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Plan for Privatization of KDB and Establishment of KDF

June 2008

Financial Services Commission

Ⅰ. Purpose

◇ Privatization of KDB is not intended for restructuring of public companies. It is a progressive strategy to develop the financial industry into a new growth engine by turning it into a high value-added industry.

◇ Korea Development Fund (KDF), an advanced market-friendly policy financing vehicle to be established with funds from KDB's privatization, will support promising SMEs.

□ The privatization initiative provides the optimal solution to realizing the national agenda of nurturing a competitive CIB (corporate and investment bank).

○ By combining KDB, which has a strong corporate banking capacity, with Daewoo Securities, Korea's leading securities house, the foundation will be laid to secure a competitive investment bank.

○ Advancement of innovative value-added industries will take place by securing a competitive investment bank, which will act as a core intermediary of the capital market.

* An investment bank that provides risk capital to innovative industries, which will be central to the future Korean economy, is a must.

□ The privatization of KDB will trigger reorganization and further advancement of the financial industry.

○ Domestic financial institutions typically stay complacent in the limited domestic market, maintaining their retail banking-focused revenue structure.

* Currently, competitiveness of domestic banks and securities firms is limited as they concentrate on retail-banking and brokerage fees, respectively.

* Overseas assets of leading global investment banks are over 50% of their total assets (e.g. Citi: 51%, HSBC: 56%, UBS: 91%). Yet, the average figure for domestic banks in 2006 was only 2.5%.

○ KDBH itself will actively seek M&A opportunities to develop into a global investment bank through diversification of revenue structure and expansion of overseas business. By presenting new business models, it will act as a benchmark for other financial institutions.

⇨ This will provide domestic financial institutions with a new impetus and opportunity to make improvement, including M&A activities, exploration of new business areas, and active overseas expansions.

□ The financial industry as a growth engine will provide a new growth momentum for the Korean economy.

○ Advancement of KDBH will promote export industrialization, and the Korean financial industry will develop as an independent high value-added industry.

* The IB industry will activate export industrialization through establishment of a global network, employment of qualified human resources, and promotion of domestic and cross-border M&As.

□ The government's support for SMEs will shift to a market-friendly policy financial system.

○ Funds raised through KDB's privatization will be used to establish Korea Development Fund (KDF), a new market-friendly policy financing vehicle that conforms to global standards.

* In many European countries and the U.S., policy financing is provided mostly through markets. Direct policy financing is minimized.

○ KDF will fully inherit KDB's role as a window for overseas funding and a market stabilizer.

○ KDF will use a more advanced indirect on-lending scheme to leverage the market's ability to select and evaluate the companies better fit for policy financing.

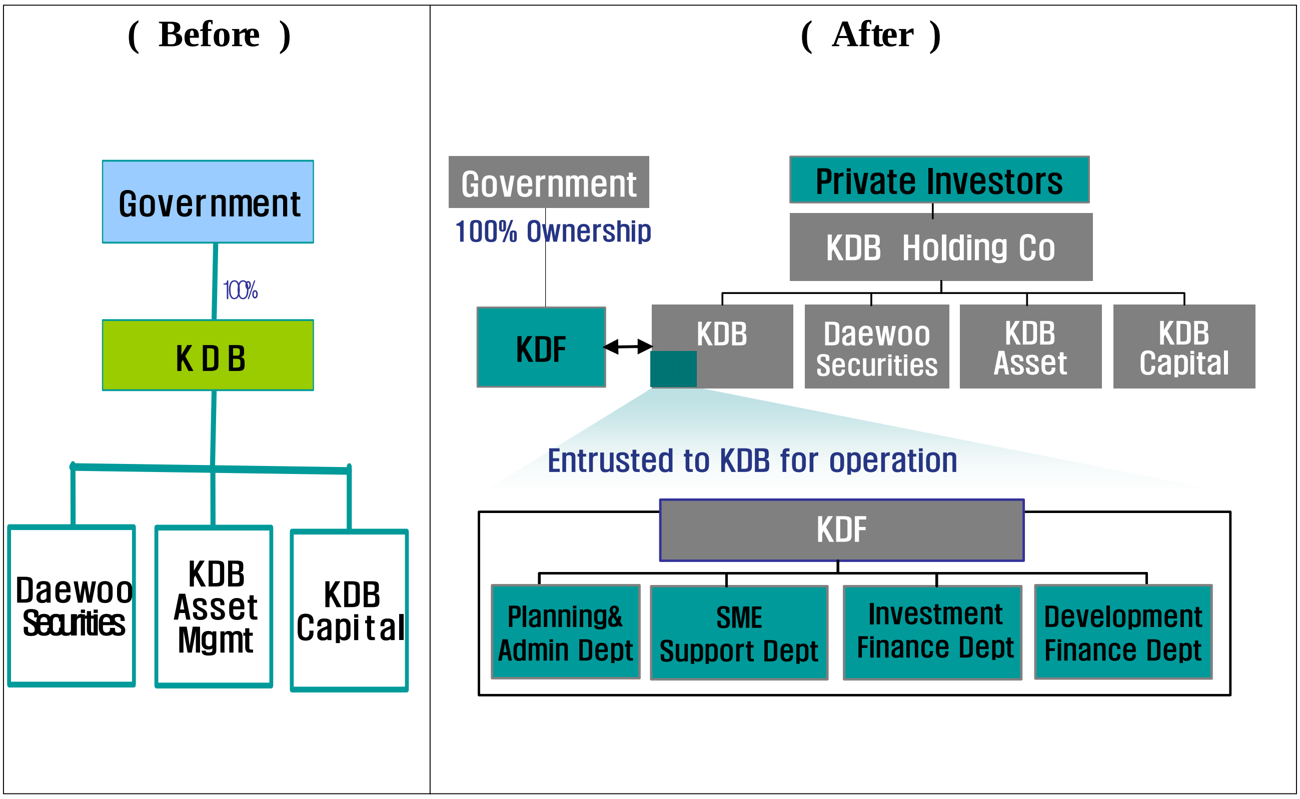
- KDF will not offer direct support to promising SMEs that have easy access to the market. Instead, it will assist* private financial institutions to select target companies themselves.

