

ASIAN DEVELOPMENT BANK

PCR: KOR 31651

PROGRAM COMPLETION REPORT

ON THE

**FINANCIAL SECTOR PROGRAM
(Loan 1601-KOR)**

TO THE

REPUBLIC OF KOREA

October 2001

CURRENCY EQUIVALENTS

(As of 31 August 2001)

Currency Unit	–	Won (W)
At Fact-Finding		At Program Completion
W1.00 = \$0.0009		W1.00 = \$0.0009
\$1.00 = W1,112.3		\$1.00 = 1,145.4

ABBREVIATIONS

ADB	–	Asian Development Bank
BOK	–	Bank of Korea
BSA	–	Banking Supervisory Authority
DMCs	–	developing member countries
EMK	–	Extended Mission to Korea
FSC	–	Financial Supervisory Commission
FSP	–	Financial Sector Program
FSS	–	Financial Supervisory Service
IFIs	–	International financial institutions
IMF	–	International Monetary Fund
ITCs	–	investment trust companies
ITMCs	–	investment trust management companies
KAMCO	–	Korea Asset Management Corporation
KDB	–	Korea Development Bank
KDIC	–	Korea Deposit Insurance Corporation
KOFEX	–	Korea Futures and Options Exchange
KSE	–	Korea Stock Exchange
LIBOR	–	London interbank offered rate
MOFE	–	Ministry of Finance and Economy
NBFIs	–	Non bank financial institutions
NPAMF	–	Non-Performing Asset Management Fund
NPL	–	nonperforming loan
TA	–	Technical Assistance

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

CONTENTS

	Page
BASIC DATA	ii
I. PROGRAM DESCRIPTION	1
II. EVALUATION OF IMPLEMENTATION	1
A. Program Components	1
B. Implementation Arrangements	6
C. Program Schedule	6
D. Conditions and Covenants	6
E. Disbursements	7
F. Environmental Impact	7
G. Performance of the Borrower and the Executing Agency	7
H. Performance of the Asian Development Bank	7
III. THE TECHNICAL ASSISTANCE	7
IV. EVALUATION OF INITIAL PERFORMANCE AND BENEFITS	8
A. Macroeconomic Performance	8
B. Attainment of Benefits	9
V. CONCLUSIONS AND RECOMMENDATIONS	12
A. Conclusions	12
B. Lessons Learned	13
C. Recommendations	14
APPENDIXES	16

BASIC DATA

A. Loan Identification

1.	Country	Republic of Korea
2.	Loan Number	1601-KOR
3.	Loan Title	Financial Sector Program
4.	Borrower	Republic of Korea
5.	Amount of Loan	\$4.00 billion
6.	PCR Number	PCR: KOR 653

B. Loan Data

1.	Fact-Finding	
	- Date Started	29 November 1997
	- Date Completed	09 December 1997
2.	Loan Negotiations	
	- Date Started	10 December 1997
	- Date Completed	11 December 1997
3.	Date of Board Approval	19 December 1997
4.	Date of Loan Agreement	23 December 1997
5.	Date of Loan Effectiveness	
	- in Loan Agreement	23 March 1998
	- Actual	23 December 1997
	- Number of Extensions	None
6.	Closing Date	
	- in Loan Agreement	30 June 2000
	- Actual	07 December 1999
	- Number of Extensions	None
7.	Terms of Loan	
	- Interest Rate	Floating
	- Maturity (number of years)	7

8. Disbursements

a. Dates

Initial Disbursement	Final Disbursement	Time Interval
24 December 1997	31 December 1998	12.2 months

Effective Date	Original Closing Date	Time Interval
23 December 1997	30 June 2000	30.3

b. Amount (\$ billion)

Original Allocation	Amount Canceled	Amount Disbursed	Undisbursed Balance
4.00	0.30	3.70	0

C. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person Days	Specialization of Members
Reconnaissance	28 Nov 97 – 13 Dec 97	10	121	VP, East Director, IED Senior Economist Resident Scholar Senior Operations & Administrative Officer Operations & Administrative Officer Senior Programs Officer Economist Assistant General Counsel Sr. Policy Officer
SPA 1	30 Dec 97 – 05 Jan 98	1	7	Operations & Administrative Officer
SPA 2 ^a	10 Aug 98 – 14 Aug 98	4	20	Director, IED Lead Financial Specialist Senior Economic Advisor/ Head, Extended Mission to Korea (EMK) Counsel Financial Analyst
Review 1 ^b	26 Oct 98 – 17 Nov 98	4	74	Director, IED Lead Financial Specialist Senior Economic Advisor/ Head, EMK Investment Officer
Review 2 ^c	07 Jun 99 – 11 Jun 99	2	10	Lead Financial Specialist Senior Economic Advisor/ Head, EMK
Review 3 ^d	18 Oct 99 – 29 Oct 99	4	34	Director, IED Lead Financial Specialist Senior Economist Senior Economic Advisor/ Head, EMK

^a Assisted by two consultants with expertise on pensions and insurance.

^b Assisted by five staff consultants with expertise on pensions, insurance, and banking.

^c Assisted by two staff consultants (financial sector reform specialist and pensions and insurance reform specialist).

^d Assisted by staff consultant (financial sector reform specialist).

I. PROGRAM DESCRIPTION

1. On 19 December 1997, the Asian Development Bank (ADB) approved, for the Republic of Korea (Korea), (i) the Financial Sector Program (FSP) loan for \$4 billion from its ordinary capital resources,¹ and (ii) a technical assistance (TA) loan of \$15 million for Institutional Strengthening of the Financial Sector.² The FSP, aimed to assist the Government immediately after the onset of the Asian crisis, was designed to address structural weaknesses of the financial sector by increasing reliance on market forces and independent regulatory oversight. The FSP focused on (i) promoting resilience of the banking system by strengthening the prudential norms and regulatory framework, (ii) improving entry and exit policies and providing financial services on a competitive basis, (iii) improving market efficiency by enhancing competition and strengthening the regulatory framework, and (iv) improving the disclosure of corporate financial and accounting information.

2. The FSP loan was part of the International Monetary Fund (IMF)-led international rescue package of \$58.4 billion in credits to assist Korea in overcoming the external payments crisis that erupted in the second half of 1997. Under this package, IMF pledged \$21 billion over three years, the World Bank provided \$10 billion, and ADB \$4 billion. These credits from international financial institutions (IFIs) were supplemented by a second-line of defense of \$23.4 billion in bilateral credits that were not used.

3. As Korea's external financial position improved, the Government canceled some unused portion of financial support extended by the IFIs. Of the \$21 billion provided by IMF, for example, \$19.5 billion was actually disbursed. The Government has already repaid the IMF loan by making a final payment of \$140 million on 23 August 2001. The Government borrowed \$7 billion from the World Bank and \$3.7 billion from ADB;³ neither of these loans was repaid ahead of schedule.

4. This program completion report provides an overview and evaluation of FSP implementation.

II. EVALUATION OF IMPLEMENTATION

A. Program Components

5. The FSP supported development of a market-based financial system, a critical component of the Report of the Presidential Commission on Financial Reform completed in November 1997. Within the overall framework of this report, the FSP focused on addressing the financial sector's structural weaknesses and strengthening the regulatory and supervisory capabilities of the sector's oversight institutions. The FSP was designed to introduce reforms in four key areas: (i) commercial banks, (ii) nonbank financial institutions (NBFIs), (iii) financial markets, and (iv) corporate accounting and disclosure standards. This section provides an assessment of FSP implementation relative to FSP targets. Compliance with policy matrix conditions is described in Appendix 1.

¹ Loan 1601-KOR: *Financial Sector Program*, for \$4 billion, approved on 19 December 1997.

² Loan 1602-KOR: *Institutional Strengthening of the Financial Sector*, for \$15 million, approved on 19 December 1997.

³ At the request of the Government of Korea (the Borrower), ADB cancelled the final tranche of US\$300 million in December 1999.

1. Commercial Banks

6. This component of the FSP focused on encouraging (i) closing or merging nonviable banks, (ii) restructuring and recapitalizing viable banks, (iii) enhancing regulatory oversight for banks, (iv) improving corporate governance of banks, and (v) increasing competition in the banking system. As a first step to rehabilitating banking, the FSP called for the restructuring plans for the two insolvent banks, Korea First Bank and Seoul Bank.⁴ These two banks were initially recapitalized through injections of Government funds (W1.5 trillion for each bank), and then majority ownership of Korea First Bank was later sold to Newbridge Capital, a foreign investor. The Government plans to privatize Seoul Bank by selling a controlling stake to foreign investors in the near future.

7. In line with the FSP, rehabilitation of the banking system involved the closure of nonviable institutions and the strengthening of balance sheets of remaining institutions by removing impaired assets from their balance sheets and recapitalizing through injections of Government funds. One key institution that has supported this process is the Korea Asset Management Corporation (KAMCO). KAMCO was initially set up in 1962 to manage and dispose of the impaired assets of Korea Development Bank (KDB). In November 1997, legislation was passed to entrust KAMCO with the administration of the Nonperforming Asset Management Fund.⁵ Under this legislation, the objective of the fund is to purchase and dispose of nonperforming loans (NPLs) of financial institutions as efficiently as possible. KAMCO can also provide workout programs for impaired assets. To enhance transparency, KAMCO is required to audit and publish its accounts on a semiannual basis. As of February 2001, KAMCO purchased W97.6 trillion worth of NPLs at a discount.⁶ Of the total NPLs transferred to KAMCO, 60.1 percent were from commercial banks, 21.5 percent from investment trust companies, 7.2 percent from guarantee insurance companies, and 3.2 percent from merchant banks. KAMCO plans to liquidate 98 percent of these assets within five years. Recovery techniques adopted by KAMCO have included foreclosure auctions, packaged loan sales, collections, and voluntary repayment.

8. Under the FSP, the Government progressively raised prudential standards of banks to Basle Core Principles of Banking Supervision. In early 1998, the 8 percent minimum capital adequacy ratio (CAR) was introduced for all banks. Subsequently, the definition of NPLs and the provision requirements for loans were tightened aligning Korean practices to the Basle Core Principles.⁷ Effective January 2000, banks were required to fully introduce “forward-looking” loan classification standards which prescribe stringent norms for foreign exchange risks.

9. Prior to the crisis, fragmented regulation and supervision of the financial system allowed institutions to engage in regulatory arbitrage. In line with the FSP, in January 1999 the Government established the Financial Supervisory Service (FSS) to consolidate four separate supervisory agencies: the Banking Supervisory Authority, the Securities Supervisory Board, the

⁴ In 1997 average, the total assets, including trust accounts, of the Korea First and Seoul were W42.6 trillion (7.8 percent) and W35.3 trillion (6.5 percent), respectively. The figures in parentheses are shares of total commercial bank assets (W542.6 trillion in 1997 average).

⁵ Following a review of the KAMCO’s funding requirements, the government mobilized W21.6 trillion for Nonperforming Asset Management Fund – W20.5 trillion in Nonperforming Asset Management Fund bonds; W0.6 trillion from financial institutions; and W0.5 trillion from KDB.

⁶ The following pricing method was used: (i) secured loans: the recent average foreclosure auction rate of comparable collateral assets, adjusted by price fluctuations; (ii) unsecured loans: 3 percent of the face value.

⁷ NPLs are made up of loans overdue for more than three months and nonaccrual loans. Nonaccrual loans include bankrupt loans, loans to borrowers whose capacity to repay are weakened, and nonperforming restructured loans (Appendix 3). See Appendix 1 for details of asset classification categories and minimum provisioning requirements.

Insurance Supervisory Board, and the Nonbank Supervisory Board. The Financial Supervisory Commission (FSC) set up in April 1998 is in charge of financial sector policy formulation. The FSC chairperson is also the governor of FSS. The move toward consolidated regulatory structures was required as functional and institutional boundaries were blurred, and this has substantially reduced the scope for regulatory arbitrage and high-risk practices by financial institutions. A unified oversight agency arguably encourages consistency in regulatory and supervisory approaches and economies of scale.

