

## Due Diligence in Korea

**The confluence of a highly industrialised economy and closely connected political and business elites makes South Korea a potential regulatory minefield for foreign investors. One of the fastest growing economies in the OECD, Korea is also rated as one of the most corrupt. The difficulty in obtaining even basic information on counterparties adds to the complexity and concerns for businesses undertaking pre-acquisition or anti-corruption due diligence in Korea.**

### Corruption and Transparency in Korea

The 2010 Transparency International Corruption Perceptions Index (CPI) ranked the Republic of Korea (Korea) 39<sup>th</sup> alongside Mauritius, rating it as more corrupt than the likes of United Arab Emirates (28<sup>th</sup>), Taiwan (33<sup>rd</sup>), Bhutan (36<sup>th</sup>) and Brunei (38<sup>th</sup>). Korea scored a lowly 5.4 out of 10, with a higher score suggesting less perceived corruption. This was down from 5.5 in 2009 and is well below the average score of 6.97 for Organization for Economic Cooperation and Development (OECD) members.

Factors which are likely to have hindered Korea's progress and drop in its score include President Lee Myung-bak's decision to pardon Lee Kun-hee, the Chairman of Samsung, who was convicted of tax evasion in 2008. The company was probed in 2008 following accusations that it had used a slush fund to bribe influential government officials in South Korea. Lee resigned in the wake of the scandal but is now back at the helm of Samsung. Other issues cited by Transparency International include nepotism in the civil service and lenient punishment of corrupt public officials.

In June 2009, The Financial Action Task Force (FATF) and the Asia Pacific Group on Money Laundering (APG) jointly conducted an [assessment](#) of the implementation of anti-money laundering and counter-terrorist financing (AML/CFT) standards in Korea in considering it for membership of the FATF. While they concluded that "the compliance culture within Korean financial institutions is very strong", they also highlighted that "issues such as beneficial ownership, politically exposed persons and correspondent banking have yet to be addressed" and criticised Korea's lack of enforcement. The report suggested that "penalties available and applied are not sufficiently effective, proportionate or dissuasive and there is a lack of focus on money laundering investigations".

### Individual and Company Due Diligence in Korea

While the methodology behind the CPI figures and ratings have been criticised, it remains a widely used benchmark for international organisations and businesses to rank countries' corruption risk. However, the index ranks "perceived levels" of public sector corruption and does not measure private sector corruption or transparency. It is Korea's high levels of private corruption and lack of corporate transparency, particularly in relation to disclosing individual corporate officers and identifying final beneficial ownership of private companies, that gives many foreign investors cause for concern when attempting to undertake due diligence in Korea.

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This information deficit makes undertaking due diligence on Korean entities, whether for commercial purposes or to ensure compliance with anti-corruption laws such as the US Foreign Corrupt Practices Act (FCPA) or UK Bribery Act, difficult and time consuming.

It is currently not possible to conduct individual Directorship searches in Korea using a Director's name. This makes identifying other interests or appointments that an individual Director of a counterparty or portfolio company may hold much more complicated and far from comprehensive. Unless investigators or researchers speak Korean and have access to a range of in-country databases, official registers and government agencies which hold this information, completing meaningful and comprehensive due diligence checks is not possible and critical background information on individuals and companies can easily be missed. Litigation searches in Korea by individual name are possible if firms have access to the correct personal information and know how to access the court records. It is also possible to conduct corporate litigation searches in Korea which can identify a company's previous involvement in civil cases. These searches can provide a significant insight into the counterparty as well as previous corruption cases and should be combined with checks of relevant regulatory or supervisory authorities, many of which maintain lists of banned or sanctioned individuals.

Korea has some of the toughest privacy laws in Asia, particularly in regards to protection of personal information. When performing pre-acquisition or anti-corruption due diligence in Korea, it is critical that any searches or investigations comply strictly with local laws and regulations. The combination of these factors means that unless companies can afford to maintain significant in-house Korean expertise within their legal and compliance teams, undertaking effective due diligence in Korea becomes an impossible task which needs to be undertaken by a specialist due diligence provider such as Billiter.

