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South Korea
Private Equity

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This country-specific Q&A provides an overview of private equity laws and regulations applicable in South Korea.

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South Korea: Private Equity

1. What proportion of transactions have involved a financial sponsor as a buyer or seller in the jurisdiction over the last 24 months?

During the last 24 months, M&A deals with financial sponsor as buyer or seller saw a proportion of approximately 32.3% among Korea's M&A deals. (Source: Mergermarket)

2. What are the main differences in M&A transaction terms between acquiring a business from a trade seller and financial sponsor backed company in your jurisdiction?

Financial sponsors generally demonstrate strong desire to avoid or limit their post-closing exposures (e.g., indemnification obligations, covenants, etc.), including by use of (i) representations and warranties with limited survival periods, cap and escrow of certain portion of the purchase price, (ii) higher de minimis and/or basket thresholds and (iii) W&I insurance policies.

3. On an acquisition of shares, what is the process for effecting the transfer of the shares and are transfer taxes payable?

Transfer of shares are effected as follows: (i) If no share certificates have been issued: by (a) the seller's written notice of the share transfer to the target company with a fixed-date stamp (sometimes accompanied by the target company's written consent with a fixed-date stamp, if desired) and (b) an updated shareholders' register reflecting the purchaser as the holder of the transferred shares (ii) If share certificates have been issued: by (a) delivery of the share certificates and (b) an updated shareholders' register reflecting the purchaser as the holder of the transferred shares (iii) If shares are electronically registered: by updating (a) shareholders' account managed by the relevant securities companies and (b) shareholders' account managed by the Korea Securities Depository. In a share sale, securities transaction tax (normally at 0.35% of the transfer price) is imposed on the seller. If the seller is a foreign entity with no permanent establishment in Korea, the buyer must withhold and pay the securities transaction tax on behalf of the seller.

4. How do financial sponsors provide comfort to sellers where the purchasing entity is a special purpose vehicle?

In Korea, sellers often rely on the reputation and credibility of financial sponsors and do not require any additional guarantee from them (particularly in the transaction involving well- recognised financial sponsors). Sometimes, financial sponsors are requested to provide binding debt and/or equity commitment letters from their financing sources or limited parent guarantees depending on the negotiation powers of the parties and other dynamics of the transaction (e.g., auction deals or deals involving attractive targets).

5. How prevalent is the use of locked box pricing mechanisms in your jurisdiction and in what circumstances are these ordinarily seen?

Use of locked box pricing mechanisms is not very common in Korea, and is used sparingly (generally in cross boarder auction deals or deals involving very attractive targets).

6. What are the typical methods and constructs of how risk is allocated between a buyer and seller?

The typical methods and constructs of how risk is allocated between a buyer and seller in Korea is generally consistent with the practice in other jurisdictions (e.g., use of representations and warranties, covenants, closing conditions, indemnification and postclosing price adjustments). Furthermore, there have been an increasing use of W&I insurance in M&A transactions in Korea.

7. How prevalent is the use of W&I insurance in your transactions?

There has been a significant growth in use of W&I insurance in M&A transactions in Korea for the last few years. Korea saw the use of W&I insurance starting from around 2013, with approximately one or two deals using W&I insurance per year until 2015. Use of W&I insurance started becoming more popular from 2016 through 2024. Nowadays, most private equity sellers and also strategic

sellers in high profile auction deals at least consider the option of demanding bidders/buyers to use W&I insurance.

8. How active have financial sponsors been in acquiring publicly listed companies?

While financial sponsors are more active in acquiring unlisted companies, it is primarily due to the fact that the M&A transactions involving listed companies make up only a small portion of the entire M&A transactions in Korea. Taking into the account the total number of M&A transactions involving listed companies and the total number of M&A transactions involving unlisted companies, we note that financial sponsors are as active in acquiring publicly listed companies as acquiring unlisted companies.

9. Outside of anti-trust and heavily regulated sectors, are there any foreign investment controls or other governmental consents which are typically required to be made by financial sponsors?

Foreign direct investments are generally subject to pre-transaction reporting requirements under the Foreign Investment Promotion Act (FIPA) or the Foreign Exchange Transactions Act (FETA). The FIPA applies, among other cases, in cases where a foreign investor invests a minimum of KRW 100 million in a target company and (i) acquires 10% or more of the equity interest in the target company, or (ii) owns any equity interest in the target company and dispatches or appoints directors, statutory auditors or executive officers of the target company. If the FIPA is not applicable the FETA applies. Investments by non-resident financial sponsors are generally subject to the FIPA.

10. How is the risk of merger clearance normally dealt with where a financial sponsor is the acquirer?

The risk of merger clearance is normally dealt with (i) by making it a closing condition and (ii) by stipulating the buyer's obligation to cooperate. Buyer's obligation can range from use of reasonable efforts to use of best efforts, or even reverse break-up fee provisions. While it only rarely rises to the level of 'hell-or-high water' provision whereby the buyer undertakes to divest its other businesses/assets to obtain merger clearance, financial investors with no anticipated competition issues sometimes accept a 'hell-or-high water' provision in the auction deals where closing certainty is a key factor.

11. Have you seen an increase in (A) the number of minority investments undertaken by financial sponsors and are they typically structured as equity investments with certain minority protections or as debt-like investments with rights to participate in the equity upside; and (B) 'continuation fund' transactions where a financial sponsor divests one or more portfolio companies to funds managed by the same sponsor?