10. Consistent with the FSP, a prime ministerial decree was issued to eliminate Government control and interference in managerial decisions of banks. Stock options are now used by several banks as a means of aligning the interests of the shareholders with those of management. To introduce greater competition in banking, the Government liberalized the entry of foreign banks. Until 1997, foreign banks were allowed to establish only branches in Korea, but now foreign banks are allowed to set up subsidiaries as well.

2. Nonbank Financial Institutions

11. As the Korean financial system grew, the market share of NBFIs in the financial sector increased substantially from 29 percent in 1980 to 68 percent in 1996. This is largely because NBFIs, relative to commercial banks, operated under a more lax regulatory regime. Many NBFIs were owned and controlled by the *chaebols*.⁸ These institutions posed a systemic threat to financial sector stability during the crisis because of the large concentration of credit risk to the troubled chaebols and their affiliates, along with high exposure to currency, bond, and equity markets. To facilitate NBFIs restructuring, the FSP sought to ease exit policies and support institutional strengthening and capacity building for NBFIs. NBFIs included (i) merchant banks, (ii) securities companies, (iii) insurance companies, and (iv) pension funds. Under the FSP, prudential regulatory and supervisory oversight was improved to enhance investor protection and achieve adequate capital structure for these institutions.

12. **Merchant Banks.** Merchant banks could borrow in foreign currency while lending in won, and were an important source of currency mismatches and excessive foreign exchange exposure in 1997. In line with the FSP, the Government imposed tighter supervisory, prudential, and accounting norms, and closed institutions that could not meet the tougher standards. Merchant banks were required to meet a minimum CAR of 6 percent effective June 1998 and 8 percent effective June 1999, and adopt internationally accepted accounting principles by April 1999. Loan classification and provisioning norms for merchant banks were also gradually made comparable with those imposed on commercial banks. Merchant banks that failed to meet the performance criteria were subject to strict penalties culminating in closure. At the end of 1997, 30 merchant banks were in operation in Korea, but only 5 remained at the end of 2000.

13. **Securities Companies.** Most of these companies had negative earnings at the time of the crisis as brokerage and underwriting commissions failed to generate sufficient revenue. To boost revenue, most of the securities companies had turned to proprietary trading and provision of guarantees for bond issues, but ended up incurring large losses from these sources. Consistent with the FSP, the Government tightened prudential standards leading to closure of 6 of the 36 securities companies in 1998. In addition, the Government introduced regulations that limit the risk-exposure of securities companies and forbid them from issuing guarantees.⁹

⁸ Chaebols are big business conglomerates.

⁹ See *Supervisory Regulations on Securities Industry*, Financial Supervisory Commission (FSC) Public Announcement no. 2000-124.

14. **Insurance Companies.** Prudential standards of the sector were below international norms, and the lack of prompt action by insurance supervisors led to a steady erosion of the financial health of insurance companies over time. The required solvency margin in 1997, at 1 percent, was much below international standards, and many companies had negative solvency margins. In line with the FSP, rehabilitation plans of 22 (18 life and 4 nonlife) distressed insurance companies were evaluated. Of these companies, 4 were closed, their business was transferred to sounder companies. Meanwhile, other companies were required to improve their solvency margins to prescribed higher levels over a period of time.¹⁰ In 1999, the FSC required that all life insurance companies should attain positive solvency margins by September 1999 and 4 percent solvency margins by March 2004. Under the FSP, insurance companies were also required to disclose, among other things, their ratings determined by the Insurance Supervisory Board¹¹ and to make the ratings available at their headquarters and at all branch offices. In addition, all non-life insurance premiums have been fully deregulated in line with the FSP since August 1998 when auto premium rates were deregulated.

15. **Pension Funds.** The national pension scheme in Korea was introduced in 1988,¹² but it was already facing underfunding problems and had not always managed to assure full funding of pension liabilities. To assist the Government with pension reforms, ADB provided a report,¹³ recommending that consideration be given to moving to a fully funded pension scheme. In line with the FSP, the Final Report of the Pension Review Committee was issued in December 1997; it recommended (i) division of the pension formula into basic and earnings-related portions, (ii) distinction between the management of the basic fund component and the earnings-related component, (iii) reduction of the benefit formula, (iv) gradual increase of the retirement age from 60 to 65, (v) revision of actuarial estimates every five years with an adjustment to the premium level as necessary (after 2009), and (vi) extension of coverage to the urban self-employed. Based on discussions between ADB and the Government, the Government revised the National Pension Act in December 1998. Consistent with the FSP, the Government raised the mandatory contribution rate for industrial workers from 6 percent to 9 percent in 1998.¹⁴

3. Financial Markets

16. Although Korea's capital market had broadened and deepened over the years, its stock market played a comparatively small role in corporate finance. The bond market was small and illiquid. Therefore, the FSP agenda for capital market reforms underscored the need to enhance the range of financial services, introduce greater competition, improve the supervisory framework, and build institutional capacity.

¹⁰ Seven life insurance companies and two nonlife insurance companies were given notes of execution requiring that they meet minimum solvency margin requirements (whereby assets were required to exceed liabilities) by the end of FY (fiscal year) 1998; seven life insurance companies were given execution plans requiring that they reduce their solvency margin shortage to 10 percent by March 1999, to 5 percent by March 2000 and to minimum solvency margin requirements by September 2000; and the FSC forced the merger of two nonlife surety insurance companies.

¹¹ This has been merged into FSS since January 1999.

¹² The Government passed the National Pension Welfare Act in 1973, but delayed the implementation of the National Pension Scheme (NPS) until 1988. The NPS provides for a basic benefit based on average earnings of all participants and an individualized, earnings-related component subject to an earnings ceiling. Participants under the NPS must be Korean nationals between the age of 18 and 60.

¹³ ADB. 1999. *Pension Reform in Korea: Key Issues and Strategic Directions*. Manila.

¹⁴ From 1999, employers and employees are each required to contribute 4.5 percent for an aggregate contribution of 9 percent under the National Pension Act.

17. By 1997, the Government had taken several measures to improve the functioning of the equity market. The infrastructure of the equity market including trading, clearing, and settlement systems was upgraded, a fully computerized trading system was introduced, regulations on stock offerings were liberalized, and foreign ownership of domestic companies was raised to 50 percent. The Government exceeded FSP requirements by eliminating the limit on foreign ownership in May 1998¹⁵ and by increasing the daily price variation limit to 15 percent in December 1998. The limit on foreign ownership of all Korea Stock Exchange (KSE)-listed bonds was abolished in December 1997, and foreign investors were allowed to engage in over-the-counter and repurchase transactions (effective May 1998) and hold unlisted bonds (effective July 1998).

18. Before the implementation of the FSP, trading in government bonds was insignificant. In view of the country's strong fiscal position, issuance of government securities was limited and policies adopted inhibited the development of the government debt market. The Government predetermined the price at which debt would be issued. This prevented effective competitive bidding for government debt and resulted in mandatory allocations of government debt to institutions.

19. Effective July 1999, the preset pricing mechanism for government bonds was eliminated, and a primary dealer system was introduced. The Government streamlined its bonds into four categories— Treasury bonds, foreign exchange stabilization bonds, national housing bonds, and compensation bonds. Of these, treasury bonds and foreign exchange stabilization bonds are issued through auction, and their interest payment mechanisms have been standardized. Following this reform in the government bond market, the Government liberalized foreign investment in corporate bonds, and introduced new standards and procedures for licensing credit-rating agencies. With these measures, the capability of the bond market to perform credit analysis and incorporate the market's assessment of risk into bond yields has been strengthened.

20. Mortgage-backed securities have been encouraged in several emerging market economies to ease the maturity mismatches and the liquidity problems experienced by commercial banks. In view of this, the FSP had envisaged setting up an institution to issue mortgage-backed securities. Following the enactment of the Mortgage-Backed Securities Company Act in January 1999, the Korea Mortgage Corporation was set up in October 1999. In line with the FSP, the Government also set up the Korea Futures and Options Exchange in April 1999. The exchange is open to foreign participation. Futures contracts on certificates of deposit, US dollars, gold, treasury bonds, and KOSDAQ index (KOSDAQ 50), and options on US dollars are traded in this market. The exchange's trading volume reached 4 million contracts in January 2001. Equity index (KOSPI 200) futures and options have been traded on the KSE since 1996 and 1997, respectively.

4. Corporate Accounting and Disclosure Standards

21. One of the most important elements of a robust and stable financial infrastructure is adequate standards of accounting and disclosure. In accord with FSP conditions, a law was enacted in 1998 requiring combined financial statements for the corporate sector from 1999.

¹⁵ Exceptions were made for a few companies operating in industries that were considered strategic. As of March 2001, foreign ownership limits remain on 7 KSE-listed companies operating in strategic industries such as telecommunications and airlines, and 14 KOSDAQ-listed companies operating in such industries as telecommunications, broadcasting, and airlines.

Furthermore, listed companies are required to prepare and disclose their financial statements quarterly, and establish audit committees with at least two thirds of their membership from outside independent directors. In 1993, a presidential decree was issued to prohibit the use of assumed or false names in financial transactions with a view to promoting transparency and equity in taxation. The FSP called for the Government to maintain the real name system, with some possible revisions. According to the Act on Real Name Financial Transactions and Guarantee of Secrecy, which was passed at the end of 1997, financial transactions both with and through financial institutions must be conducted under a customer's real name.

B. Implementation Arrangements

22. The Ministry of Finance and Economy (MOFE) was the Executing Agency for the FSP and had overall responsibility for FSP implementation. MOFE consulted with Bank of Korea (BOK) and the FSC to ensure that reforms were undertaken promptly.

C. Program Schedule

23. The Board approved the FSP loan and the related TA loan (Loan 1602-KOR) on 19 December 1997. The FSP loan became effective on 23 December 1997, upon fulfillment of all loan effectiveness conditions. The utilization period for the FSP loan was 30 months from the date of loan effectiveness. The FSP loan was closed in December 1999 following the Government's decision not to draw the last tranche. The Government showed full commitment to the Program and ensured that the FSP remained on track. The Government also met all requirements for the submission of reports, including its own program completion report.

D. Conditions and Covenants

24. The FSP was supported by a loan of \$4 billion from ADB's ordinary capital resources. The loan carried an interest rate of the London interbank offered rate (LIBOR) plus ADB's standard spread (0.6 percent) for public sector loans and a commitment charge of 0.75 percent per annum. Each tranche of the loan was to be repaid in full on the date seven years after its disbursement.

25. The loan was to be released in four tranches. The release of the second, third, and fourth tranches depended upon satisfactory implementation of the FSP and fulfillment of all conditions for release of these tranches. The Policy Matrix comprised 43 actions that were completed prior to Board consideration. For the release of the second tranche 8 actions were required; 11 actions for third tranche; and 7 for release of the fourth tranche.

26. All of the actions that were expected to be taken prior to the release of the second and third tranches of the FSP have been either fully or substantially complied with. Only one condition for the third tranche was delayed somewhat in consultation with ADB. This condition relating to abolishment of the practice of presetting the interest rate in auctioning government securities was complied effective July 1999. Of the 12 actions (7 tranche release conditions included) that were expected to be taken prior to the release of the final tranche, 11 have been either fully or substantially complied with. The outstanding condition requiring reduction of the reserve requirements for commercial banks is still pending. BOK and MOFE contend that, in the existing circumstances, lowering of reserve requirements would complicate monetary management and contribute to inflationary pressures.

