

# **Financial Sector Restructuring in Korea**



**August 3, 1998**

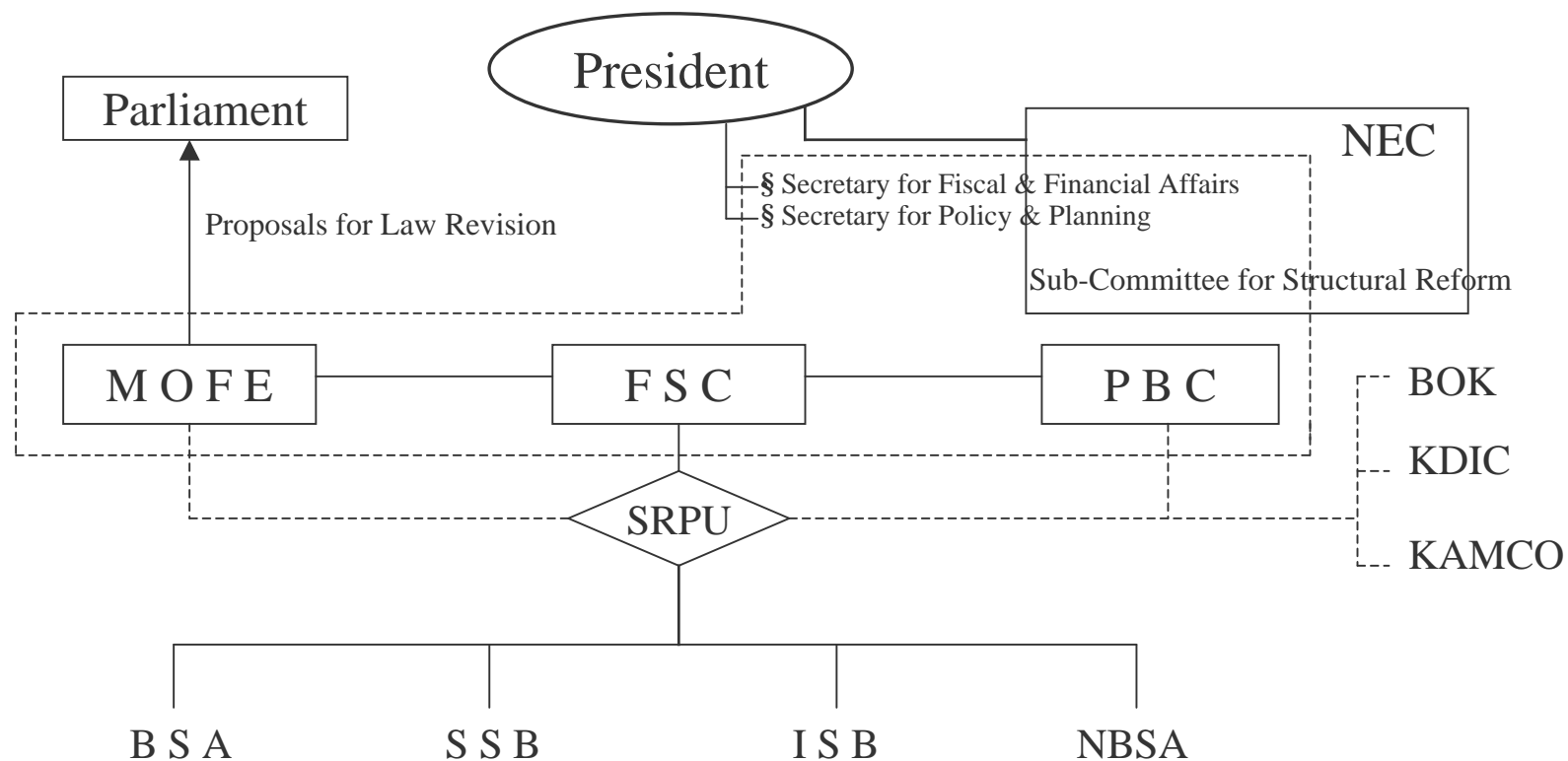
**Financial Supervisory Commission**

# Basic Principles of Financial Sector Restructuring

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- ☞ Efficient use of public resources
  - Market-oriented restructuring
  - Burden-sharing with shareholders, employees and managerial staff
- ☞ Complying to international standards
- ☞ Sequential restructuring
  - Banks first
  - But NBFIs destabilizing the financial system shut down any time
- ☞ Closely linked to corporate sector restructuring
  - Accelerate corporate restructuring through bank reform
  - Enhance transparency of corporate management
  - Facilitate exit of non-viable corporations
- ☞ Strengthening financial supervision