One way for Korea to demonstrate its commitment to combating corruption and increasing commercial transparency without impinging upon personal privacy would be for the Korean government to overhaul the Supreme Court registration system to provide access to individual Directorship searches, in-line with other advanced Asian economies such as Singapore and Hong Kong. This would promote greater commercial transparency and might eventually help Korea to move up the CPI rankings or gain membership of the FATF.

### Chaebol Corruption

One factor which often gives foreign firms a false sense of security in Korea is the interaction with large well known counterparties. Chaebol (재벌) is the name used to refer to major Korean conglomerates, which include household names such as LG, Samsung, Daewoo and Hyundai, which dominate the Korean economy. The name in Korean translates as "business family" as well as "monopoly", and these business groupings with their various listed and unlisted affiliated entities have a reach which extends far beyond the economic arena to Korean politics. A notable example is that of Chung Mong-joon (정몽준), who is not only a member of the National Assembly of Korea, but is also the controlling shareholder in Hyundai Heavy Industries Group. He is also a Vice President of FIFA and has recently announced that he will seek selection as the Grand National Party candidate in next year's Korean Presidential elections.

The Chaebols' reach extends out to every corner of the Korean economy and most small to mid-sized businesses are in some way linked to the Chaebols as suppliers, distributors or shareholders or through family ties. Understanding these linkages and how these relationships are maintained is a critical component in any due diligence exercise. The lack of transparency and difficulty in accessing information often means that foreign investors are unaware of major political and business linkages. It is equally important that the Chaebols understand that their Western business partners will undertake enhanced due diligence prior to establishing a significant commercial relationship and that, with major subsidiaries in the US and Europe, they too are subject to new laws such as the UK Bribery Act and increased enforcement of the FCPA.

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### Acquisition and Oversight of Korean Entities

The problems in undertaking due diligence on Korean companies and ensuring ongoing anti-corruption compliance at Korean subsidiaries or joint venture partners is exemplified by the Tyco case. In 2006, the United States Securities and Exchange Commission (SEC) settled a civil injunctive action against NYSE-listed Tyco International Ltd for allegedly violating federal securities laws by overstating its reported financial results. The SEC also alleged that Tyco violated the FCPA following its acquisition of Dong Bang Industrial Co Ltd, a Korean fire protection services firm. While due diligence on Dong had highlighted that illicit payments to government officials were common in the South Korean contracting business, the SEC [alleged](#) that Tyco “did not have uniform company-wide FCPA compliance program in place or a system of internal controls that could detect and prevent FCPA misconduct at its globally dispersed business units.” Following the acquisition, Dong Bang executives allegedly provided entertainment to government officials, including the South Korean Minister of Construction and Finance, and made at least one payment to an employee of a government-operated power plant to obtain business. For Tyco its business units in Brazil and Korea were where the US authorities were able to identify alleged misconduct and inadequacies.

In March 2011, in another significant case which highlights FCPA risks in Korea, IBM resolved civil charges brought by the SEC for [allegedly](#) violating the FCPA when its subsidiaries and a majority-owned joint venture were accused of providing cash payments, improper gifts, as well as improper travel and entertainment to government officials. More recently, the SEC is reported to have commenced an [investigation](#) into Diageo in Korea, while in May 2011 the Incheon District Prosecutor’s Office indicted representatives of two Korean companies under the Act on Combating Bribery of Foreign Public Officials in International Business Transactions, the Korean equivalent of the FCPA. This is believed to be the first domestic prosecution involving a Chinese entity for bribery in Korea. The accused are alleged to have bribed the executive of a Chinese government-owned airline, who is considered to be a public official under Korean law. How many other domestic and foreign-owned businesses operating in Korea will fall under the spotlight of Korean and US authorities in this seemingly corrupt and difficult due diligence environment remains to be seen.

### Billiter Partners

Billiter Partners is a specialist provider of investigations and compliance due diligence reports on counterparties. Billiter work with clients globally, across all sectors, to design and implement compliance due diligence programmes that are tailored to the needs of each individual business and help our clients comply with the FCPA and a number of other domestic anti-bribery laws and rules based regimes, including the provisions of the UK Bribery Act. Our research teams in Hong Kong and London possess dedicated Korean language researchers and Korean due diligence expertise.

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