E. Disbursements

27. The first tranche (\$2 billion) was released following loan effectiveness in December 1997, the second tranche (\$1 billion) in January 1998, and the third tranche (\$0.7 billion) in December 1998. All of these three releases met the original schedule. The fourth tranche (\$0.3 billion) was scheduled to be released in December 1999, but the Government decided not to draw this final tranche. The disbursements for the first and second tranches were on-lent to Korea Development Bank by the Government, and utilized to support the bank's foreign exchange obligations to BOK and credit guarantee programs for small and medium-sized enterprises. An ADB review mission advised the Government that the third and fourth tranches should be reflected in the consolidated Government budget in line with ADB's standard procedures. All the three released tranches of the FSP loan were used to finance the development needs of the financial sector to meet the FSP objectives.

F. Environmental Impact

28. The FSP was classified as Environment Category C as it had no direct environmental impact.

G. Performance of the Borrower and the Executing Agency

29. The overall performance of the Borrower and the Executing Agency was satisfactory. The Government showed a strong commitment to meeting the FSP objectives. In many areas, the Government's actions and ownership went beyond FSP expectations. A number of policy actions were implemented well before the required deadline. MOFE implemented the FSP effectively in consultation with BOK and FSC, and cooperated fully with ADB for reviewing the progress of FSP implementation.

H. Performance of the Asian Development Bank

30. ADB's performance was satisfactory. Faced with the crisis that had brought the entire economy to near collapse, ADB's response was quick and its approach was flexible. ADB closely monitored implementation of the FSP through the Seoul-based Extended Mission to Korea (EMK) and several missions from headquarters.¹⁶ The EMK, staffed with a senior economic adviser from headquarters and one long-term consultant, was maintained from October 1998 to January 2000. It engaged in active dialogue with relevant government officials on tranche release conditionalities, undertook policy consultations, and prepared progress reports and tranche release papers. ADB also closely coordinated its implementation with the work of other agencies, notably IMF and the World Bank.

III. THE TECHNICAL ASSISTANCE

31. The TA loan was approved in December 1997 together with the FSP loan to support FSP implementation by providing institutional strengthening of the financial sector. However, the loan remained unused due to difficulties encountered with the disbursement arrangements and some overlapping resulting from subsequent TA support from the World Bank. In early October 1998, ADB and the Government agreed to change the scope and implementation arrangements for the TA loan. Three of the four original components of the TA-scope, i.e., Part A: Strengthening the FSS, Part C: Upgrading the Credit Information and Rating System, and Part D: Mortgage-Backed Securities were replaced with one new component covering the

¹⁶ See Basic Data.

restructuring of financial institutions. The other component for KAMCO remained unchanged. For the implementation arrangements, the proceeds of the TA loan were re-lent through KDB and not made available through budgetary allocations as originally envisaged. In 1999, the TA loan agreement was amended to reflect these changes in scope and implementation arrangements. On Board approval,¹⁷ the after-the-fact financing of three consulting contracts for two commercial banks and KAMCO was provided to KDB. The TA also financed management consulting services and training programs for KAMCO and the Korea Deposit Insurance Corporation (KDIC). The loan is expected to be closed in 2002.

IV. EVALUATION OF INITIAL PERFORMANCE AND BENEFITS

A. Macroeconomic Performance

32. Despite its strong macroeconomic performance up to 1997, Korea's financial sector was weak and the corporate sector was heavily leveraged. In particular, the excess capacity resulting from overleveraging and overinvestment in the corporate sector increasingly eroded the profitability of the corporate and financial sectors. The sequencing of capital account liberalization also led to concentration of the short-term foreign debt among financial institutions. Commercial credit and short-term flows were liberalized first, with significant restrictions on long-term capital inflows such as foreign direct investment still left in place. Following the foreign exchange crises in Thailand and Indonesia, subsequent decline in the Hong Kong stock market on 23 October 1997 created difficulties for Korea to roll over a large stock of short-term foreign debt (at about \$100 billion). The mounting repayment of the short-term debt of banks quickly depleted foreign exchange reserves.

33. In response to Korea's request, IMF mobilized external financial support of \$58.4 billion. In line with the IMF program, monetary conditions were tightened, and subsequently, money market interest rates rose sharply to 25 percent on 13 December. The Government abolished the band on the exchange rate on 15 December. However, the market remained vulnerable in the wake of weak foreign exchange reserves position and high short-term debt. During 5–24 December, the won depreciated by about 70 percent, and the stock market dropped by another 20 percent. The amount of usable foreign exchange reserves fell from \$29.4 billion at the end of 1996 to \$4.2 billion on 18 December. Net of forward commitments, they were negative.

34. International credit-rating agencies downgraded Korea's external debt to a speculative grade, and Korea suffered a rapid depletion of foreign reserves and loss of market confidence. In such a dire a situation, the FSP loan contributed significantly to arresting the spreading of the crisis. It provided liquidity assistance for overcoming the immediate foreign exchange crisis. The loan's first tranche of \$2 billion was released upon its effectiveness on 23 December, and it was utilized quickly by the Government to replenish BOK's foreign exchange reserves. In addition, the FSP, along with the front-loading of IMF's additional inflows, helped restore investor confidence and market stability by supporting a program of major structural reforms in the financial sector. At the end of 1997, usable foreign exchange reserves grew to \$9.1 billion.

35. During FSP implementation, the turnaround in the macroeconomic situation and in Korea's international financial position was remarkable (Appendix 2). After contracting sharply in 1998, real gross domestic product (GDP) grew strongly in 1999 at a rate of more than 10 percent. Inflation remained under control, and international reserves reached \$74 billion at the end of 1999 (8.5 months of imports) from as low as \$ 2.5 billion in late 1997. By end of 1999,

¹⁷ R233-98. TA Loan 1602-KOR: *Institutional Strengthening of the Financial Sector – Change in Scope and Implementation Arrangements, Post-Facto Financing of Consulting Services*, 22 December 1998.

Korea's sovereign credit rating had been upgraded to investment grade, and margins on Korean borrowings had been compressed significantly.¹⁸ All this is mainly attributable to the revival of investor confidence inspired by the sound macroeconomic management of the Government. Since the last quarter of 2000, however, unfavorable external conditions and incomplete reform of corporate and financial sectors have cooled the robust recovery during FSP implementation, with renewed distress in the domestic capital markets.

B. Attainment of Benefits

36. The FSP was effectively implemented. Most progress was in three areas: (i) banking consolidation; (ii) restructuring of NBFIs; and (iii) broadening and deepening of capital markets.

1. Banking Consolidation

37. At the end of 1997, 26 commercial banks accounted for 51 percent of total financial assets. Of these, 17 large commercial banks controlled more than two thirds of the total commercial bank assets. Fifty-two foreign banks were operational, but their market share was only 3 percent of total financial system assets and 9 percent of total banking system assets, and their business concentrated on wholesale banking. Before the crisis, government intervention in decision making of banks was common, and this lack of independence prohibited banks from developing strong credit-risk management practices. Lending decisions tended to rely heavily on collateral and intercompany guarantees rather than projected cash flows. Loan review processes tended to be inadequate and management information systems tended to be rudimentary. In addition, prudential regulation was lax and fell short of international best practice. In particular, the loan classification and provisioning rules were based on the loan's servicing record and the availability of collateral without due regard to the borrower's future capacity to repay. Accounting and disclosure standards were also weak.

38. In line with the FSP, the first priority was given to maintaining public confidence in the banking system. In mid-November 1997, the Government announced that it would guarantee all deposits of financial institutions until the end of 2000.¹⁹ Effective January 2001, the Government reduced coverage of the deposit insurance scheme, but the upper limit was increased to W50 million from the prescribed limit of W20 million due to apprehensions about financial stability.

39. The second task was identification, development, and implementation of exit strategies for nonviable banks. For viable banks, rehabilitation plans specifying measures to achieve minimum risk-adjusted CAR of 8 percent and to restructure operations were required. Finally, bank balance sheets were strengthened by removing NPLs and infusion of additional capital. KDIC supported this process by guaranteeing deposits in failed financial institutions and providing recapitalization funds, while KAMCO acquired NPLs from banks' balance sheets at a discount (footnote 5).

40. Progress in bank restructuring during 1998-2000 was substantial. Two large commercial banks (Korea First Bank and Seoul Bank) were taken over by the Government on 31 January 1998 with a 94 percent equity stake in each of the banks.²⁰ In July 1998, five small banks with

¹⁸ The interest spread of Korea's sovereign bonds over US Treasuries was as high as 1000 basis points in the wake of the crisis in 1997. At the end of 2000, the spread of foreign exchange stability bonds over US Treasuries was 240 basis points.

¹⁹ A deposit insurance scheme was introduced in January 1997, providing full coverage for all deposits not exceeding W20 million per individual depositor.

²⁰ With additional injection of public funds, the Government's stake was later raised to 100 percent.

negative capital adequacy ratios (ranging from negative 4 percent to negative 11 percent and negative net worth of W920 billion) were closed.²¹ Their operations were transferred to five stronger banks under purchase and assumption agreements. The remaining seven undercapitalized banks were required to take remedial action under approved rehabilitation plans. In November 2000, the Government announced that Cho-Hung and Korea Exchange Bank were allowed to pursue their own rehabilitation plans including raising capital and removing NPLs. The Government decided to inject additional public funds into Hanvit, Kwangju, Kyongnam, and Peace and then to merge them in a government-owned financial holding company.

41. Financial restructuring was supported by public funds²² of W127 trillion (\$112 billion)²³ in 2000, or 25 percent of gross domestic product (Appendix 3, Table A3.1). Almost half of these funds went to the banking system. The restructuring resulted in consolidation of banking as the number of commercial banks was reduced from 26 to 17.

42. The FSP called for full implementation of the Basle Core Principles of Banking Supervision. According to FSC's projection, the restructured commercial banks individually exceeded the minimum risk-adjusted CAR of 8 percent at the end of 2000 (Appendix 3, Table A3.3). Compared with precrisis levels, these CARs are credible as they are based on enhanced accounting standards (closer to international best practice) and tighter loan classification and provision rules. To implement the Basle Core Principles fully, forward-looking criteria²⁴ were also introduced.

43. The FSP supported speedy resolution of NPLs in the banking system through KAMCO. The ratio of NPLs in the banking system declined to 8.3 percent at the end of 1999, and further to 6.6 percent at the end of 2000 (Appendix 3, Table A3.5). Since loan classification standards were tightened in 1999, NPLs reflect a more realistic assessment of the financial health of banks. Bank deposits continued to grow strongly after the crisis (34 percent annually)²⁵ and this reflects restoration of public confidence in the banking system, one of the FSP objectives. However, bank lending that contracted in 1998 following the crisis grew at a slower pace subsequently.

2. Restructuring of NBFIs

44. A vast majority of NBFIs in the sector were insolvent following the crisis. NBFi rehabilitation has involved the exit of weaker institutions and the strengthening of the balance sheets of remaining institutions by removing NPLs and injecting additional capital from the Government. NPLs were transferred from NBFi balance sheets to KAMCO, and KDIC guaranteed deposits of failed institutions and provided a part of the recapitalization funds required (footnote 22).

45. The merchant banking subsector, a major source of instability leading to the 1997 crisis, contracted significantly. Tightened minimum capital requirements, loan classification, and

²¹ The combined assets of the five banks in 1997 were W39.6 trillion, accounting for 7.3 percent of total commercial bank assets.

²² Public funds include funds from KDIC (including the issuance of Deposit Insurance Fund bonds guaranteed by the Government); funds from KAMCO (mainly from Nonperforming Asset Management Fund); recycled portion of these funds; and funds from the Public Funds Management Fund.

²³ Using the exchange rate of W1,130.6 per \$, annual average in 2000.

²⁴ Under these criteria, banks are required to use loan classification standards based on the prospects of debtors to generate sufficient future cash flow, instead of standards based entirely on delinquency criteria.