  * In order to disperse the SME credit risk to be taken by private financial institutions, KDF can provide support through credit enhancement (50%), securitization, etc.

- KDF will promote stable long-term funding by developing and supporting SMEs through the capital market.

Previous SME Financial Support	New Market-friendly SME Financial Support
▪ Short-term loans ▪ Direct support from a policy financing institution ▪ Evaluation focused on tangible collateral and solvency of each SME ▪ Support provided mostly through indirect financing (loans and guarantees)	▪ Long-term loans ▪ Indirect support through market intermediary ▪ Evaluation focused on profitability and technology capacity ▪ Utilization of capital market for investment and securitization in addition to loans and guarantees

◈ Organization Structure of the Privatized KDBH



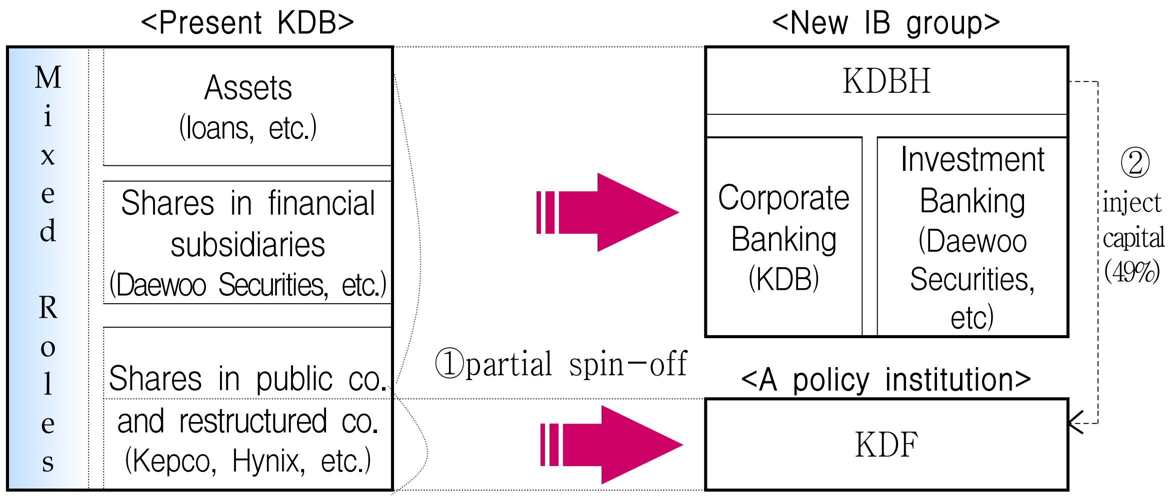
Before	After
Coexistence of policy banking and commercial banking	Commercial banking → Investment banking under holding company structure Policy banking → Market-friendly policy financing
Increased market friction and limited advancement of private financial sector	No market friction and further advancement of private financial sector

Ⅱ. Privatization of KDB

□ KDBH and KDF will be set up through the spin-off of KDB.

- ○ KDBH will be established with KDB and its financial subsidiaries, including Daewoo Securities. Part of KDB's equity investment in the previously distressed companies (e.g. Hynix) and public companies (e.g. Kepco), together with KDB's liabilities, will be transferred to launch KDF.

□ As soon as KDF is established, 49% of KDBH shares will be transferred to KDF in the form of capital injection. KDF will then begin to provide market-friendly financing for SMEs.