(A) In 2024, among private equity transactions, around 6.7% accounts for minority investments (out of around 465 deals by PE surveyed, 31 deals accounted for minority stake deals). (Source: Mergermarket) The investment structure varies from common shares, redeemable convertible preferred stocks (RCPSs) or convertible preferred stocks (CPSs) to bonds with warrants (BWs) or convertible bonds (CBs) depending on the circumstances. We have seen a decreasein the number of minority investments by private equity funds into a member of large business conglomerates in Korea.

(B) On July 2022, Hahn & Co (South Korea's biggest private equity firm) created the very first and largest continuation fund along with Coller Capital and closed a USD 1.5bn GP-led transaction in Ssangyong C&E Co. (a South Korea-based cement manufacturer). Other South Korean private equity firms started using continuation funds as well, including IMM Investment's acquisition of 33.7% of Oheim through continuation fund for KRW 30 billion (USD 22.6 million). We expect that, in line with the general market consensus, continuation fund will be more widely used in the Korean M&A market after the transactions described above.

12. How are management incentive schemes typically structured?

Management incentive schemes are typically structured as cash compensation (typically by way of M&A bonus or severance pay). Stock options or phantom stock are also frequently used.

13. Are there any specific tax rules which commonly feature in the structuring of management's incentive schemes?

Management incentives are generally treated as ordinary

income, and will be taxed accordingly. It is always recommended to have tax and legal experts involve in an early stage to exploit any tax efficient alternative structures.

14. Are senior managers subject to non-competes and if so what is the general duration?

In the context of a M&A transaction (i) senior managers that are also the seller are often asked (and agree in consideration of the transaction) to be subject to noncompete obligations for a duration of around three to five years; however, (ii) senior managers that are not the sellers are rarely asked (or agree) to be subject to any non-compete obligations. As a matter of principle, the Korean courts will recognise post-termination noncompete obligations, but solely to the extent that such obligations are limited in its scope and duration and do not overly limit or restrict the subject's freedom of occupation and right to work (as provided for in Articles 15 and 32 of the Constitution of the Republic of Korea). In determining the enforceability of non-compete obligations, the Korean courts will consider (i) the employer's needs, (ii) subject's position at the employer company, (iii) scope and duration, (iv) whether the subject is adequately compensated and (v) the circumstances around termination of the subject's employment.

15. How does a financial sponsor typically ensure it has control over material business decisions made by the portfolio company and what are the typical documents used to regulate the governance of the portfolio company?

A financial sponsor would typically enter into a shareholders agreement (in case of joint ventures) and/or amend the Articles of Incorporation and the board rules of the portfolio company to ensure that the financial sponsor has control over material business decisions (i.e., veto rights), and (ii) nominate one or more directors and executive officers for the portfolio company to (x) control the board of directors or (y) exercise veto rights as stipulated in the shareholders agreement and/or the Articles of Incorporation.

16. Is it common to use management pooling vehicles where there are a large number of employee shareholders?

It is not common to use management pooling vehicles in transactions involving financial sponsors. Sometimes private equity buyers offer individual sellers to re-invest certain portion of their sales proceeds into the private equity's acquisition vehicle so that they can share the leverage and upside when the private equity exits.

17. What are the most commonly used debt finance capital structures across small, medium and large financings?

Regardless of the size of the capital financing, the most commonly used debt finance capital structure is a syndicated loan. For small and medium size capital financing, issuance of redeemable convertible preferred stocks (RCPSs) or convertible bonds (CBs) are also commonly used.

18. Is financial assistance legislation applicable to debt financing arrangements? If so, how is that normally dealt with?

There is no law on point with respect to debt financing arrangements. In Korea, it is normally dealt with the assessment of whether there is any breach of fiduciary duty of the relevant directors (which breach may give rise to criminal liabilities). In general, provision of the target company's assets as a collateral to the buyer's acquisition financing (or the target company guaranteeing the buyer's acquisition financing) without receiving the adequate consideration for such provision of collateral (or guarantee) is deemed a breach of fiduciary duty by the directors of the target company; and as such, such arrangements are not permitted in Korea. The buyer would typically provide the shares in the target company as collateral to its acquisition financing. Occasionally, the buyer (i.e., its investment vehicle, which is the borrower for the buyer's acquisition financing) would merge with the target company after completion of the M&A transaction.

19. For a typical financing, is there a standard form of credit agreement used which is then negotiated and typically how material is the level of negotiation?

There is no legally required or commonly used standard form of credit agreement. However, most financial institutions have (and prefer to use) their own standard forms and there are market terms and conditions normally agreed. The level of negotiation varies on a deal-by deal basis, but the material terms (e.g., mandatory payment, change of control, representations

and warranties, covenants, collateral package and event of defaults) are often heavily negotiated.

20. What have been the key areas of negotiation between borrowers and lenders in the last two years?

They vary on a deal-by-deal basis, based on our experience, mandatory prepayment and (financial and other) covenants are heavily negotiated recently. In particular, in the past two years where sellers' need for closing certainty and buyers' need for a walk-away right became important in light of the unstable movements in the cost of financing and foreign exchange rate, the definition of 'material adverse effect' as well as the conditions precedent and termination rights are also heavily negotiated.

21. Have you seen an increase or use of private equity credit funds as sources of debt capital?

Yes, there has been an increase in use of private equity credit funds as sources of debt capital. However, the credit funds primarily engage in conventional minority equity investments and are only seldom used for convertible bond investments; and as such, the market does not view credit funds as a meaningful source of debt capital yet.

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