²⁵ Average annual growth rate of deposits in won over 1998-2000.

provisioning regulations for merchant banks (comparable with those for commercial banks) have sharply curtailed the capability of the restructured merchant banks to engage in unsound activities. Similarly, changes in legislation have reduced the capability of securities companies to assume risk that might destabilize markets. In line with the FSP, securities companies are no longer allowed to provide guarantees for corporate bonds.

46. The life insurance industry continues to show a negative net worth and operates at a loss. Before the crisis, life insurance companies in Korea tended to act like quasi banks, carrying short-term savings products on the liability side and commercial loans on the asset side. A combination of a high level of NPLs, high policy lapse rates, high administrative costs, and unproductive distribution channels has stifled the industry's profitability. Profitability of the insurance industry is dependent on continuous improvement in these areas, and the adoption of sound policies in investment and risk management, and related parties transactions. After the crisis, the portion of loans in total assets has sharply decreased, and the industry has shown some signs of improvement in management efficiency and distribution productivity. Life insurance companies will be gradually required to meet a 4 percent solvency margin (plus 0.3 percent of the sum at risk) by March 2004. Given the difficult financial situation of most insurance companies, the Government and ADB agreed to introduce the risk-based solvency standard gradually to avoid major disruptions to the insurance subsector.

47. The National Pension System was projected to face a rapid increase in pension disbursement from 2008 and generate fiscal deficits by 2020 that would over the period deplete the reserve fund by 2031. Faced with such prospects, the Government established a pension review committee to examine the system. Both the committee and ADB study (footnote 11) have provided a set of suggestions for reforms of the Korean pension system. So far, the Government has tightened the benefits, improved the pension fund management and revised the National Pension Act to allow for pension fund to invest in KOSDAQ and overseas markets beginning in July 2001. Over the long run, the Government needs to also look at other issues such as segregation of basic and earning related funds, a shift from taxation of contributions to a tax deferral strategy at pension payment stage, and establishment of Board of Trustees to manage the pension funds.

3. Broadening and Deepening Capital Markets

48. Under the FSP, foreign participation in the capital market increased substantially, measured in terms of the number of foreign investors, foreign portfolio investment flows, trading activities of foreign investors in the stock market, and shareholdings by foreign investors (Tables A3.6-A3.10 in Appendix 3). In 2000, 704 companies were listed on the KSE, with total market capitalization of W188 trillion (\$166 billion).²⁶ The summary of overall trading and listing activities in the stock market during 1996–2000 is presented in Appendix 3 (Table A3.11).

49. To gain transparency and liquidity in the government bond market, competitive bidding procedures were introduced along with larger size of issues and consolidation of types in line with the FSP. In April 1999, the interdealer market for government securities was set up inside the KSE with the introduction of a primary dealer system. The interdealer market is a wholesale government bond market equipped with an electronic trading system called KTS (KSE Trading System for government securities). Treasury bonds and foreign exchange stabilization bonds dominate trades on this market. All trades conducted on the interdealer market are settled on the contract day (T+0), on a netting basis, under the book-entry system of the Korea Securities

²⁶ Using the average exchange rate of US\$1:W1,130.6 in 2000.

Depository. The KSE also has a general bond market, a retail market where investors trade various fixed income securities including corporate bonds, government bonds, and municipal bonds. The general bond market is a typical order-driven market and all trades are settled on a netting basis on the contract day. Tables A3.12 and A3.13 in Appendix 3 summarize listing and trading activities in the bond markets.

50. The opportunities for risk pricing and management have been expanded with the introduction of newer financial instruments such as asset-backed securities, futures, and options. For example, the Korea Mortgage Corporation issued mortgage bonds of W1.28 trillion in 2000, using mortgages originated by the National Housing Fund. In accord with the FSP, the Korea Futures and Options Exchange opened in April 1999. Futures contracts on certificates of deposit, US dollars, gold, Treasury bonds, and KOSDAQ 50 index, and options on US dollars are being traded. The exchange's accumulated trading volume reached 4 million contracts in January 2001. Equity index (KOSPI 200) futures and options have been traded on the KSE since 1996 and 1997, respectively.

51. Although the investment trust companies were not covered by the FSP, they have emerged as a major area of systemic weakness, aggravating financial market instability and undermining the development of a vibrant capital market. The industry holds about 40 percent of the total listed bond issues, while their trading activities account for about 30 percent of the average stock market trading volume. The industry's large exposure to Daewoo²⁷ triggered early redemption of the beneficial certificate issued by investment trust companies (ITCs) and investment trust management companies (ITMCs) in July 1999. The redemption pressure forced ITCs and ITMCs to sell their assets to satisfy investor demands, which in turn paralyzed the corporate bond market. Despite the Government's efforts to stabilize the corporate bond market including the creation of the Bond Market Stabilization Fund in September 1999 and the KDB Quick Underwriting Program²⁸ in January 2001, the corporate bond market has since been chronically weak.

V. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

52. FSP was highly successful. The Program was highly relevant given that the FSP was a direct and spontaneous response to the emerging crisis and aimed to address the structural weaknesses of the financial sector that magnified the dimensions of crisis. The Program was implemented effectively and efficiently as Korea showed strong ownership and commitment for restoring financial stability by pursuing financial restructuring as well as strengthening prudential norms and regulatory framework. The compliance with all conditions of FSP was satisfactory and in some areas went beyond expectation and a few policy actions were even implemented well before the required deadline.

53. ADB's program being an integral component of the overall structural reforms being pursued by Korea has also supplemented and complemented IMF and the World Bank policy

²⁷ ITCs and ITMCs were holding 37 percent of total Daewoo debt and more than 80 percent of Daewoo's domestic bonds and commercial papers at the time of its collapse in July 1999.

²⁸ The KDB Quick Underwriting Program was set up in January 2001 to cover W25 trillion (\$20 billion) of a total of W65 trillion (\$52 billion) in corporate bond repayments due in 2001. Under this program, KDB plans to mobilize W20 trillion to purchase maturing obligations after participating companies make the required repayments of 20 percent due, or W5 trillion. Creditor banks and KDB will take up to W6 trillion, or 30 percent of the total funds to be mobilized, with the rest to be sold on the market. The corporate debt acquired by KDB will be issued as primary collateralized bond obligations and collateralized loan obligations with 50 percent guaranteed by the Government.

reform packages with the former including macroeconomic stabilization elements and the latter also supporting the process of corporate restructuring and labor market reform (footnote 29). Relative to other crisis-affected economies, Korea's stable political environment, and capacity to implement complex reform agenda facilitated smooth and effective implementation of the FSP. As part of the total rescue package, the FSP loan was successful in helping to arrest further spreading of the crisis, and helped with banking system and NBF's consolidation and restructuring, and broadening and deepening capital markets.

54. Korea needs to continue the momentum of its structural reforms. There is need for accelerating corporate restructuring and strengthening governance of conglomerates and completing the process of financial restructuring by privatizing the acquired banks. This will help sustain the structural reforms pursued under the FSP and its impact, while helping country withstand external shocks.

B. Lessons Learned

55. A few key lessons can be drawn from the experience with FSP implementation, particularly in relation to crisis assistance. The FSP loan, part of an international package to overcome the external payments crisis, has to be recognized as a different product from normal lending operations in a number of aspects. Special characteristics of crisis assistance include its unanticipated character and exceptional scale and required flexibility in design and implementation. Crisis assistance needs to more sharply concentrate on restoring financial and macroeconomic stability in the near term and structural adjustment efforts need to focus on medium-term agenda to sustain the economic stability. More long-term reform agenda need to be addressed by follow up advisory support after the crisis is mitigated. Furthermore, to mitigate the liquidity crisis urgently, ADB needs to be well positioned financially and administratively to respond to the vulnerabilities within compressed time frames.

1. Timeliness and Relevance

56. The timeliness in delivering fast-disbursing assistance contributed significantly to the FSP's effectiveness. ADB modified its policies and standard practices concerning the size of assistance, processing procedures, ceiling on program lending, and approved the loan within a remarkably short time span of less than a month. The formulation of the FSP was initiated and concluded by a mission to Korea from 29 November to 11 December 1997 and was a response to the Government's request for ADB financial assistance for financial sector reform. The loan was processed, negotiated, and approved expeditiously, and became effective on 23 December 1997. In this process ADB coordinated closely with IMF and the World Bank,²⁹ and made ad hoc modifications to standard processing procedures. The requirements for a formal management review, staff review committee, and loan and technical assistance coordination committee meetings were waived. After this experience, ADB is institutionalizing modalities and procedures for processing and implementing crisis interventions (para. 63).

57. Structural weaknesses in the financial and corporate sectors were at the heart of the crisis in Korea. Therefore, the financial sector reform program of the Government, which was supported by the FSP, was the centerpiece of the overall reform program. Overloading of reforms would have undermined the effectiveness of the FSP as an emergency package.

²⁹ Although overall donor coordination was satisfactory, information sharing could have been better, particularly in the early months of the crisis.

2. Policy Dialogue and Policy Advice

58. The provision of crisis assistance only in the form of funds, without addressing the structural causes of the crisis, may not succeed in restoring investor confidence and market stability, and in any case will not lead to sustainable resolution of the crisis. In this regard, policy dialogue and advice are an essential part of crisis assistance. In the course of FSP implementation, ADB was active in policy dialogue and provided advice through the EMK and several missions from headquarters. ADB's contribution in this respect was particularly prominent in the areas of insurance and pension. ADB provided reports on those areas and discussed their recommendations extensively with Korean authorities which are under consideration.

3. Link between Corporate and Financial Restructuring

59. Compared with the World Bank support, which covered broader areas,³⁰ the FSP supported the Government's efforts to contain crisis and was an effective component of an international rescue package for restoring financial sector stability. However, the sustainability of FSP benefits is likely to depend on the success of corporate sector restructuring to ensure effective debt resolution and viability of the borrower which is critical for the resumption of credit growth. Prior to the crisis, most Korean corporations had relied heavily on debt finance, principally provided by the banks, rather than on equity finance. As a result, strengthening prudential standards as a part of FSP affected not only the net worth of banks but also the viability of the highly leveraged corporations. To rebuild their own balance sheets, banks became more restrictive in their corporate lending practices because of fear of defaults in an uncertain economic environment. Therefore, financial sector restructuring would not be sustainable without putting the corporate sector on a healthier footing. As Daewoo-related losses showed, despite a substantially improved capital base during FSP implementation, banks' balance sheets were still vulnerable to large shocks from the corporate sector.

4. Understanding of Bank Procedures

60. Korea had not borrowed from ADB for almost 10 years when the FSP loan was provided. The Government was not familiar with ADB's standard disbursement procedures and driven by its urgent requirements, and utilized their own internal procedures for channeling the first and second tranches of disbursements. Nevertheless, integrity of loan utilization was not compromised, and loan proceeds were utilized to support the development need of the financial sector in line with the FSP objectives. This experience highlights the importance of understanding of ADB procedures by the government concerned in case of ADB non-standard assistance such as during a crisis.

C. Recommendations

1. Program-Related

61. The last loan approved to Korea before the FSP was on 15 December 1988. With Korea having virtually graduated from ADB, ADB's in-house expertise on Korea was limited. Nevertheless, ADB geared itself and prepared the FSP based on a steep learning curve. Maintaining a current knowledge base on all developing member countries (DMCs) even when

³⁰ The World Bank's structural adjustment loan covered: financial sector restructuring and development, corporate sector reform including reforms of corporate governance and competition policies, labor market reform and the strengthening of social safety nets, and institutional reform in economic policy management.

DMCs are not active borrowers will be prudent to deal with emergency situations. Given increasing incidence and the highly contagious nature of financial crisis, keeping abreast of financial sectors in major DMCs by regular monitoring is particularly important. In this regard, ADB with Government's support should continue to closely monitor recent developments in the Korean financial sector and ensure that the sector's reform program remains on track to consolidate and expand the gains under the FSP.

