International Monetary Fund

For more information, see Republic of Korea and the IMF

Seoul, Korea
July 24, 1998

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D. C. 20431

Dear Mr. Camdessus:

1. We are pleased that, during our discussions with the IMF over the past two weeks, we have again reached a common understanding on the state of the Korean economy and on the priorities for reform in the period ahead. These policies are described in the attached Memorandum on the Economic Program. Since the last review in May, macroeconomic policies have been eased to contain the extent of economic downturn. At the same time, Korea has been intensifying its reform efforts in all major sectors of the economy. Priority has been given to reform of the banking system, which is key to the success of other restructuring efforts. Corporate reform is also gaining momentum. The government has been working closely with the World Bank and has put in place a framework for corporate debt restructuring, including procedures for debt workouts. The government's corporate restructuring plan, which has been agreed with the World Bank in the context of a Structural Adjustment Loan, is attached to the Memorandum on the Economic Program.

2. Additionally, the voluntary restructuring of the large conglomerates is advancing through the disposal of assets, attraction of foreign capital, and rationalization of business operations. In recent weeks, ambitious plans have been announced for the immediate privatization of five public enterprises, to be followed by the gradual privatization of six others.

3. The domestic economy, however, appears to be falling further into recession and consumer and investor confidence is at a low ebb. Unemployment has increased faster than previously expected and more layoffs are expected to result from the acceleration of restructuring. Externally, the weaker regional economic environment has begun to have a negative impact on export growth.

4. With the strengthening of the external position, we have decided to shift the focus of

macroeconomic policies toward supporting an early recovery of domestic demand. The government's priority is to take strong actions at this time to contain the economic recession to a manageable level. On the fiscal side, the budget deficit will be expanded from 1 3/4 percent to 4 percent of GDP. This is consistent with the international consensus on fiscal flexibility as expressed in the recent Joint Manila Framework/G7 Deputies Meeting in Tokyo. Higher government expenditures will be used to bolster the social expenditure program, increase social overhead capital investment, as well as to moderate the credit crunch in small- and medium-sized enterprises, trade financing and the housing sector.

5. The recent strengthening of the won has signaled a return of market confidence and provides an opportunity for continued easing of monetary policy. The government intends to take advantage of exchange rate stability to further reduce interest rates in the period ahead.

6. Korea, under the strong leadership of President Kim Dae-jung, remains fully committed to the ongoing reform process. Our policies for the remainder of 1998 are set out in the attached Memorandum on the Economic Program for the third Quarterly Review which updates the Memorandum on the Economic Program of May 4, 1998. We will continue to work in close collaboration with the Fund and World Bank on developing and implementing policies to strengthen our financial system and industrial base so as to place Korea back on a path of strong and sustainable growth.

/s/	/s/
Chol-Hwan Chon Governor Bank of Korea	Kyu-sung Lee Minister of Finance and Economy

ATTACHMENT

Korea: Memorandum on Economic Program, 1998

Macroeconomic Policies	
Objectives	Recognizing that the downturn in economic activity is proving to be more severe and protracted than anticipated, economic policies aim to: • boost confidence and consolidate the progress made in resolving the external financing crisis; • support a recovery of domestic demand and strengthen the social safety net so as to mitigate the hardship of the unemployed; • press ahead with financial sector and corporate restructuring so as to lay the foundation for the resumption of sustained growth.
	Macroeconomic objectives for 1998 are: • containing the decline in real GDP to 4 percent, with recovery starting in 1999; • inflation averaging 9 percent, and declining by end-year; • a current account surplus of US$33–35 billion.
Monetary and exchange rate policy	• The monetary program is designed to provide adequate scope for accommodating a further gradual reduction in interest rates, without jeopardizing the inflation target. • Call interest rates will continue to be lowered, subject to the broad stability of the won in nominal effective terms. More generally, interest rate policy will continue to be

