INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR THE PREPARATION OF A DRAFT CONVENTION ON SUBSTANTIVE RULES REGARDING INTERMEDIATED SECURITIES
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COMMENTS BY GOVERNMENTS AND INTERNATIONAL ORGANISATIONS

(Comments by the Government of the Republic of Korea)

I. INTRODUCTION

The issue of reducing legal risk and enhancing economic efficiency is not merely confined to cross-border securities transactions but is attracting special attention from all states that are striving to increase competitiveness in their financial markets.

Over the past couple of years, the Korean government has made amendments to its financial laws with an emphasis on easing restrictions and protecting investors. Along with this process, efforts are being made to lower legal risks that might arise during cross-border securities transactions. In this respect, the government is paying close attention to the Convention being drafted by UNIDROIT.

With respect to the Convention, the Korean government fully agrees that the level of harmonisation regarding substantive rules should be reasonably limited to an extent that is achievable and necessary to improve legal stability and economic efficiency. Given that each country has its own unique legal system governing commercial and securities transactions and supervisory activities, it is unrealistic to expect a collective amendment.

Below, we give our opinion on the preliminary draft convention adopted in February 2006.

II. COMMENTS ON SPECIFIC PROVISIONS

1. Definition of "securities" — Article 1(a)

Article 1(a) defines "securities" as any shares, bonds or other financial instruments or financial assets (other than cash) or any interest therein, which are capable of being credited to a securities account. We basically agree with this comprehensive approach. As developments in financial markets continue to bring new products to market, it appears necessary to expand the definition of securities so that new types of securities can be included in the Convention.

However, each country can decide how far it should extend the definition, taking account into its own unique circumstances. We believe this option should be fully reflected in the Convention.

> Many Asian countries, including Korea, still define "securities" based on a "positive" system, whereas the majority of countries in Europe and North America apply a "negative" system. Under the "positive" system, when a whole new product (e.g. a new derivative product) is to be registered (issued) as a "security", an amendment of the relevant law is necessary to add the new product to the securities list. Such a restrictive definition by Asian countries stems from the fact that their financial laws draw strict boundaries between different financial industries such as the securities, banking and insurance industries.
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> Recently, many Asian countries have been carrying out financial market reforms. Their reform agendas generally aim to eliminate barriers between financial industries and change from a "positive" system to a "negative" or a "negative-inclined positive" system when defining securities.

In conclusion, it appears reasonable to define "securities" from the reasonability and functionality perspectives, which are the basic principles behind the development of the Convention. In this regard, we feel articles need to be added which clarify the point that, if a "security" is defined as such by domestic non-Convention law, all other provisions of the Convention shall apply to it.

2. Protection of an innocent ("good faith") acquirer of securities — Article 7

Protecting an innocent acquirer of securities is critical to ensure the safety and stability of transactions. Therefore, it seems reasonable to include this in the Convention.

From the functionality and reasonability standpoint, however, we consider it unfair to apply Article 7 uniformly to all contracting states. It seems reasonable to allow each state to determine the boundaries of detailed conditionality under its domestic non-Convention law.

Under the domestic non-Convention law, each state has its own rules to protect innocent acquirers or purchasers of intermediated securities, which have different implications depending on each legal system.

There are the following differences between the Convention and the Korean law:

> 1) On the subjective elements (e.g. intention) that determine whether a securities acquisition is innocent:

- According to Article 4 of the Convention, a person acts with knowledge of an adverse claim if that person (a) has actual knowledge of the adverse claim, or (b) has knowledge of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim.

- Korean law states that the person must have "intention" or "gross negligence" in order to determine that the person is acting with knowledge of an adverse claim.

> 2) On securities credited to a securities account of an account holder:

- In case of a donation, the Convention rules out the protection rules for an innocent purchaser or acquirer of securities.

- Korean law does not limit the application of the protection rules with the background of the credit, which merely serves as a reference to determine whether the credit arises with the intention or negligence of the third party or acquirer.

3. Priority among competing security interests — Article 6.2

Article 6 of the Convention determines the priority between competing security interests, but does not deal with security interests acquired under Article 5(2). This raises questions about how to prioritize between a security interest delivered as stated in Article 5(2) and others acquired elsewhere, either by the ways permitted by the domestic non-Convention laws or by other methods.

The acquisition of a security interest under Article 5(2) is not different from that under Article 5(3), as both are permitted by the Convention. Rather, the method mentioned in Article 5(2) is the most typical way to acquire a securities interest.

To complement this Article, we suggest that Article 6(2) be divided into the following two provisions:

> 6.2 Security interests that become effective against third parties under Article 5(2) and Article 5(3) have priority over any security interest that becomes effective against third parties by any method permitted by domestic non-Convention law other than those provided by Article 5(2) or 5(3).
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> 6.3 Security interests that become effective against third parties under Article 5(3) shall be ranked according to the time of occurrence of the following events:
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> > (i) when the collateral agreement is entered into, if the relevant intermediary is itself the collateral taker;
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> > (ii) when a designating entry is made;
> >
> > (iii) when a control agreement is entered into, or, if applicable, a notice is given to the relevant intermediary.