2. General

62. During the Asian crisis, ADB had little option but to respond quickly with available instruments to address rapidly unfolding events. Since ADB's existing modalities were all geared to providing development assistance, attempts were made to adapt these to the needs of crisis assistance through improvisations and ad hoc changes. Unanticipated large-scale lending, which is typical of crisis assistance including the FSP, could have adverse impact on ADB's financial position. Concerns were also raised in relation to the FSP over the length of maturity and grace periods, and loan charges.³¹

63. ADB would benefit from developing a comprehensive framework for providing crisis assistance in the future. To this end, a special program loan modality has been instituted³² to carry short maturity and grace periods, and higher loan charges than normal program loans. The proposal also argued that ADB's loan charge structure should be in line with that of other IFIs so that loan pricing is not an issue when a DMC seeks assistance from an IFI. In this regard, close coordination among IFIs assumes great importance in designing crisis assistance. Moreover, to ensure that the special program modality is effectively operationalized, appropriate procedures need to be incorporated in the program lending procedures to allow for expeditious processing of crisis assistance.

³¹ The discrepancy in maturity and charge structures among IFIs was noteworthy. For example, the World Bank's structural adjustment loans carried an interest rate of 6-month US dollar LIBOR plus 0.75 percent with an up-front fee of 1.5 percent of principal at effectiveness. They had a term of 15 years with a grace period of 5 years.

³² See *Review of ADB's Program Lending Policies*. November 1999.

APPENDIXES

Number	Title	Page	Cited on (page, para.)
1	Status of Compliance with Program Components and Conditions	17	1, 5
2	Macroeconomic Indicators	29	8, 35
3	Financial Sector Data	30	10, 41

STATUS OF COMPLIANCE WITH PROGRAM COMPONENTS AND CONDITIONS

Program Components and Conditions	Status of Compliance
<p>I. Banking – Ensure resilience of the banking system through increased reliance on market forces with independent regulatory oversight</p>	
<p>A. Restructure viable financial institutions to restore stability and ensure capital adequacy of banking institutions.</p> <ul style="list-style-type: none"> • Review funding requirements for the Korea Asset Management Corporation (KAMCO) relative to conglomerate bankruptcies since 19 November 1997 and make necessary arrangements for the additional financing required. • Fully implement business plan of the KAMCO. <ul style="list-style-type: none"> a. Complete arrangements for acquisition of banks' nonperforming loans (NPLs) to reduce NPLs by one half of their end-September 1997 level of W21.5 trillion. b. Finalize acquisition and pricing of NPLs. • The KAMCO will seek to maximize recovery from purchased loans 	<p>Complied with. Following a review of KAMCO's funding requirements, the Government arranged W21.6 trillion for the Nonperforming Asset Management Fund (NPAMF). Of the funding mobilized, W20.5 trillion was by way of NPAMF bonds, W0.6 trillion from financial institutions, and W0.5 trillion from Korea Development Bank (KDB).</p> <p>Complied with. As of February 2001, KAMCO purchased W97.6 trillion worth of NPLs. Of the total NPLs, 60.1 percent were from commercial banks, 21.5 percent from investment trust companies, 7.2 percent from surety insurance companies, and 3.2 percent from merchant banks. For this, KAMCO spent W37.8 trillion using the following pricing method:</p> <ul style="list-style-type: none"> • Secured Loans: the recent average foreclosure auction rate of comparable collateral assets, adjusted by price fluctuations; • Unsecured Loans: 3 percent of the face value. <p>By mid-2000, more than 50 percent of the NPLs had been purchased by KAMCO. The ratio of NPLs in the banking system had declined to 6.6 percent at the end of 2000.</p> <p>Substantially complied with. KAMCO plans to liquidate 98 percent of assets by the end of 2004. Through December 2000, asset disposal amounted to W45.7 trillion. However, W15.0 trillion consisted of “reverse and cancellation” operations under which an asset acquired by KAMCO is returned to the originating institution, at the original purchase price, net of interest.</p> <p>Recovery techniques have included foreclosure auctions, packaged loan sales, collections, and voluntary repayment.</p>

Program Components and Conditions	Status of Compliance
<p>B. Reestablish confidence in financial sector institutions through initial government protection augmented by full reliance on credit analysis for future bank lending with increased management accountability to shareholders for profitability.</p> <ul style="list-style-type: none"> • Eliminate formal and informal government approval, permission, and control over managerial decisions of banks. • Encourage stock options (approved in April 1997) for bank management by increasing understanding of the role of such systems as managerial incentive schemes to encourage bank profitability. • Apply stringent standards with respect to profitability in CAMEL ratings.¹ 	<p>Complied with. Prime Minister's Decree, No. 408 was issued on 13 November 2000 to eliminate formal and informal government control over the managerial decisions of banks.</p> <p>Complied with. To encourage stock options for bank management, the Government introduced tax exemptions on capital gains from exercising options in August 1997. Since Housing and Commercial Bank introduced a stock option scheme for its chair in October 1998, several commercial banks have followed this approach. Stock option schemes in some of less sound banks are structured so that capital gains depend not just on stock price performance relative to the industry average but also on a capital adequacy ratio or the level of NPLs.</p> <p>Complied with. In June 1998, the Bank Supervisory Authority (BSA)² adopted the "operational expense/revenues ratio" as one of the indices of earnings in the CAMEL ratings. Due consideration is given to profitability when the Financial Supervisory Service (FSS) determines management scores of individual banks.</p>
<p>C. Enhance regulatory measures with independent oversight.</p> <ul style="list-style-type: none"> • Amendment of the Bank of Korea (BOK) Act to provide for BOK independence and autonomy. <ul style="list-style-type: none"> a. Annual inflation target to be set in consultation with the Government minister concerned b. Operational independence granted to BOK c. Restructuring of the Monetary Board to give effect to operational independence. • Enactment of a bill (expected by December 1997) to consolidate supervision of all commercial banks, specialized banks, merchant banks, securities firms, and insurance corporations in a body with operational and financial autonomy 	<p>Complied with. The National Assembly approved amendment of the Bank of Korea Act to guarantee operational independence and autonomy of BOK at its 186th session on 29 December 1997. Under the amended Act (Act No. 5491), the governor of BOK chairs the Monetary Board, a decision-making body for monetary and credit policies; and BOK sets the annual inflation target in consultation with the Ministry of Finance.</p> <p>Complied with. The National Assembly passed the act for the Establishment of the Financial Supervisory Institutions (Act No. 5490) on 29 December 1997. Under this act, supervision of all commercial banks, specialized banks, merchant banks, securities firms, and</p>

¹ CAMEL ratings encompass capital adequacy, asset quality, management, earnings, and liquidity scores for banks.

² The current consolidated supervisory body, the Financial Supervisory Service, was established on 2 January 1999.

Program Components and Conditions	Status of Compliance												
<p>and with the powers needed to restructure and exit ailing institutions.</p> <ul style="list-style-type: none"> Review prudential standards with approval of an action plan to meet the Basle Core Principles. 	<p>insurance corporations is consolidated in a body with operational and financial autonomy and with the powers needed to restructure and resolve ailing institutions.</p> <p>Substantially complied with. In August 1998, the Bank Supervisory Authority (BSA) introduced a program for meeting the Basle Core Principles. The major tightening of prudential regulations included</p> <ul style="list-style-type: none"> Deduction from Tier 2 capital all provisioning of assets, except those classified as “normal” and “precautionary” (1 January 1999); Assets in trust accounts with guarantees to be weighted at 50 percent from 1 January 1999 and 100 percent from 1 January 2000; Rules to be applied to all trust accounts ensuring segregation for management as well as accounting purposes (1 January 2000); Revising loan classification criteria to reflect capacity to repay in addition to past performances. (December 1999). <p>In addition, prudential regulations were introduced so that loans of more than 90 days past due would be classified as “substandard” or lower (1 July 1998) and the provisioning rate for “precautionary” assets was increased from 1 percent to 2 percent (1 July 1998).</p> <table border="1" data-bbox="1171 870 1738 1052"> <thead> <tr> <th><u>Loan Classification</u></th> <th><u>Provisioning Rate</u></th> </tr> </thead> <tbody> <tr> <td>normal</td> <td>0.5%</td> </tr> <tr> <td>precautionary</td> <td>2%</td> </tr> <tr> <td>substandard</td> <td>20%</td> </tr> <tr> <td>doubtful</td> <td>50%</td> </tr> <tr> <td>estimated loss</td> <td>100%</td> </tr> </tbody> </table>	<u>Loan Classification</u>	<u>Provisioning Rate</u>	normal	0.5%	precautionary	2%	substandard	20%	doubtful	50%	estimated loss	100%
<u>Loan Classification</u>	<u>Provisioning Rate</u>												
normal	0.5%												
precautionary	2%												
substandard	20%												
doubtful	50%												
estimated loss	100%												
<ul style="list-style-type: none"> Fully implement the Basle Core Principles 	<p>Substantially complied with. Forward-looking criteria (FLC) were introduced on a trial basis on 30 June 1999, and took effect in January 2000. Under FLC, banks are required to use loan classification standards based upon the prospects of debtors to generate sufficient future cash flow, instead of standards based entirely on delinquency criteria. The Korean Banking Institute has been offering training courses to bankers on how to assess health of banks on FLC.</p> <p>Progress in relation to the Basle Core Principles is being made in several areas, including market risk, risk management and consolidated measurement, and reporting of banks’ positions. Banks will eventually be required to hold capital against market risk. Enhanced capital</p>												

Program Components and Conditions	Status of Compliance
<ul style="list-style-type: none"> Establish a timetable for all banks to meet or exceed the Basle capital adequacy standards. 	<p>requirements for market risk are scheduled to take effect in January 2002. The FSS supervises banks on a consolidated basis (i.e., including foreign branches and subsidiaries).</p> <p>Complied with. In 1998, a timetable was established for banks to meet or exceed the Basle capital adequacy standards: March 1999: 6% March 2000: 8% December 2000: 10% (recommended)</p> <p>Table A3.3 in Appendix 3 summarizes the status of the 17 commercial banks' compliance with these standards. In November 2000, the Government announced rehabilitation plans for 7 financially distressed banks, 5 of which could not meet the Basle capital adequacy standard of 8 percent as of June 2000. The plans include injecting additional public funds and merging some banks in a government-owned financial holding company.</p>
<ul style="list-style-type: none"> Fully implement loan loss provisioning and mark-to-market accounting. Raise the current ratio of banks' foreign exchange assets and liabilities to 70 percent (from 60 percent in August 1997) The current ratio of banks' foreign exchange assets and liabilities will be raised to normal banking standards. 	<p>Substantially complied with. The BSA required banks to make provisions of 100 percent of actual loan losses and valuation losses on marketable securities investments. Mark-to-market accounting for won-denominated bonds is required from 1 January 1999.</p> <p>Complied with. Previously, BOK raised the required current ratio of banks' foreign exchange assets and liabilities to 70 percent.</p> <p>Complied with. The FSS now uses the "maturity ladder" approach, under which banks are required to have</p> <ul style="list-style-type: none"> (i) foreign assets with a maturity of three months or less equal to no less than 80 percent of foreign currency liabilities of three months or less, (ii) a positive mismatch in the 7 day period, and (iii) a negative mismatch of no more than 10 percent in the 1-month period. <p>Observance of these limits is monitored on a monthly basis. In addition, the short-hand position (i.e., the greater between the sum of overbought positions and the sum of oversold positions) of any bank may not exceed 20 percent of the bank's capital.</p>

