

Introduction to Act on Security over Movable Assets and Receivables

By Yully KANG, Partner

In the past, Korean laws on security interests in personal property did not allow debtors in secured transactions to make effective use of movable assets and receivables as collateral. Acknowledging the need for reform, the Korean government enacted the Act on Security over Movable Assets and Receivables (the "Law on Security"), which became effective on June 11, 2012.

For a long time there had been a strong demand from the corporate sector to improve the system regarding security interests in movable assets, such as raw materials and goods in stock, as well as in receivables, namely accounts receivable. Many corporations had wanted an option to use their movable assets, such as their inventory, and accounts receivable for collateral in secured transactions when borrowing from financial institutions, but the old system discouraged such use. For movable assets, the old scheme required the physical possession of movable assets by a secured creditor in order to establish the lien and its perfection against third parties. This proved inefficient for a debtor, as the debtor no longer could make use of such assets for the debtor's business. For accounts receivable, the old law did not ensure enough protection for a secured creditor. In order to perfect a lien on accounts receivable against account debtors with the obligation to pay a debtor the amount due and against third parties, the old law required either a notice by the debtor to each account debtor with a fixed date stamp or the approval of the lien from each account debtor. Where many account debtors were involved, the compliance with the requirement was overly time consuming and expensive. Also, there was no central filing system for perfection or notice of liens. This meant that a secured creditor left open the possibility of third-party claims. All these limitations on perfection and notice to claimants made secured lending against movable assets and accounts receivable not attractive in Korea.

The Law on Security was enacted against this backdrop. It was a response to the demands of the corporate sector and academics alike for reforms in the current system to effectively utilize movable assets and accounts receivable, so as to promote international secured transactions involving security interests in such collateral, and to fall in line with the uniform standards for secured transactions promoted by member nations of the United Nations. The following are some major points of the Law on Security.

1. A new registry is established for the creation and perfection of security interests. In the case of movable assets, once details of movable assets are recorded at the registry, security interests are created and perfected against third parties. This is also the case for accounts receivable, but the lien against account debtors is not perfected against the account debtors merely by recording such details at the registry. (This will be discussed later in the document.) The purpose of making a filing with the registry is to give a national notice to all claimants of the existence of a security interest in movable assets and accounts receivable.
2. The new registry for making security interest filings is organized by the names of debtors that provide the security interest. This is in contrast to the registry for real estate, which is organized by the locations of properties. Before a debtor makes a filing with the new registry, the debtor must register the debtor's name, either a corporation name if the debtor is a legal entity or trade name if the debtor is an individual merchant.
3. The types of collateral that can be used for security interest includes existing movable assets (e.g. goods in stock) and accounts receivable as well as movable assets and accounts receivable to be acquired in the future. For accounts receivable yet to be created, they can be used for security interests and recorded at the registry on the condition that 1) they are distinguishable from other accounts receivable, and that 2) they are restricted to cash. Please note that securities are governed under the Financial Investment Services and Capital Markets Act. So securities do not fall under the purview of the Law on Security. Rather when securities are used as collateral, the Korean Civil Code and Korean Commercial Code apply.
4. Security interests and methods for creating and perfecting them allowed under the Law on Security do not represent an exclusive list. Other security interests and methods for creating and perfecting them permitted under the Korean law remain valid and fully enforceable. The ranking of priority among permitted security interests is determined by the chronological order of their perfection.

In addition to the major points of the Law on Security mentioned above, there are additional points that a secured creditor must keep in mind in establishing a security interest against a debtor pursuant to the Law on Security.

1. When providing the security interest in the debtor's collateral under the Law on Security, the debtor is obligated to confirm the debtor's ownership of the collateral and to disclose the existence of other security interests in the collateral. But given that there is no way to confirm debtor's statements, it is advisable that the secured creditor perform full due diligence on the collateral and the debtor's disclosures.
2. Upon default the secured creditor may use a public auction by the court or private sale of collateral to enforce the secured creditor's security interest. In the event that more than two secured creditors are involved, the junior creditor can proceed with the private sale only after the junior creditor obtains the approval of the senior creditor. If the junior creditor opposes the private sale of collateral by the senior creditor and has yet to receive the junior creditor's share of the secured debt from the senior creditor, the junior creditor may apply for the public auction by the court.
3. In order to perfect a lien on the accounts receivable, either the creditor or debtor must deliver to the account debtor a certified document from the security registry evidencing the filing of the security interest in the accounts receivable. Please note that this is the only method for perfection of the security interest against the account debtor under the Law on Security, although as mentioned previously, other methods for creation of a lien over the accounts receivable permitted under the Korean Civil Code and for perfection against the account debtor, such as the giving of notice to the account debtor with a fixed date stamp permitted by the Korean Civil Code, are still valid.