

November 18, 2015

**Members of the sub-committee for examining bills**

**The National Policy Committee**

**The National Assembly of the Republic of Korea**

**Re: Proposed Bill of the Corporate Restructuring Promotion Act as a Permanent Statute**

Dear members:

The International Swaps and Derivatives Association, Inc. (“ISDA”)<sup>1</sup> is grateful for the opportunity to submit comments on the proposed amendments to the Corporate Restructuring Promotion Act (“CRPA”), the bill of which was discussed by the sub-committee for examining bills of the National Policy Committee (the “Sub-Committee”) on July 21, 2015.

We set out our comments in the table below:

<b>Proposed amendments</b>	<b>ISDA’s suggestions</b>
<p>Article 2 (Definitions)</p> <p>(1) The term "company" means a company defined in Article 169 of the Commercial Act; or a person incorporated for the purpose of engaging in any other profitmaking activities and prescribed as such by a Presidential Decree.</p>	<p>Article 2 (Definitions)</p> <p>(1) The term "company" means a company defined in Article 169 of the Commercial Act; or a person incorporated for the purpose of engaging in any other profitmaking activities and prescribed as such by a Presidential Decree; <u>except (i) a financial institution (as defined in Article 2(1) of the Act on the Structural Improvement of the Financial Industry); and (ii) a person prescribed as a “financial markets infrastructure” by a Presidential Decree.</u></p>
<p>&lt;New&gt;</p>	<p>Article 5-4 (Special rules governing qualified financial transactions)</p>

<sup>1</sup> Since 1985, ISDA has worked to make the global OTC derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s web site: [www.isda.org](http://www.isda.org).

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	<p>(1) <u>Where a credit extension is a qualified financial transaction (as defined in Article 120(3) of Debtor Rehabilitation and Bankruptcy Act), the termination and settlement of such transaction under a base contract (as defined in the Debtor Rehabilitation and Bankruptcy Act) shall not be deemed to be an exercise of rights to financial claims under Article 5-2(3).</u></p> <p>(2) <u>Where a qualified financial transaction is terminated and settled pursuant to a base contract, the final outstanding amount determined following the termination and settlement of the base contract shall be deemed to be the amount of the financial claim under Article 5-2(3) for such qualified financial transaction.</u></p>
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- ISDA understands that the amendments to the CRPA as a permanent statute (“Amendments”) which the Sub-Committee has been considering are proposed to facilitate corporate restructuring proceedings and enhance financial market stability by addressing the legal and practical issues that have been seen under the current CRPA. The proposed Amendments are also essential for converting CRPA into a permanent statute. However, it has been brought to our attention that the proposed Amendments to the CRPA may have the unintended consequence of changing the Republic of Korea from a netting friendly jurisdiction to a non-netting friendly jurisdiction.
- The enforceability of close-out netting is the first building block of prudent risk management for OTC derivatives and the Basel capital framework specifically recognizes it as a risk reduction tool. Close-out netting has significant benefits as exposures can be recognized on a net instead of gross basis, resulting in a more efficient use of credit lines. It also facilitates the posting of collateral to offset exposures, and lowers the reserves required to satisfy regulatory capital requirements. Lowering reserves and posting collateral for net instead of gross exposures reduce costs, and credit and systemic risks.
- ISDA is an international association that has published a standardized contract, the ISDA Master Agreement (‘ISDA MA’), which is being used for about 90% of OTC derivatives transactions globally. The ISDA MA and related documentation materials published by ISDA have helped to significantly reduce credit and legal risks. One important way they do this is through their netting provisions, which enable firms to net their exposures with each other. This means that, in the event of an early termination, amounts due under all transactions entered into pursuant to a single ISDA MA will be netted against each other to result in a final

close-out amount payable by one party to the other. ISDA works to ensure market participants realize this important risk-reducing benefit by soliciting legal opinions on the enforceability of netting in various jurisdictions. Under Korean regulations regarding financial investment business, financial institutions are required to enter into contracts with close-out netting provisions and we understand that the ISDA MA is frequently used in documenting OTC derivative transactions between financial institutions in Korea.

- We obtained legal opinions in respect of the enforceability of the close-out netting provisions in the ISDA MA from Korean counsel as early as in 1997 and the opinion has been updated regularly since then. According to the Korean counsel, Korea has netting legislation which protects the enforceability of close-out netting regarding “Qualified Financial Transactions” (as defined in Article 120(3) of Debtor Rehabilitation and Bankruptcy Act). We understand under Articles 120(2), 120(3) and 336 of the Debtor Rehabilitation and Bankruptcy Act, Qualified Financial Transactions that are derivative transactions will be terminated and settled in accordance with the terms agreed by the parties in the base contract even if rehabilitation and bankruptcy procedures have commenced with respect to one party. This ensures enforceability of the close-out netting provisions of the base contract.
- Enforceability of provisions relating to close-out netting of Qualified Financial Transactions following commencement of restructuring proceedings under the CRPA is not prescribed in any provisions of the Amendments. This results in legal uncertainty on the effects of contractual close-out netting provisions. This legal uncertainty would negatively impact OTC derivative transactions with financial institutions, or exchange-traded derivatives on the Korea Exchange (KRX) traded by financial institutions, by deterring parties from entering into transactions with financial institutions or reducing transaction volumes.
- In order to maintain the enforceability of close-out netting under Korean law, we would recommend that the changes set out in the table be made to the bill of Amendments for the reasons stated below:
  - The wording is added to Article 2(6) so that financial institution (including institutions that operate financial market infrastructure for exchange-traded derivatives such as KRX) will not be subject to the CRPA. Financial institutions are already subject to the recovery and resolution regime under the Act on the Structural Improvement of the Financial Industry (“SIFIA”) and other applicable regulations, and should not be further subject to the restructuring proceedings under the CRPA. Nothing in the SIFIA would adversely affect the enforceability of close-out netting provisions.
  - The new provision of Article 5-4 provides that, where restructuring proceedings under the CRPA have commenced with respect to a company that is a party to an OTC derivative transaction, the counterparty would be able to enforce the close-out netting provisions under the base contract.

Should you have any questions, please contact Claire Kim, Assistant Director, Policy, Asia Pacific ([ckim@isda.org](mailto:ckim@isda.org), +852 2200 5903).



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