Program Components and Conditions	Status of Compliance
<p>D. Improve competitiveness in the banking system by opening access for new entrants and reducing costs of being a bank.</p> <ul style="list-style-type: none"> Permit foreign banks to establish bank subsidiaries. 	<p>Complied with. The General Banking Act (December 1997) was revised to allow foreign banks to establish bank subsidiaries with permission from the Ministry of Finance and Economy (MOFE).</p>
<ul style="list-style-type: none"> BOK will place full reliance on open market operations for the implementation of monetary policy so that the reserve requirements for banks will be reduced from the current level of 3.3 percent.³ 	<p>Not complied with. BOK has been placing increasing emphasis on open market operations for monetary management. However, reserve requirements have not changed since February 1997, when the weighted average of reserve requirements was 3.1 percent.</p> <p>Reserve requirements are being retained to protect against risks associated with delays in settlements among banks.⁴ BOK and MOFE contend that, in existing circumstances, lowering of reserve requirements would complicate monetary management and contribute to inflationary pressures.</p>
<p>E. Exit of nonviable banking institutions.</p> <ul style="list-style-type: none"> Develop rehabilitation plans for the two distressed banks. Explore mergers with another financial institution or disposal of some or all of their banking business, to restore profitability to an acceptable level and meet minimum solvency requirements. 	<p>Complied with. Initial rehabilitation plans of the two banks, Seoul Bank and Korea First Bank, were approved by BSA in February 1998. The plans covered aspects such as lay-offs, disposal of subsidiaries, and closure of branches.</p> <p>Complied with. Newbridge Capital now owns 51 percent of Korea First Bank. The Government holds a 100 percent stake in Seoul Bank, but plans to privatize it by selling controlling stakes to foreign investors in the near future. Seoul Bank is now under restructuring, in consultation with Deutsche Bank.</p>
<p>II. Nonbank Financial Institutions – Improve access and provide financial services on a competitive basis</p>	
<p>A. Merchant Banks: Improve exit policies.</p> <ul style="list-style-type: none"> Agree on recovery/rehabilitation program for suspended merchant banks or closure within four months from the date of official suspension. 	<p>Complied with. In February 1998, rehabilitation plans for troubled merchant banks were submitted to the Merchant Banks' Rehabilitation Evaluation Committee. On the basis of these plans, licenses of 16 (of 30) merchant banks were revoked; these banks were closed. The assets and liabilities of the closed merchant banks were taken over by a bridge bank.</p>

³ The level prevailing in December 1997.

⁴ BOK has been seeking ways to reduce the risk associated with settlement delays. For example, it introduced the Daylight Overdraft Facility in September 2000.

Program Components and Conditions	Status of Compliance
<ul style="list-style-type: none"> • Full implementation of merchant bank restructuring program. 	<p>Complied with. Of 30 merchant banks in operation at the end of 1997, only 5 remain in operation at the end of 2000, including Hanaro, a merchant bank established by the Korea Deposit Insurance Corporation (KDIC). The Government plans for Hanaro to be merged in a government-owned financial holding company.</p> <p>Regulations for merchant banks are now similar to those for commercial banks and include limits on connected lending and large exposures. Merchant banks were required to meet a minimum risk-adjusted capital adequacy ratio (CAR) of 6 percent by June 1998 and 8 percent by June 1999. Loan classification and provisioning norms for merchant banks were also gradually made comparable with those imposed on commercial banks. Merchant banks that failed to meet the performance criteria were subject to strict penalties culminating in closure. At the end of 1997, 30 merchant banks were in operation in Korea, but only 5 remained at the end of 2000.</p>
<p>B. Securities companies: Enhance investor protection.</p> <ul style="list-style-type: none"> • Fully implement the requirement that the amount of corporate bonds that can be guaranteed by a securities company should be no more than 100 percent of its equity capital. • Review the regulatory framework for securities companies to enhance investor confidence. • Issue revised supervisory guidelines, if necessary, following consultations with Asian Development Bank (ADB). 	<p>Substantially complied with. Effective April 1998, securities companies were no longer allowed to provide guarantees for corporate bonds except for one time to support rollover of bonds outstanding as of 31 July 1997.</p> <p>Complied with. A review of the supervisory regulations for securities companies was undertaken.</p> <p>Complied with. New regulations were issued in April 1998. While ADB was not consulted, subsequent review indicates that the supervisory guidelines are appropriate.</p>
<p>C. Insurance: Improve insurance services by increasing competitiveness within the industry.</p> <ul style="list-style-type: none"> • Issue the guidelines that permit entrance of the five largest chaebols to the insurance market. • Fully implement solvency standards and provide ADB with a complete review of individual insurance companies' 1997 performance. 	<p>Complied with. Notifications issued in February 1998 provide opportunities for the five largest chaebols to gain access to the insurance market by rescuing insolvent insurance companies.</p> <p>Complied with. Existing prudential ratio of 1 percent (capital to liabilities) imposed in 1994 was substituted by minimum solvency standards whereby assets were required to exceed liabilities. Data provided by the Insurance Supervisory Board (ISB) shows that at the end of March 1998 (fiscal year [FY] 1997), only 10 of the 33 life insurance companies and 13 of the 17 non-life insurance companies</p>

Program Components and Conditions	Status of Compliance
<ul style="list-style-type: none"> Discuss with ADB measures to be taken according to solvency regulations for ailing insurance companies and enforce exits as necessary, for nonviable insurance companies. 	<p>met the minimum solvency standards.</p> <p>Complied with. In 1998, the Appraisal Committee for the Rehabilitation Plan evaluated rehabilitation plans of 22 insurance companies which failed to meet solvency margin standards or had liabilities in excess of assets. On the basis of this evaluation:</p> <ul style="list-style-type: none"> seven life insurance companies and two non-life insurance companies were given notice to take steps to meet minimum solvency margin requirements by the end of FY1998; seven life insurance companies were given execution plans requiring that they reduce their solvency margin shortage to 10 percent by March 1999, to 5 percent by March 2000, and to minimum solvency margin requirements by September 2000; four life insurance companies were closed by the Financial Supervisory Commission (FSC) and their business transferred to four healthier companies; and The FSC forced the merger of two non-life surety insurance companies.
<ul style="list-style-type: none"> Require annual ratings all insurance firms by the Insurance Supervisory Board (ISB), and the posting of these ratings in all their offices with full reports available to customers on request. The regulatory agency will periodically publish a complete set of ratings with public explanations. Continue implementation of actions required under the solvency regulations. 	<p>Substantially complied with. The ISB amended the management evaluation standards of insurance companies in February 1998 to enable them to determine ratings for life and non-life insurance companies. These ratings take into consideration various financial and nonfinancial factors. Based on the results of FY1997, ratings were determined by the ISB for all life insurance companies and non-life insurance companies that are not Korean branches of foreign companies. The ratings of life insurance and non-life companies were published in newspapers and insurance industry publications in 1998. Finally, the ISB issued regulations, to be effective for FY1998 that require insurance companies to disclose, among other things, their rating as determined by the ISB and to make them available at their headquarters and at all branch offices.</p> <p>Substantially complied with. The authorities have been pursuing a restructuring plan for the life insurance sector based on consolidation and recapitalization. Under the plan, buyers had been sought for 7 financially distressed institutions since 1999. Of these 7 institutions, 1 company was closed, 2 were merged, and 4 were acquired by other companies in 2000.</p> <p>One key element of the restructuring plan is to impose progressively strict measures culminating in closure of companies that fail to meet</p>

Program Components and Conditions	Status of Compliance
<ul style="list-style-type: none"> • Liberalize completely non-life insurance premiums 	<p>solvency standards. Life insurance companies will be gradually required to meet a 4 percent solvency margin (plus 0.3 percent of the sum at risk) by March 2004. As a first step, all firms were required to achieve a positive solvency margin by the end of September 1999.</p> <p>Complied with. Following the deregulation of rates for auto insurance in August 1998, non-life insurance premiums have all been deregulated.</p>
<p>D. Pensions: Introduce more market-determined asset management.</p> <ul style="list-style-type: none"> • Final report of the pension review committee to be issued • Raise mandatory contribution rate to 9 percent for industrial workers in 1998. • Discuss with ADB recommendations of the pension review committee, including implementation schedule, and implement recommendations acceptable to Government. 	<p>Complied with. Final report of the pension review committee was issued on 27 December 1997. The report recommended (i) division of the pension formula into a basic and earnings-related portion, (ii) distinction between the management of the basic fund component and the earnings-related component, (iii) reduction of the benefit formula, (iv) gradual increase of the retirement age from 60 to 65, (v) revision of actuarial estimates every five years with an adjustment to the premium level as necessary (after 2009), and (vi) extension of coverage to the urban self-employed.</p> <p>Complied with. In 1998, the mandatory contribution rate for industrial workers was raised from 6 percent to 9 percent with employers, employees and the retirement pension reserve each required to contribute 3 percent.</p> <p>From 1999, employers and employees are each required to contribute 4.5 percent for an aggregate contribution of 9 percent under the National Pension Act.</p> <p>Complied with. The final report of the pension review committee was provided to ADB, and its recommendations were reviewed and discussed with the Government. Based on the discussions, the Government revised the National Pension Act in December 1998.</p>

Program Components and Conditions	Status of Compliance
<p>E. Enhance independent regulations and strengthen prudential and supervisory functions.</p> <ul style="list-style-type: none"> Enactment of a bill to ensure independent regulation as noted above under the banking section. Amendment of the regulatory framework for nonbank financial institutions to undertake any needed improvements and develop effective enforcement mechanisms. 	<p>Complied with. The regulatory framework for nonbank financial institutions have been revised to undertake needed improvements and to develop effective enforcement mechanisms through the passage of the following legislation on 19 December 1997:</p> <ul style="list-style-type: none"> The Act for Establishment of the Financial Supervisory Institutions Financial Industry Restructuring Act Merchant Bank Act Trust Business Act Credit Union Law Insurance Business Law Mutual Savings and Finance Companies Act
<p>III. Financial Markets – Improve range of financial services and efficiency of these markets through enhanced competition and an independent regulatory framework</p>	
<p>A. Government bonds</p> <ul style="list-style-type: none"> The internal preset rate in the auctioning of government securities is to fully reflect the market rate in the secondary market. Delete preset rate mechanism in auctioning of government securities to ensure that system is fully market determined. Consolidate grain security bonds with National Debt Management Fund bonds 	<p>Complied with. MOFE eliminated the preset mechanism effective July 1999.</p> <p>Complied with. In 1999, the Government revised the relevant law to consolidate grain security bonds with Treasury bonds (formerly known as National Debt Management Fund bonds).</p>
<ul style="list-style-type: none"> Standardize the interest payment mechanisms of the government bonds issued via auction to simplify trading and pricing in the secondary market. 	<p>Substantially complied with. As of March 2001, there are 4 categories of government bonds – Treasury bonds, foreign exchange stabilization bonds, national housing bonds, and compensation bonds. Of these, Treasury bonds and foreign exchange stabilization bonds are issued at auction, and their interest payment mechanisms are standardized as follows:</p> <ul style="list-style-type: none"> maturity of 1 year or less: payment at maturity date maturity of more than 1 year: payment every 3 months