# Role and Structure of Official Agencies for Crisis Management



NEC: National Economic Council; MOFE: Ministry of Finance and Economy; PBC: Planning and Budget Commission; BOK: Bank of Korea; KDIC: Korea Deposit Insurance Corporation; KAMCO: Korea Asset Management Corporation; SRPU: Structural Reform Planning Unit; BSA: Banking Supervisory Authority; SSB: Securities Supervisory Board; ISB: Insurance Supervisory Board; NBSA: Non-bank Supervisory Authority

# Structural Reform Planning Unit

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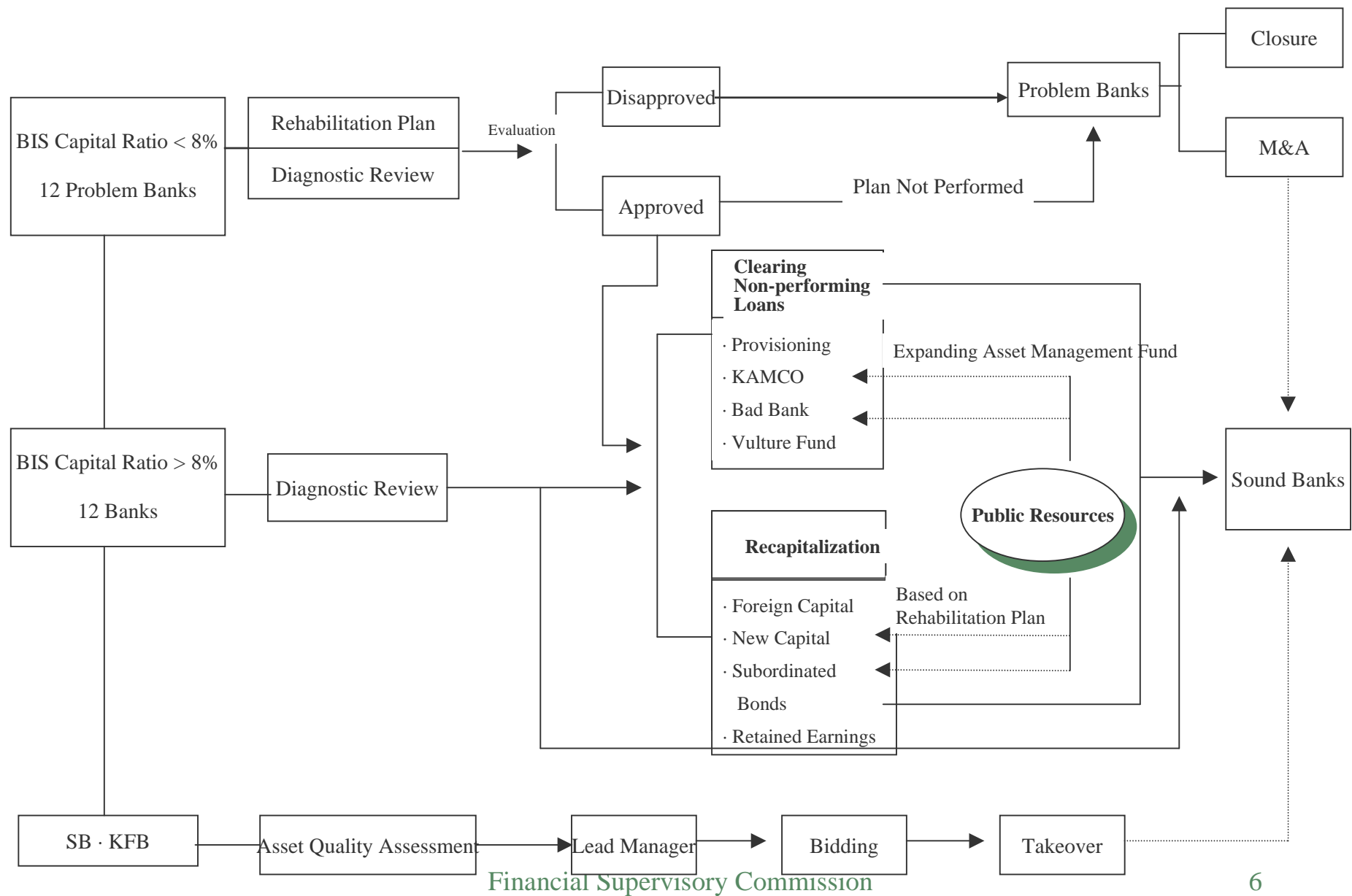
- ☛ The Chairman of the FSC acts as Head of the Unit
- ☛ Composed of around 50 members
  - Seconded from existing agencies
  - Participated by private experts
- ☛ Main Functions
  - Designing an overall strategy and work plans for structural reform of financial and corporate sectors
  - Monitoring the implementation of the work plans
  - Analyzing the developments in financial and corporate sectors
  - Advising decision-makers at higher levels
  - Setting up a contingency plan

