USER'S GUIDE TO 2014 ISDA KOREAN LAW CREDIT SUPPORT ANNEX (BILATERAL FORM – LOAN AND PLEDGE)

I. Background

This Guide sets out the position under Korean law at the date of publication of this Guide and parties should consult with their legal advisors when considering entering into the Korean law Credit Support Annex (the "Annex").

The Annex offers two different methods of providing Korean collateral between counterparties to transactions documented under a 1992 ISDA Master Agreement or 2002 ISDA Master Agreement (each, an "ISDA Master Agreement"): namely, pledge and lending.[i] The term "Korean collateral" refers to Korean corporate or government bonds ("Securities"), Korean Won ("Cash") or a Cash Deposit (which can be denominated in currencies other than Korean Won) which is defined in Paragraph 12 of the Annex as "a bank deposit including any interest accrued thereon in the account ("Deposit Account") opened and maintained in a commercial bank ("Depository Bank") located in the Republic of Korea and agreed upon by the parties". Capitalized terms used herein without definition have the same meanings as in the Annex.

1. Pledge (*Jil Kwon*)

Under Korean law, personal property including securities and claims (such as contractual rights to payment) are typically provided as collateral in the form of pledge. Under the Korean private international law and Korean choice of law rules, the validity (together with all proprietary aspects such as perfection, priority, foreclosure) of the pledge of Securities or Cash Deposits would be governed by Korean law. The Annex has been drafted so that pledges of Securities or Cash Deposits as collateral in relation to ISDA Master Agreements can be effected and documented under a Korean law-governed credit support document.

2. Lending ("*Sobi Daecha*")

"*Sobi Daecha*" is a Korean law concept that applies to lending and borrowing of fungible property (such as cash, grain, securities, etc.) where title to the property passes absolutely to the borrower and the borrower is required to return equivalent property of the same type, quality and quantity upon maturity of the loan.

Under the *Sobi Daecha* structure, collateral is provided in the form of a loan of securities or cash, coupled with the right to set off the collateral repayment obligation (in cash) against the secured obligation. The borrower (i.e., the Secured Party) takes title to the collateral and therefore, will be able to rehypothecate. The term "rehypothecation" as used herein refers to the disposition of collateral by the secured party by sale, assignment, repurchase transaction or other transfer of disposition of the collateral prior to a default under the secured obligation.

[i] Other methods of providing personal property and claims as collateral under Korean law include: *Yangdo Tambo* (assignment for collateral purposes) and *Sobi Imchi* (special deposit). Under *Yangdo Tambo*, title to the collateral is transferred to the secured party for collateral purposes and the title transfer is valid against any third parties; the majority view is, however, between the secured party and the collateral provider, the secured party is deemed to hold the collateral in trust so that upon discharge of the secured obligation, the secured party is obligated to return the collateral to the collateral provider. Consequently, the secured party under *Yangdo Tambo* arrangement would not be permitted to rehypothecate or otherwise dispose of the collateral until the secured obligation is defaulted. *Yangdo Tambo* is not included in the Annex because it is determined to have no particular merits due to impossibility of rehypothecation, uncertainty in tax consequences and regulatory obstacles, particularly when a party is a non-resident in Korea.

Under *Sobi Imichi*, parties to a deposit transaction for fungible property may agree that the depository will be allowed to dispose of the deposited property and in such a case, the same rule for *Sobi Daecha* will apply, i.e., the depository returns to the depositing party the property of the same type, quality and quantity. Special deposit (*Sobi Imchi*) is derived from the Roman law of "depositum irregular" and is generally adopted in the Civil Law countries. It is the view of many commentators that under *Sobi Imchi* (as under *Sobi Daecha*), the depositor has only a contractual right for the return of the deposited property of the same type, quality and quantity, but has no property right. The *Sobi Imchi* will entail a special deposit of securities to be made by the collateral provider coupled with a set off right of the obligation to return the cash equivalent of equivalent securities against the secured obligation of the defaulting party.[i] Under the *Sobi Imchi* structure, the collateral taker (i.e., depository) will take title to the collateral and accordingly will be able to rehypothecate. *Sobi Imchi* is not adopted in the Annex mainly due to the lack of special tax exemptions and regulatory uncertainties.