Program Components and Conditions	Status of Compliance
<p>B. Corporate bonds</p> <ul style="list-style-type: none"> Increase percentage limits of corporate bonds that may be held by foreign investors, in consultation with ADB. 	<p>Substantially complied with. The ceiling on foreign ownership of all Korea Stock Exchange (KSE)-listed bonds was abolished in December 1997. Effective July 1998, foreign investors are allowed to hold unlisted bonds and engage in repurchase transactions.</p>
<p>C. Credit-rating agencies</p> <ul style="list-style-type: none"> Encourage domestic credit-rating agencies (CRAs) to undertake institutional strengthening programs, to increase financial analysis capability. 	<p>Complied with. New Standards on licensing CRAs (for nonguaranteed bonds) came into effect in 1999. These standards are intended to prevent moral hazard and enhance institutional strengthening and reporting requirements. Measures to prevent moral hazard include prohibitions on the issuance of rating on companies with which the CRA has close ownership relations. The CRAs are also required to report default ratios on companies they have rated. Further measures to strengthen the CRAs institutionally include a paid-in capital of W30 billion and the employment of at least 30 qualified analysts. As of January 2001, Moody's holds a 10 percent stake in one domestic agency, and Fitch IBCA holds about 9 percent stake in another agency.</p>
<p>D. Equity market</p> <ul style="list-style-type: none"> Korea Stock Exchange (KSE) <ul style="list-style-type: none"> Increase daily price change limit to 10 percent. The limit on foreign ownership in a KSE-listed company is raised to 50 percent by December 1997 and then to 55 percent by December 1998. Over-the-counter market (KOSDAQ) <p>Permit foreign investment up to 25 percent in a KOSDAQ-listed company and raise limit on a single foreign investor to 10 percent by December 1998, and then raise limit on foreign ownership to 55 percent by December 1999.</p> 	<p>Complied with. The daily trading band for stock price fluctuation was increased to 12 percent in March 1998, and then to 15 percent in December 1998. For the futures market, the band was increased from 7 percent to 10 percent in December 1998.</p> <p>Substantially complied with. Limit on foreign ownership in a KSE-listed company was raised to 50 percent on 11 December 1997, and abolished in May 1998. As of March 2001, however, foreign ownership limits remain on 7 companies, operating in strategic industries, such as telecommunications and airlines.</p> <p>Substantially complied with. Limit on foreign ownership was abolished on 25 May 1998. As of March 2001, however, foreign ownership limits remain on 14 companies, operating in strategic industries, such as telecommunications, broadcasting, and airlines.</p>

Program Components and Conditions	Status of Compliance
<p>E. Mortgage-backed securities</p> <ul style="list-style-type: none"> • Take necessary measures, including creation of legal framework, for establishment of a financial institution that will securitize mortgage-backed loans. • Establish a financial institution to issue mortgage-backed securities for purchases of mortgage-backed loans 	<p>Complied with. A law concerning asset-backed securitization came into effect on 16 September 1998. This law deals with all asset-backed securitization. To establish an institution that issues mortgage-backed securities, the Mortgage-Backed Securities Company Act was enacted in January 1999.</p> <p>Substantially complied with. Following the enactment of the Mortgage-Backed Securities Company Act in January 1999 and approval by the FSC, the Korea Mortgage Corporation (KOMOCO) opened for business in October 1999. Initial shareholders included the Ministry of Construction and Transportation (W45 billion), Kookmin Bank (W15 billion), Korea Exchange Bank (W15 billion), Korea Housing and Commercial Bank (W15 billion) and Samsung Life Insurance (W10 billion). Subsequently, the International Finance Corporation (IFC) and one foreign institution with expertise in mortgage finance⁵ participated, each holding a 9.5 percent stake as of March 2001. In 2000, KOMOCO issued mortgage bonds of W1.28 trillion, using mortgages originated by the National Housing Fund. Gradually, KOMOCO plans to shift operations to mortgages originated by other financial institutions.</p>
<p>F. Derivatives Market</p> <ul style="list-style-type: none"> • Establish the Korea Futures and Options Exchange (KOFEX) to offer foreign exchange and interest rate futures and options with foreign participation allowed with respect to the underlying assets open to foreign investment. 	<p>Complied with. The KOFEX opened in April 1999 in Pusan. Futures contracts on certificates of deposit, US dollars, gold, Treasury bonds, and KOSDAQ index (KOSDAQ 50), and options on US dollars are traded as of December 2000. This exchange is open to foreign participation. The participation rate of foreign investors was, for instance, about 3 percent during 12-16 March 2001.</p> <p>The daily trading volume reached 10,000 contracts in July 1999, and the accumulated trading volume reached 4 million contracts in January 2001. Activity on KOFEX has been less than projected, largely because of low confidence in the clearing system. Equity index (KOSPI 200) futures and options have been traded on the KSE since 1996 and 1997, respectively.</p>

⁵ KML Holdings Co., Ltd.

Program Components and Conditions	Status of Compliance
IV. Corporate Accounting and Disclosure Standards – Improve accuracy and timely disclosure financial and accounting information	
<ul style="list-style-type: none"> • Enactment of a bill (an act concerning external audit of joint stock corporations) requiring corporate financial statements to be prepared on a consolidated basis and certified by external auditors. • Maintain real name system, with some possible revisions. 	<p>Complied with. A bill was enacted in December 1997 requiring combined financial statements for the corporate sector from 1999. In 1999, the Government announced that the 30 largest business groups are required to prepare financial statements on a consolidated basis from 2000.</p> <p>Complied with. The Real Name Financial Transactions and Guarantee of Secrecy Act was passed at the end of 1997. According to this act financial transactions both with and through financial institutions must be conducted under a customer’s real name.</p>

MACROECONOMIC INDICATORS

Item	1995	1996	1997	1998	1999	2000
Income and Growth						
	(annual percentage change)					
GDP Growth (% , in constant prices)	8.9	6.8	5.0	(6.7)	10.9	8.8
Money and Inflation						
	(annual percentage change)					
Consumer Prices (annual average)	4.5	4.9	4.5	7.5	0.8	2.3
Broad Money (M2) (end-of-period)	15.6	15.8	14.1	27.0	27.4	25.4
Government Finance						
	(percent of GDP)					
Overall Fiscal Surplus/ Deficit (-)	0.3	0.1	(1.5)	(4.2)	(2.7)	(1.3)
Balance of Payments						
	(\$ billion)					
Merchandise Trade Balance	(4.4)	(15.0)	(3.2)	41.6	28.4	16.6
Exports	124.6	130.0	138.6	132.1	145.2	175.8
Imports	129.1	144.9	141.8	90.5	116.8	159.2
Current Account Balance ^a	(8.5)	(23.0)	(8.2)	40.4	24.5	11.0
Net Financial Flows	17.3	23.9	1.9	(3.4)	2.4	12.3
Net Direct Investment	(1.8)	(2.3)	(1.6)	0.7	5.1	3.5
Net Portfolio Investment	11.6	15.2	14.3	(1.9)	8.7	12.1
Other Investment, Net	7.5	11.1	(10.8)	(2.2)	(11.4)	(3.3)
Other Capital Flows, Net	(0.5)	(0.6)	(0.6)	0.2	(0.4)	(0.5)
Capital and Financial Account Balance	16.8	23.3	1.3	(3.2)	2.0	11.7
	(annual percentage change)					
Export (\$) growth (%)	31.2	4.3	6.7	(4.7)	9.9	21.1
Import (\$) growth (%)	31.9	12.3	(2.2)	(36.2)	29.1	36.3
External Payments Indicators						
Gross Foreign Reserves (\$ billion) ^b	32.7	33.2	20.4	52.0	74.1	96.2
- as percent of short-term external debt	41.6	35.7	32.1	169.4	189.0	217.6
Unemployment Rate (%)	2.0	2.0	2.6	6.8	6.3	4.1
Exchange Rate (Won per \$, annual average) ^c	771.0	804.8	951.1	1,398.9	1,189.5	1,130.6

^a Excludes official transfers.

^b Include gold, special drawing rights, reserve position in the International Monetary Fund and foreign exchange.

^c Refers to average basic rate as provided by Korea Exchange Bank.

Sources: Bank of Korea; Ministry of Finance and Economy; and Asia Recovery Information Center, Asian Development Bank.

FINANCIAL SECTOR DATA

Table A3.1: Public Funds
(November 1997 - December 2000)

(unit: billion won)

	Korea Deposit Insurance Corporation (KDIC)	Korea Asset Management Corporation (KAMCO)	Fiscal Expenditure	Bank of Korea (BOK)	Total
November 1997 - December 1999					
Banks	30,083.8	19,488.0	17,877.9	700.0	68,149.7
Nationwide	30,083.8	14,168.6	5,628.9	0	49,881.3
Regional	0	2,592.3	1,468.4	0	4,060.7
Specialized	0	2,727.1	10,780.6	700.0	14,207.7
Merchant Banks	8,837.4	1,755.5	0	0	10,592.9
Securities Co.	14.4	56.3	0	0	70.7
Insurance Co.	6,545.6	1,371.5	0	0	7,917.1
Investment Trusts	0	0	900.0	0	900.0
Mutual Savings/ Credit Unions	4,166.2	105.1	0	0	4,271.3
Others	0.1	-	0	0	0.1
Total	49,647.5	22,776.4	18,777.9	700.0	91,901.8
January 2000 - December 2000					
Banks	9,595.2	1,553.0	100.0	200.0	11,448.2
Nationwide	7,212.7	1,109.8	0	0	8,322.5
Regional	482.5	39.9	0	0	522.4
Specialized	1,900.0	403.3	100.0	200.0	2,603.3
Merchant Banks	2,805.5	0	0	0	2,805.5
Securities Co.	4,900.0	0	0	0	4,900.0
Insurance Co.	4,251.5	323.5	0	0	4,575.0
Investment Trusts	0	8,239.3	0	0	8,239.3
Mutual Savings/ Credit Unions	1,056.9	19.8	0	0	1,076.7
Others	0	1,951.7	0	0	1,951.7
Total	22,609.1	12,087.3	100.0	200.0	34,996.4
Total					
Banks	39,679.0	21,041.0	17,977.9	900.0	79,597.9
Nationwide	37,296.5	15,278.4	5,628.9	0	58,203.8
Regional	482.5	2,632.2	1,468.4	0	4,583.1
Specialized	1,900.0	3,130.4	10,880.6	900.0	16,811.0
Merchant Banks	11,642.9	1,755.5	0	0	13,398.4
Securities Co.	4,914.4	56.3	0	0	4,970.7
Insurance Co.	10,797.1	1,695.0	0	0	12,492.1
Investment Trusts	0	8,239.3	900.0	0	9,139.3
Mutual Savings/ Credit Unions	5,223.1	124.9	0	0	5,348.0
Others	0.1	1,951.7	0	0	1,951.8
Total	72,256.6	34,863.7	18,877.9	900.0	126,898.2

Bank of Korea (BOK)

Korea Asset Management Corporation (KAMCO)

Korea Deposit Insurance Corporation (KDIC)

Source: *Monthly Bulletin*, the Bank of Korea, February 2001.

Table A3.2: Closure of Financial Institutions

Subsector	Number of Institutions as of December 1997	Number of Institutions as of March 2001	January 1998-March 2001			Newly Created Institutions
			Revocation of License/Liquidation	Mergers	Total	
Banks ^a	33	22	5	6	11	
Merchant Banks	30	5	23	3	26	1
Leasing Co.	25	19	8	1	9	3
Securities Co.	36	43	6	1	7	14
Insurance Co.	50	40	7	6	13	3
Investment Trusts	31	29	9	1	10	8
Mutual Savings / Finance Co.	231	146	72	25	97	12
Credit Unions	1,666	1,311	258	101	359	4
Total	2,102	1,615	388	144	532	45

^a Including specialized banks.

Source: Financial Supervisory Commission/Financial Supervisory Service. 2001. *Financial Reform and Supervision in Korea 2001*.