# Non-performing Assets (Mar. 98)

(Billion won)

	Total Loans	Problem Loans		Non-Performing Loans		Non-Performing Securities	Non-Performing Assets
			Ratio		Ratio		
<b>Banks</b>	516,606	87,265	16.9%	38,935	7.5%	9,297	48,232
Commercial banks	365,071	68,576	18.8%	28,044	7.7%	8,844	36,887
Specialized banks	151,536	18,689	12.3%	10,891	7.2%	453	11,344
<b>Non-bank Financial Institutions</b>	256,972	24,761	9.6%	17,653	6.9%	15,324	32,978
Merchant banks	46,443	3,485	7.5%	2,231	4.8%	1,835	4,066
Securities Firms	17,375	2,184	12.6%	1,622	9.3%	1,256	2,877
Insurance Companies	49,540	6,134	12.4%	4,762	9.6%	6,065	10,827
Life	41,473	2,285	5.5%	1,055	2.5%	4,775	5,829
Property & Casualty	4,467	249	5.6%	107	2.4%	1,290	1,398
Fidelity surety	3,600	3,600	100%	3,600	100%	0	3,600
Investment Trust company	82,950					2,669	2,669
Leasing Companies	35,135	6,732	19.2%	5,081	14.5%	3,500	8,581
Mutual Savings	25,527	6,226	24.4%	3,957	15.5%	0	3,957
<b>Total</b>	<b>773,578</b>	<b>112,026</b>	<b>14.5%</b>	<b>56,588</b>	<b>7.3%</b>	<b>24,621</b>	<b>81,209</b>

## Financial Sector Restructuring



# Diagnostic Review for all commercial banks

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- ☛ For 12 problem banks, performed before June 30
- ☛ For remaining 12 banks + KLTCB, performed by early September
- ☛ Performed by internationally-recognized accounting firms
- ☛ Focus on asset quality assessment
- ☛ Importance
  - providing the FSC with realistic assessment of the problem
  - and with better understanding for building strategies for damage control
  - reference for M&A negotiation, etc

# Rehabilitating Undercapitalized Commercial Banks

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- ☛ 12 problem banks with BIS/ CAR < 8% at the end of 1997
- ☛ Rehabilitation plans submitted on April 30, 1998
- ☛ Plans to be evaluated by June 30, 1998
- ☛ Appraisal Committee including international experts evaluated the plans and made recommendation to the FSC.
- ☛ FSC made decisions on June 29, 1998



## Resolution for 12 Problem Banks (6/29/98)

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- ☞ None of rehabilitation plans submitted by the banks received approval
- ☞ 7 banks including four top six banks received conditional approvals
  - These banks need to submit plans to implement the conditions (done)
  - The plans will contain change in management, recapitalization and merger plans, capital reduction, cost reduction, schemes to prevent the accumulation of NPLs
- ☞ 5 banks' plans were disapproved ⇨ taken over by healthier banks under purchase and assumption arrangements
  - Dong Hwa ⇨ Shinhan; Dongnam ⇨ Housing & Commercial ; Dae Dong ⇨ Kookmin ; Chung Chong ⇨ Hana ; Kyungki ⇨ Koram