	conducted in a flexible manner with upward and downward adjustments as necessary. • Exchange rate policy will remain flexible and BOK intervention will be limited to smoothing operations.
Reserve management policy	• Usable reserves are expected to increase to US$43 billion at end-year. Consequently, the end-December target of US$41 billion should be met without difficulty.
BOK foreign exchange window	• The BOK foreign exchange window was closed effective May 15, 1998 and schedules to repay emergency support by end-June 1999 have been agreed with banks; penalty interest rates have been reduced to 400–600 basis points above LIBOR. Any amounts overdue in terms of the repayment schedules will be subject to a penalty interest rate of LIBOR plus 800 basis points.
Fiscal policy	• In order to support economic activity and to further strengthen the social safety net, the Supplementary Budget to be passed in August increases the deficit in 1998 to 4 percent of GDP, which is consistent with allowing the automatic stabilizers to work; • The increase in the deficit will be primarily financed by market issuance of government bonds. To facilitate timely disbursement of spending, the issuance of bonds will be initiated in advance of planned spending.
	Measures to be taken in the August Supplementary Budget include: • a 30 percent increase in social safety net expenditure; • an 8 percent increase in social overhead capital expenditure; • an increase in net lending of 25 percent; • a 30 percent reduction in special consumption tax rates on consumer durables and automobiles (effective July 10); • an increase in the excise taxes on gasoline and diesel to remove distortions in relative prices and to address environmental concerns; • a 10 percent increase in the rate of withholding tax on interest income.
Social Safety Net	• To augment its contribution to the social compact with labor and business, the government has increased its commitment to provide expenditures on the social safety net, including unemployment insurance, from W 7.9 trillion to W 10.4 trillion (about 2 1/2 percent of GDP); • The government will continue to keep under close review the adequacy and effectiveness of social safety net expenditures in light of the economic situation.
	The social safety net has been expanded by providing for: • an additional W 1.0 trillion in transfers to the unemployed; • an extra W 0.5 trillion for public works; • a further allocation of W 1 trillion for loans to the unemployed; In addition, by early-1999 the coverage of the unemployment insurance system will be widened to all firms (from firms with more than five employees) and to part-time and temporary workers.
Fiscal contingency measures	• In order to ensure that fiscal policy provides the intended support to the economy, the government will take all necessary measures, including securing the requisite financing, to realize the budgetary spending target and allow the automatic stabilizers to work fully. • The government will continue to closely monitor the economic situation in consultation with the Fund with a view to undertaking timely corrective policies in the event that the economic downturn proves to be significantly worse than expected. In such event, the government will introduce additional fiscal measures, including increasing spending in employment-generating categories and on the social safety net to avoid a withdrawal of fiscal stimulus.

Temporary assistance to credit-constrained enterprises	• Up to $3.3 billion in trade financing will be provided on commercial terms to small- and medium-sized enterprises, and larger enterprises not affiliated with the top five chaebols, for periods of up to one year, comprising; ○ US$3 billion for import financing, of which: US$1 billion has been financed through the World Bank's SAL, and a further US$2 billion will be provided if necessary from reserves in excess of program targets. Of the latter, at least US$1 billion will be reserved for small-and medium-sized enterprises; ○ US$0.3 billion in BOK rediscount of export bills for small- and medium-sized enterprises; • Guarantee ceiling of Credit Guarantee Funds for small- and medium-sized enterprises has been raised by W 10 trillion through an injection of W 0.5 trillion. A further increase is being contemplated.
Privatization	The government has announced immediate privatization of 5 state-owned enterprises and their 21 subsidiaries, and gradual privatization, by 2002, of 6 other state-owned enterprises.

Financial Sector Restructuring		
Type of measure	**Measure**	**Timing**
Undercapitalized Commercial banks	The remaining 7 of the 12 undercapitalized banks will submit implementation plans.	July 31, 1998
	The FSC to announce its decisions on the implementation plans. If a plan is agreed, on the basis that it is likely to be achieved, the bank and the FSC will agree an MOU which will include: • a sufficient initial increase in capital that makes the attainment of minimum capital requirements feasible and credible; • a clear timetable for achieving specific performance indicators including improvements in capital ratios to 6 percent by March 1999, 8 percent by March 2000; • banks will be encouraged to increase their capital ratios further to 10 percent by December 2000; • for regional banks that do not engage in international business and commercial banks that do not lend in amounts above W 5 billion to an individual corporate and that do not engage in international business the timetable will be 4 percent by March 1999, 6 percent by March 2000, and 8 percent by December 2000; • a timetable for progressive cost reductions; • a clause requiring further capital increases on account of: (i) supervisory examinations leading to a reclassification of assets; (ii) any further deterioration in asset quality; (iii) the strengthening of supervisory rules and procedures.	September 30, 1998
	Banks whose implementation plans are not approved, will be subject to mandatory mergers or transfer of business under P&A, or exit under the Prompt Corrective Action procedures. Where approved plans are not, in the event, achieved, banks will be subjected to graduated responses depending on the seriousness of the failure. When solvency is threatened this will include mergers and acquisitions, P&A transactions or liquidation.	
	Legislation will be submitted to amend the Financial Institutions Restructuring Act, inter alia: • to redefine a "distressed" institution so as to allow imposition of sanctions before actual insolvency is reached; and	August 31, 1998