Table A3.3
Capital Adequacy Ratio: Commercial Banks

(Unit : %)

Bank	1992	1993	1994	1995	1996	1997	1998	1999	2000.12
Cho-Hung Bank	9.86	9.79	10.07	9.01	8.48	6.50	0.93	9.80	9.78
Hanvit Bank	-	-	-	-	-	-	12.05	8.67	10.26
(Commercial Bank of Korea)	9.22	9.84	10.56	9.64	9.25	7.62	-	-	-
(Hanil Bank)	11.35	11.09	11.04	9.72	8.89	6.90	-	-	-
Korea First Bank	10.09	10.19	10.04	8.71	9.14	(2.7)	(1.47)	11.44	13.40
Seoul Bank	10.89	9.71	10.62	8.97	8.56	0.97	(0.88)	10.41	10.08
Korea Exchange Bank	7.43	9.23	9.06	8.66	9.16	6.79	8.06	9.76	9.19
Kookmin Bank	-	-	-	6.06	8.46	9.78	10.09	11.38	11.18
Korea Housing & Commercial Bank	-	-	-	-	-	10.29	10.79	11.74	9.92
Shinhan Bank	13.79	13.26	11.68	11.77	10.03	10.29	14.69	13.85	12.30
KorAm Bank	7.95	8.56	8.49	8.57	8.80	8.57	15.21	12.14	8.67
Hana Bank	10.57	7.62	8.12	8.35	8.71	9.29	13.10	12.33	10.45
Peace Bank	-	26.12	12.10	9.49	8.92	5.45	(1.79)	5.15	10.09
Nationwide Commercial Banks	10.40	10.40	10.19	8.97	8.97	6.66	8.22	10.79	10.52
Daegu Bank	14.85	12.87	11.77	11.12	9.93	11.25	11.42	12.12	11.69
Pusan Bank	9.45	10.28	10.27	8.61	8.58	9.66	9.25	11.45	10.53
Kwangju Bank	20.52	18.75	14.05	12.96	11.27	10.65	10.12	8.63	10.12
Bank of Cheju	30.71	29.44	32.16	24.32	14.95	12.13	9.65	7.85	10.14
Jeonbuk Bank	25.14	22.71	19.13	16.43	15.13	13.27	12.94	13.36	10.87
Kyongnam Bank	18.46	14.83	11.62	10.03	9.41	12.27	11.87	12.39	10.06
Regional Banks	16.34	14.86	13.11	11.44	10.15	9.60	8.31	11.36	10.77
Domestic Commercial Banks	11.18	11.00	10.62	9.33	9.14	7.04	8.23	10.83	10.53

Note: 1. Based on Basle Capital Accord.

2. The figures are calculated on the condition that allowance for valuation of securities and credit losses are made no less than 100% from 1997.

Source: Financial Supervisory Service.

Table A3.4: Return on Assets: Commercial Banks

Bank	(unit: %)							
	1993	1994	1995	1996	1997	1998	1999	2000
Cho-Hung Bank	0.45	0.51	0.39	0.34	(0.72)	(4.80)	(1.69)	0.21
Hanvit Bank	-	-	-	-	-	-	(2.82)	(4.36)
(Commercial Bank of Korea)	0.04	0.20	0.34	0.35	(0.45)	(4.46)	0.00	0.00
(Hanil Bank)	0.55	0.48	0.31	0.19	(0.73)	(4.24)	0.00	0.00
Korea First Bank	0.68	0.46	0.06	0.02	(4.61)	(7.94)	(3.21)	1.13
Seoul Bank	0.05	0.23	0.02	(0.67)	(3.25)	(8.03)	(9.59)	(2.53)
Korea Exchange Bank	0.32	0.34	0.35	0.29	(0.15)	(1.85)	(1.80)	(0.90)
Kookmin Bank	0.00	0.00	0.41	0.56	0.31	0.16	0.16	0.97
Korea Housing & Commercial Bank	0.00	0.00	0.00	0.00	0.36	(0.68)	1.02	0.94
Shinhan Bank	0.96	0.82	0.70	0.63	0.19	0.18	0.30	0.85
KorAm Bank	0.35	0.42	0.28	0.40	(0.38)	0.33	0.24	(1.59)
Hana Bank	0.70	0.49	0.55	0.55	0.39	0.69	0.47	0.05
Peace Bank	0.09	0.33	(0.63)	0.16	(0.88)	(6.54)	(1.13)	(1.40)
Nationwide Commercial Banks	0.41	0.40	0.28	0.23	(0.90)	(2.99)	(1.42)	(0.53)
Daegu Bank	0.86	0.68	0.84	0.73	0.17	(4.85)	0.29	0.13
Pusan Bank	0.44	0.35	0.50	0.58	0.23	(4.61)	0.05	0.09
Kwangju Bank	0.81	0.86	0.53	0.22	(1.00)	(5.16)	(1.41)	(2.18)
Bank of Cheju	1.06	0.94	0.40	-0.36	(3.05)	(8.71)	0.45	(1.59)
Jeonbuk Bank	0.21	0.83	0.29	0.30	(2.35)	(6.03)	(0.02)	0.20
Kyongnam Bank	0.64	0.27	0.79	1.02	0.05	(5.41)	0.12	(4.05)
Regional Banks	0.67	0.53	0.56	0.47	(1.17)	(5.83)	(0.11)	(1.07)
Domestic Commercial Banks	0.45	0.42	0.32	0.26	(0.93)	(3.25)	(1.31)	(0.57)

Note: Including trust accounts.

Source: Financial Supervisory Service

Table A3.5
Non-performing loans (NPLs): Commercial Banks
(W billion)

Year	Total Loans	Nonperforming Loans ¹⁾	Nonperforming Loans					Ratio of Nonperforming Loans to Total Loans (percent)
			Loans Overdue for More than 3 Months	Nonaccrual Loans	Nonaccrual Loans			
					Bankrupt Loans	Loans to Borrowers Whose Capacity to Repay are Weakened	Nonperforming Restructured Loans	
1999	328,294.5	27,393.8	6,113.3	21,280.5	4,842.1	7,299.2	9,139.2	8.3
2000	361,608.6	23,850.2	3,802.4	20,047.8	3,333.1	3,885.9	12,828.8	6.6
2001 ^a	362,311.6	19,536.6	3,130.1	16,406.5	3,816.1	4,031.1	8,559.3	5.4

^a End of March.

Note : 1. Nonperforming loans by forward looking criteria from 1999.

Table A3.6: Number of Foreign Investors

Year	United States		United Kingdom		Japan		Taiwan		Others		Total	
1992	502	(31.7)	314	(20.2)	110	(7.0)	266	(16.9)	380	(24.2)	1,572	(100.0)
1993	983	(35.8)	478	(17.4)	237	(8.6)	353	(12.9)	694	(25.3)	2,745	(100.0)
1994	1,228	(36.9)	565	(15.9)	293	(9.5)	400	(11.7)	941	(25.3)	3,427	(100.0)
1995	1,553	(36.2)	682	(16.5)	365	(8.5)	442	(10.3)	1,244	(29.1)	4,286	(100.0)
1996	1,930	(36.5)	781	(14.8)	441	(8.3)	497	(9.4)	1,645	(31.1)	5,294	(100.0)
1997	2,369	(36.3)	806	(13.8)	528	(7.9)	504	(7.8)	2,307	(34.2)	6,514	(100.0)
1998	3,225	(38.0)	859	(10.1)	677	(8.0)	514	(6.1)	3,205	(37.8)	8,480	(100.0)
1999	3,900	(39.2)	963	(9.7)	803	(8.1)	534	(5.4)	3,753	(37.7)	9,954	(100.0)
2000	4,602	(39.2)	1,057	(9.0)	942	(8.0)	566	(4.8)	4,581	(39.0)	11,748	(100.0)

Note: The figures in parentheses represent the percentages to the total amount.

Source: Financial Supervisory Service.

35

Table A3.7: Types and Number of Foreign Investors

End of	Institutional Investors				Sub-total	Individuals	Total
	Funds	Pensions	Securities	Others			
1992	574	102	80	139	895	677	1,572
1993	1,070	240	96	247	1,653	1,092	2,745
1994	1,377	282	128	324	2,111	1,316	3,427
1995	1,864	351	153	398	2,766	1,520	4,286
1996	2,412	432	191	477	3,512	1,782	5,294
1997	3,198	476	250	595	4,519	1,995	6,514
1998	3,763	522	285	759	5,329	3,151	8,480
1999	4,239	598	310	938	6,085	3,869	9,954
2000	4,966	686	336	1,225	7,213	4,535	11,748

Source: Financial Supervisory Service.

Appendix 3, page 6

Table A3.8: Foreign Capital Movement
(\$ million)

Year	Inflow	Outflow	Balance
1992	2,735	662	2,073
1993	7,635	1,936	5,699
1994	8,637	6,695	1,942
1995	10,216	7,766	2,450
1996	12,570	8,004	4,566
1997	13,201	12,120	1,081
1998	16,480	11,698	4,782
1999	41,743	36,247	5,496
2000	60206 ^P	48801 ^P	11405 ^P

^P Preliminary figure.

Note: The figures include only portfolio investment such as stocks, bonds, beneficiary certificates, derivatives.

Source: Bank of Korea.

Table A3.9: Trading Activities of Foreign Investors
(W billion)

Year	Purchase	Sale	Balance
1995	7,602.1	6,284.1	1,318.0
1996	10,123.5	7,049.7	3,073.8
1997	11,061.1	10,637.1	424.0
1998	17,269.6	11,546.2	5,723.4
1999	45,465.1	43,948.9	1,516.2
2000	63,168.7	51,781.5	11,387.2

Source: Korea Stock Exchange.

Table A3.10: Shareholdings by Foreign Investors

Year	Number of Listed Shares			Market Value				Share (%)
	Total Number of Listed Shares (millions)	Shares Held by Foreigners	Share (%)	Total Market Value (W billion)	Direct Investment by Foreigners (W billion)	Portfolio Investment by Foreigners (W billion)	Total Investment by Foreigners (W billion)	
1995	7,609.4	762.3	10.0	144,151.4	2,659.5	14,063.4	16,722.9	11.8
1996	8,598.4	989.3	11.5	117,370.0	2,953.4	12,268.6	15,222.0	13.0
1997	9,030.8	819.8	9.1	70,988.9	1,623.3	8,734.7	10,358.0	14.6
1998	11,443.7	1,204.1	10.5	137,798.5	3,103.2	22,530.2	25,633.4	18.6
1999	17,325.8	2,136.9	12.3	349,504.0	5,936.2	70,654.3	76,590.5	21.9

Source: Financial Supervisory Service.

Table A3.11: Stock Market (Korea Stock Exchange)

Item	1996	1997	1998	1999	2000
KOSPI ^a (Closing)	651.2	376.3	562.5	1,028.1	504.6
(Average)	833.4	654.5	406.1	806.8	734.2
Trading Volume (Daily Average, million shares)	26.6	41.5	97.7	278.6	306.2
Trading Value (Daily Average, billion won)	486.8	555.8	660.4	3,481.6	2,602.1
Stock Issue (billion won)	5,042.9	3,155.6	13,488.9	35,147.0	5,788.9
IPOs ^b	1,391.4	479.3	36.8	1,720.1	-
SEOs ^c	3,651.5	2,676.3	13,452.1	33,426.9	5,788.9
Number of Listed Companies	760	776	748	725	704
Market Capitalization (trillion won)	117	71	138	350	188

Source:

^a Korea Composite Stock Price Index.

^b Initial public offerings.

^c Seasoned equity offerings.

Table A3.12: Listed Bonds
(W trillion)

Year	Public Bonds			Corporate Bonds			Total Amount Listed
	Number of Issuers	Number of Listed Issues	Amount Listed	Number of Issuers	Number of Listed Issues	Amount Listed	
1996	129	5,808	102.4	1,977	8,762	73.1	175.5
1997	160	7,717	138.1	1,827	8,170	86.0	224.1
1998	140	7,090	214.6	1,512	6,500	119.4	334.0
1999	139	5,701	253.3	1,078	4,054	111.1	364.4
2000	111	5,030	296.8	727	2,436	127.9	424.7

Source: Korea Stock Exchange.

Table A3.13: Bond Trading

(W billion)

Year	Korea Stock Exchange Market			OTC Market
	Public Bonds	Corporate Bonds	Total	
1996	192	1,186	1,378	114,484
1997	237	3,807	4,044	139,451
1998	6,519	8,968	15,488	431,898
1999	281,921	11,685	293,606	745,740
2000	23,521	3,648	27,169	932,087

Source: Korea Stock Exchange for KSE market figures and Korea Securities Computer Corporation for over-the-counter market figures.