## Key Statistics for Acquiring & Failing Banks

	Establishment Year	Total assets (bil. won)	No. of Staff	No. of Branches
Shinhan	1981	43,585	4,605	223
Dong1Hwa1 ↗	1989	12,968	2,105	138
Housing1&1Commercial	1967	46,953	11,076	499
Dongnam1 ↗	1989	10,056	1,843	119
Kookmin	1963	54,400	12,248	511
Dae1Dong1 ↗ 11	1989	7,715	1,888	107
Hana	1971	22,944	1,707	110
Chung1Chong1 ↗	1968	4,829	1,592	120
Koram	1983	16,434	2,138	122
Kyungki1 ↗	1969	8,894	2,602	194

↗ failing banks

# Measures to protect acquiring banks from spilled over problem loans

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- ☞ Only good assets will be purchased with 6-month put option
- ☞ Won-denominated guarantees, liabilities not related with banking business or under court proceedings will not be assumed
- ☞ Korea Deposit Insurance Corporation (KDIC) will cover for net deficits from P&A transactions
- ☞ Fresh capital injected by the government to enhance acquiring bank's BIS ratio to pre-acquisition level
- ☞ Acquiring bank's bad assets purchased by KAMCO
- ☞ Public resources as much as 10 trillion won are estimated to be used for resolving 5 failed banks.
  - Purchase of NPLs: 3.9 trillion won (acquiring: 1.7, acquiree: 2.2)
  - Capital subscription: 2 trillion won
  - Compensation for net liabilities: 4.1 trillion won

# Resolution of 7 conditionally-passed banks

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- ☞ Implementation plans submitted
  - management change, recapitalization and merger plans, capital reduction, management improvement, etc
- ☞ FSC review
  - Template approach to test the feasibility of implementation
- ☞ Decisions to be made by the end of September
- ☞ Hanil and CBK: merger with government assistance
  - first voluntary merger
  - purchase of NPLs and capital injection by government
  - Terms of reference b/w government and merged bank
- ☞ 3 regional banks

# Privatization of Seoul and Korea First Banks

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## ☞ Time Frame

1. Selecting Morgan Stanley as lead manager for the process
2. Diagnostic audit performed by Coopers & Lybrand (done)
3. Sell strategy being developed based on valuation results from MS
4. Downsizing
5. Obtain bids before Nov. 15, 1998

## ☞ Importance

- Less fiscal burden
- Restoring market confidence
- Inflows of fresh foreign capital

# Restructuring of NBFIs

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## ☛ Restructuring principles

- Self-driven rehabilitation will be encouraged under the responsibility of major shareholders
- If a recovery is deemed unrealistic, NBFIs will be exited promptly

## ☛ Merchant banks

- 14 banks: licenses revoked, 2 banks: further review for revocation
- Further recapitalization schedule for meeting BIS/CAR > 8% by June 30, 1999

## ☛ Leasing companies

- Insolvent companies whose parent banks do not possess clear commitment will be liquidated through a bridge leasing company soon

# Restructuring of NBFIs (continued)

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## ☛ Insurance companies

- Rehabilitation plans ⇒ Due diligence (done)
- Review by an appraisal committee (undergoing)
- Resolutions (P&A, liquidation through a bridge company): August

## ☛ Securities houses

- Due diligence by the mid September
- Review and appropriate measures by the end of September

## ☛ Investment trust companies

- Rehab plans already submitted
- Management improvement measures by September
- Amendment to related rules will be pursued in conjunction with bank trust accounts.

