Policy Directions for Second Stage of Korean Banking Sector Restructuring.

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December 7, 2000 - In line with plans to complete the second phase of financial sector reform, the government is accelerating the pace of banking sector restructuring by actively promoting the creation of bank financial holding companies and consolidation among healthier banks by the end of 2000. The measures are being taken in order to lay foundations for a world-class and internationally competitive financial system in Korea.

1. Background

Since the beginning of Korea's financial crisis in late-1997, the number of banks operating in Korea has been reduced to 22 from 33 by P&A and mergers as of end-November 2000.

The government is pursuing the second stage of financial restructuring with a focus on strengthening the competitiveness of the domestic financial industry by clearing up ailing assets such as non-performing loans and implementing forward-looking reforms based on the results of the initial stage of financial restructuring.

2. Policy Directions for Second Stage of Banking Sector Restructuring

Introduction of Financial Holding Companies

Based on the assessment by the independent Management Evaluation Committee (MEC), Hanvit Bank, Peace Bank of Korea, Kwangju Bank and Cheju Bank were judged to be not self-sustainable. Consequently, these four banks and Kyongnam Bank, which was under a management improvement requirement, will be subject to inclusion as a subsidiary of a government-led FHC in accordance with the policy directions reported to the Tripartite Commission of government, management and labor on July 12, 2000.

To promote increased consolidation in the domestic banking sector, the government may also offer priority approval to sound banks and regional banks if they are willing to be voluntarily integrated as an FHC. Banks wishing to join the government-led FHC will be included in the FHC if it will contribute to the formation of a large and financially sound "leading" bank.

Presently, the government plans to launch its FHC during the first quarter of 2001 and subsequently restructure the business operations of banks under the FHC umbrella. The government hopes that the restructuring of businesses will serve as a model to help strengthen the overall international competitiveness of the entire domestic financial industry.

To this end, the FHC's management will be organized to ensure that the most talented financial specialists and managers assume senior management positions, in order to effectively pursue a more innovative and productive business strategy.

Mergers between Sound Banks

Amid the ongoing second stage of financial reform and restructuring, additional mergers between sound banks and the formation of new FHCs are expected as banks continue to seek to improve their levels of financial soundness and competitiveness.

Negotiations are underway, for example, regarding the proposed merger between KorAm Bank and Hana Bank, which would create the nation's second largest bank in terms of total assets.

Mergers among sound banks will also help address lingering problems plaguing domestic banks, including excessive bad assets, low profitability, weak IT investment, and a failure to achieve economies of scale, which have significantly hindered their ability to compete on a global scale.

Restructuring of Seoul Bank

In accordance with a special contract signed with the Korean government, Deutsche Bank has been providing technical advice for the financial and management normalization of Seoul Bank.

However, if the ongoing effort to find an international buyer is unsuccessful by the end of the first half of 2001, the bank will likely be included in an FHC.

3. Additional Measures

The injection of additional public funds into ailing banks will be made in order to lower the ratio of non-performing loans to total loans below 6 percent by the end of 2000 and raise the BIS ratios of the respective banks to the minimum 10 percent level.

Based on the due diligence of the banks conducted by the Korea Deposit Insurance Corp. (KDIC), the total amounts of the public fund injections will be determined.

A limit on total fund injections will be stipulated in an MOU and the allotments will be provided on a phased basis (two or more provisions).

The government will also require the banks to perform their self-rescue efforts, including capital reductions by existing shareholders, as a prerequisite for the injection of public funds.

Prior to any injection of public funds, the KDIC will request the signing of an MOU that stipulates clear and concrete goals for productivity, return on assets, and return on equity. Should a bank fail to meet these goals, it will be required to freeze all employee wages and immediately implement additional self-rescue measures.

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