□ Disposal of the 49% share injected into KDF (2009 - 2010)

- ○ The 49% stake transferred to KDF will be disposed through various means (e.g. Pre-IPO investment, IPO, block sales).
- ○ The investment banking capability will be enhanced by attracting strategic investors.

□ Disposal of the remaining KDBH shares (51%) (2011 - 2012)

- ○ Shares will be sold to domestic and foreign consortium (pension fund, PEF, etc.) seeking to either enlarge their structure or sharpen their competitiveness by engaging in investment banking businesses.

Ⅲ. Measures to Minimize Effects on KDB's External Debt

□ The government will provide guarantee or other equivalent measures to secure the payment of the existing debts of KDB to prevent possible demand by overseas investors for early redemption.

○ The Offset of Losses (KDB Act Article 44) will remain effective for as long as the government stays the controlling shareholder of KDB.

□ While the government remains as the controlling shareholder, part of KDB's new external debts will be guaranteed by the government in case there are concerns over possible reduction in KDB's overseas funding activities due to adverse changes in market conditions.

* New guaranteed debts will be issued, subject to prior approval by the National Assembly, for specific purposes such as refinancing of existing guaranteed debts, within an approved limit.

Ⅳ. Transformation of KDBH into an IB Group

□ To maximize the sales value of KDBH, its transformation into a global investment bank will be actively supported.

○ (Deregulation) FSC's approval on budget & business plans will be abolished. Existing restrictions on the taking of demand deposits and other operations will be lifted as well.

○ (Governance) KDBH will attract renowned investment banking experts by utilizing proper incentives linked to successful privatization. For the sake of managing government assets, the privatization process will be monitored by a government-appointed Chairman of BOD.

○ (Sizing up) KDBH will seek additional M&A opportunities in the domestic and overseas financial markets to secure global competitiveness.

Ⅳ. Plan for the Operation of KDF

□ (Organization) During the early stage, the number of KDF's staff will be kept at a minimum by entrusting the operation to KDB.

* Once privatization has been completed, KDF will be run by its own staff and reorganization of roles with other policy financing institutions will be considered.

□ (Main functions) KDF will introduce a market-friendly system to support SMEs and will take over the policy financing roles previously played by KDB.

○ (Financing for SMEs) In the process of supporting SMEs, by utilizing private financial institutions' capability to evaluate, implement and review, KDF will provide indirect loans, co-investments, and credit enhancement through an on-lending scheme.

- KDF will provide the funds and guidelines for on-lending. Meanwhile, private financial institutions will evaluate the eligibility of the company, determine the interest rate, and extend the loan.
- In order to mitigate the risk burden on the private financial institutions, KDF will provide credit enhancement (up to 50% of the loan) and securitization.
- KDF will differentiate itself from existing policy finance institutions by specifying* eligible SMEs and developing support programs in cooperation** with other financial institutions.

* KDF will specialize in companies with credit ratings from B to BBB screened by private financial institutions as eligible. Meanwhile, existing policy finance institutions will focus more on policy-oriented financing, e.g. offering support to companies with low credit ratings and short industry experience, or technology-based companies.

** Co-financing with commercial banks on "Technology guarantee loans" by KIBO Technology Fund will be considered.

○ (Other Policy Financing) KDF will carry out other policy financing roles, e.g. a market stabilizer at times of crisis and a window for overseas funding, that do not trigger competition with the private sector.

□ (Sources for operation) Funds, raised through the disposal of KDBH shares (49%), and other shares in restructured companies, acquired from the spin-off of KDB, will be main source of operation.

V. Timeline of the plan

	Privatization of KDB	**Establishment of KDF**
June 2008	- Announcement of the government's privatization plan - Non-deal Roadshow for overseas investors	- Announcement of the government's privatization plan
Jun - Jul	- Carrying out legislation process [Revised KDB Act Draft] - Reform of KDB's corporate governance	- Carrying out legislation process [KDF Act Draft]
Aug	- Submission of revised KDB Act draft to the National Assembly	- Submission of KDF Act draft to the National Assembly
Sept - Oct	- Review by the National Assembly	- Review by the National Assembly
Nov - Dec	[After approval by the National Assembly] - Spin-off of KDB - Establishment of KDBH	[After approval by the National Assembly] - Establishment of KDF through spin-off of KDB
Jan 2009	- Investment in KDF with 49% share of KDBH	- Capital injection with 49% share of KDBH
Jan 2009 - Dec 2010	- Disposal of the 49% share owned by KDF (Pre-IPO, IPO, block sale)	- Receive sales proceeds from disposal of the 49% share
After 2011 - 2012	- Disposal of controlling shares and completion of the privatization within the term of the current government.	