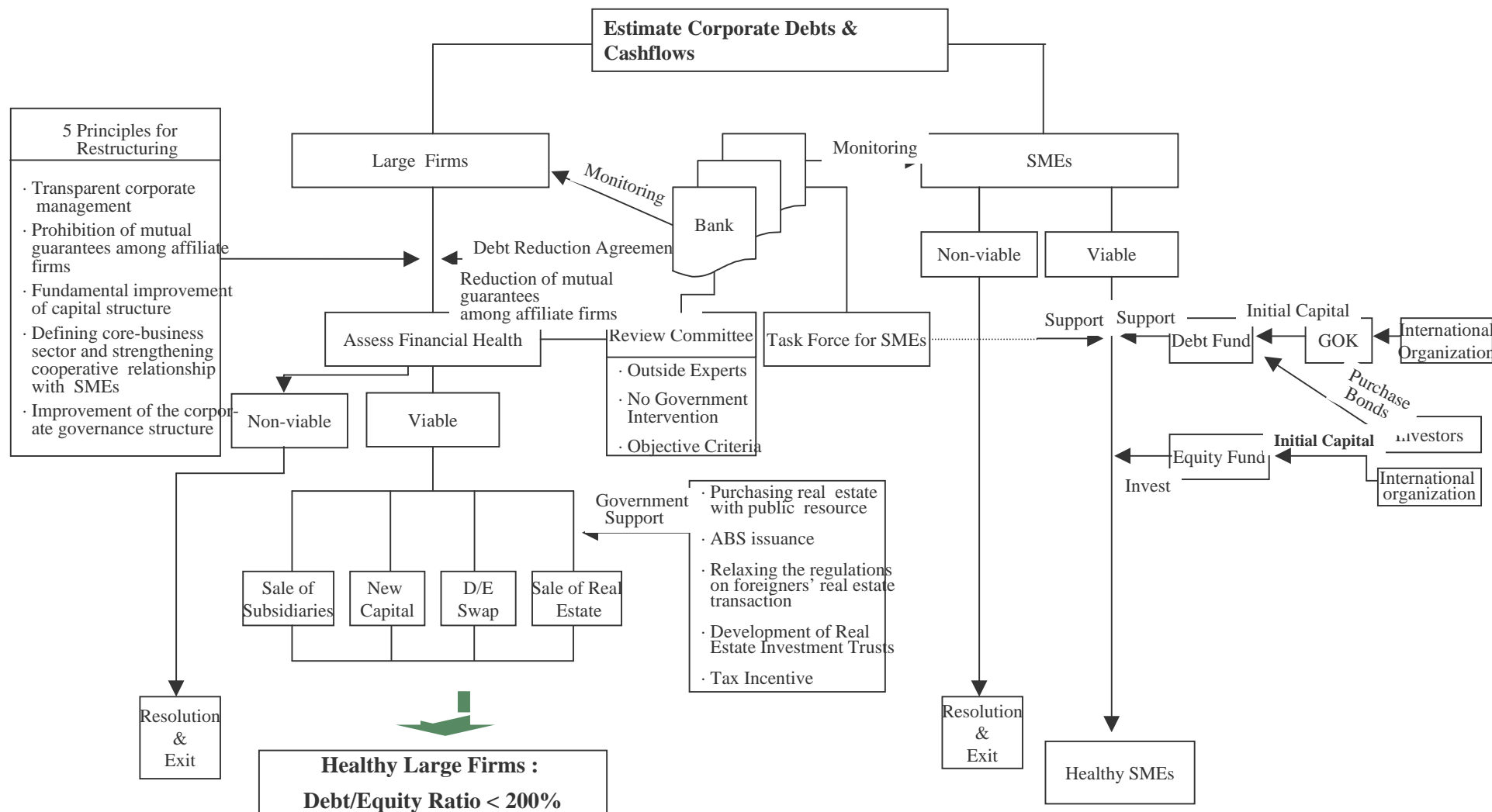
# Financing Plan for Financial Restructuring

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- ☛ The program targets disposal of NPLs totaling 100 trillion won
  - Financial institutions will dispose half of them on their own accord.
  - KAMCO will purchase remaining half at around 25 trillion won.
  
- ☛ 16 trillion won for recapitalization of financial institutions.
  
- ☛ 9 trillion won for pledged depositor protection.
  
- ☛ All together 50 trillion won will be mobilized by issuing public bond guaranteed by the government.
  - Interest cost will be borne by the budget.
  - Resources will be generated by fiscal tightening and privatization of state-owned enterprises.



# Corporate Sector Restructuring



# Corporate Sector Restructuring

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- ☛ Financial Structure Improvement Agreements between main creditor banks and 64 business groups
- ☛ 55 companies were classified as non-viable by creditor banks
- ☛ 208 financial institutions signed on “Corporate Restructuring Agreement” to carry out corporate workout efficiently
  - From the day creditors’ council is called to convene, all creditor institutions effectuate a standstill on all claims on the debtor
  - Cases where more than three meetings of the creditors’ council took place without producing any mutual agreement can be referred to the arbitration committee (“Corporate Restructuring Coordination Committee”)