathom how a foreign private equity fund can be considered a foreign direct investment and therefore obtain various benefits under the FIPA on the basis of only acquiring at least ten percent of the total outstanding shares of a Korean company (including acquisitions made in aggregate with other funds).

Hence, when Sovereign acquired 14.99% of SK Corp. shares, SK Corp. became by default a foreign investment company within the meaning of the FIPA. Under the MRFTA, the parent SK Group therefore violated the restrictions on gross investment amount and became subject to voting rights restrictions based on the number of shares held. The violation exceeded the scope of the MRTFA by virtue of the exemption under FIPA, leading to a completely unexpected result. The South Korean government has therefore proposed to amend the relevant provision of the MRFTA (Chapter 10, Article 1, Section 3).[44] The proposed amendment would exempt foreign investments from the restrictions on gross investment amount and be applicable only if a foreign investor (or its subsidiaries) holds more than ten percent of the total outstanding shares of the invested companies. This amendment alone, however, would not completely resolve the problem outlined above.

VI. CONCLUSION

This Article has given a brief and general introduction to foreign funds and reviewed several legal issues related to the current state of their equity investments in South Korea. The Korean securities market is now a part of the global capital market. Securities investments held by foreign investors amount to approximately 40 percent of the total aggregate value of listed securities in the Korean market and more than 50 percent of these foreign-owned securities are held by foreign funds. Foreign securities investments in South Korea will probably not decline in the near future. In this setting, one should not focus solely on negative aspects of foreign fund investments or conclude that management of Korean companies by foreigners is entirely bad. In reality, foreign investment activities in South

[44] *Translator's Note*: This amendment was passed by the Korean National Assembly in December 31, 2004, and became effective April 1, 2005.

Korea have had great positive impact on the economy. In particular, they have made substantial contributions to improving corporate governance of Korean companies. Therefore, this Article suggests that further efforts should be made by the South Korean government to devise and improve ways of attracting foreign investment, including foreign funds, to the Korean capital markets. The current system demands further reform, since foreign investments still face unreasonable procedural hurdles like the short time limitation imposed on filing of the statement of substantial share ownership statement. In addition, South Korea should encourage and promote long-term direct investments by foreigners, rather than focusing only on portfolio investments. South Korea should also conduct analyses of investment trends and techniques, taking into account different types of investors.

Moreover, South Korea should implement additional legal measures to further alleviate the impact of reverse discrimination against its domestic companies and investors. In this context, the recent amendment to the IAMA bodes well. It is poised to create a vital framework through which domestic funds can compete effectively with their foreign counterparts. Similar to foreign funds, domestic private equity funds will assume a significant role in South Korea's corporate governance system and the M&A market.

Because this Article examined several legal issues from the author's standpoint, it was unable to consider many other important aspects of this debate. The author hopes further discussions will continue on such matters in the future.