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# RECENT CHANGES TO THE COMMERCIAL CODE PROVISIONS ON EXCHANGEABLE BONDS

Since its enactment in 1962, the Commercial Code has been amended some 20 times. The latest amendment, however, is the first to contain amendments to the "Bonds" Section. These amendments took effect in April, 2012, and include new provisions for the delegation of bond issuance related matters to a company's representative director and matters relating to bond management companies. Bond classes have also been diversified to include participating bonds, redeemable bonds, derivatives-linked bonds and exchangeable bonds.

The exchangeable bond class was actually first introduced in the "Act on Development of the Capital Market" in 1987 – a concept taken from abroad. Exchangeable bonds continued to be regulated under the subsequent Securities and Exchange Act of 1997 and the Financial Investment Services and Capital Market Act of 2007.

But since the above statutes' provisions on exchangeable bonds governed exchangeable bonds issued by listed companies only, it was the generally accepted view that exchangeable bonds can only be issued by listed companies with respect to listed securities; this drew some criticism. By including new exchangeable bond provisions in the latest amendment to the Commercial Code, the intent of legislators is to expressly permit the issuance of exchangeable bonds by non-listed companies with respect to non-listed securities.

The Commercial Code defines an exchangeable bond as "a bond that can be exchanged for an equity security or any other security" and includes detailed rules on exchangeable bonds in its Enforcement Decree. According to such Enforcement Decree (announced in accordance with the implementation of the amended Commercial Code this year), a company's board of directors shall decide the major terms and conditions of the exchangeable bonds, and a company that issues exchangeable bonds shall deposit the securities to be exchanged for such bonds in the Korea Securities Depository.

The Enforcement Decree also states that where a company issues bonds that can be exchanged for its treasury stock to persons other than its shareholders, the board of directors may decide the party to which the bonds will be issued unless otherwise specified in the company's articles of incorporation.

In this regard, the generally accepted view is that a board can make all decisions regarding an issuance of exchangeable bonds that are not exchangeable for treasury stock, on the basis that it would not have significant influence on the governance structure of the issuing company. But, exchangeable bonds that are exchangeable for treasury stock could influence the governance structure of a company, depending on the exchange conditions and the exchange amount. Accordingly, the new amendments permitting a board of directors to determine the terms and conditions of exchangeable bonds that are exchangeable for treasury stock have drawn criticism from some scholars that the effects of an issuance of such exchangeable bonds would in fact be substantially the same as an issuance of new shares. These scholars argue that the new amendment to the Commercial Code has the effect of regulating issuances of exchangeable bonds that are exchangeable for treasury stock at the same level as new share issuances.

In short, the aim was to regulate issuances of exchangeable bonds for treasury stock by requiring that a company's articles of incorporation permit such issuances or provide for a special resolution of the general meeting of the company's shareholders on such issuances. But due to differences of opinion among legislators composing the Enforcement Decree, the requirement for a decision by the general meeting of shareholders was replaced by a requirement for a decision at the board of director level only.

In other countries, there are cases in which issuances of exchangeable bonds for treasury stock are regulated at the same level as issuances of new shares, and the exchangeable bonds are referred to as convertible bonds to distinguish them from other exchangeable bonds.

Some scholars theorize that the same level of duty of care required for issuing new shares should be imposed on directors deciding issuances of exchangeable bonds for treasury stock. But there are also objections to such argument, as there is no such explicit rule.

There was a total of 12 issuances of exchangeable bonds in 2011, and 3 occurred before October, 2012. But none of the issuances were conducted by a non-listed company on non-listed securities.

It is hoped that the latest amendment to the Commercial Code will benefit and develop Korea's capital market and improve the financials of non-listed companies.

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