	• to permit the full write down of shareholder equity.	
Remaining Commercial Banks	Assessments of asset quality and managerial capacity by internationally recognized accounting firms, signed by domestic and international partners. If a commercial bank's capital ratio is found to be below 8 percent as of end-June 1998 the FSC will proceed on a similar basis to that described above.	September 30, 1998
	If the capital asset ratio of a bank which had been above 8 percent subsequently falls below 8 percent, the FSC will invoke the Prompt Corrective Action procedures.	
Korea First Bank and Seoul Bank	Obtain bids for privatization	November 15,1998
Use of public funds for bank restructuring	Public funds should only be used to the extent that is necessary to facilitate the liquidation of failed institutions and the restructuring of viable but weak banks. Specifically, restructuring which involves the use of public funds should be limited to: • private sector recapitalizations and mergers approved by the FSC, where there is adequate burden sharing, which would be expected to involve contributions of capital from existing or new shareholders, and/or other stakeholders; or • P&A transactions; or • direct recapitalization by the government with full write down of shareholder capital and replacement of management, in exceptional cases and where a bank is of systemic importance.	
	Government and KDIC funds can only be used, either to inject capital directly (including contributions to cover the deficiency in net worth in P&A transactions) or to purchase impaired assets through KAMCO.	
	• The bulk of asset purchases by KAMCO should be from commercial banks and other financial institutions where there is a deposit guarantee. In exceptional cases, asset purchase may be made from other institutions if failure of these institutions poses a systemic risk. Any such purchases would be made in the context of a comprehensive restructuring plan for the relevant sector. • Purchases should be at prices that reflect actual and expected recovery rates as well as the opportunity cost of the funds employed for collateralized loans, and nominal prices for unsecured loans. • KAMCO's acquisitions and recovery performance should be subject to a half-yearly audit to international standards by a firm with international experience in the valuation of impaired assets. The results of the reviews and any qualifications will be published. Any losses identified will be reflected in KAMCO books within one month of the completion of the audit.	January 1, 1999
	Capital subscriptions from KDIC should be on terms that provide the authorities with a share in any improvement in profitability and give the authorities powers, e.g., by the exercise of conversion rights, to take control in the event of a deterioration.	
Specialized and development banks	• Provide for recapitalization of the IBK (W 1.5 trillion). • Provide additional W 1.3 trillion in capital to KDB, KEXIM and IBK in the context of the August Supplementary Budget.	End-1998
	Sign contracts for diagnostic reviews, including assessments of asset quality, as for commercial banks	September 30, 1998

Merchant banks	Minimum capital ratios of 8 percent will be achieved by June 30, 1999. All merchant banks will be encouraged to move progressively beyond the minimum 8 percent capital adequacy ratio after June, 1999.	June 30, 1999

Prudential regulations and supervision		
Type of measure	**Measure**	**Timing**
Prudential Regulations	The FSC will issue an implementation plan by August 15 to bring Korea's prudential regulations closer to international best practice as expressed in the Basle Committee's *Core Principles.* Such a plan will cover:	
	• Deduction from Tier 2 Capital of all provisions except those in respect of all assets classified as "normal" and "precautionary."	January 1, 1999
	• Introduction of rules providing full disclosure to trust beneficiaries, and precluding any possibility of payment by managing banks to make good or guarantee any loss:	
	(i) All trust accounts with guarantees will be regarded as on balance sheet for all supervisory and accounting purposes. For capital adequacy purposes, assets in such accounts will be weighted at 50 percent from January 1, 1999, and 100 percent from January 1, 2000.	January 1, 1999
	(ii) Introduction of restrictive rules to be applied to all trust accounts ensuring segregation for management as well as accounting purposes.	January 1, 2000
	• Revision of loan classification procedures to incorporate the findings of diagnostic reviews, and to ensure that classifications by managements, as well as reviews by examiners, fully reflect capacity to repay and not simply past performance.	January 1, 1999
Prudential rules for foreign exchange liquidity and exposures	Compliance with existing guidelines for commercial banks that require banks to have: • short-term assets (less than 3 months) of at least 70 percent of short term liabilities; • long term borrowing (more than 3 years) in excess of 50 percent of long term assets.	January 1, 1999
	Announce guidelines for merchant banks which will require that short-term assets exceed 50 percent of short-term liabilities by end-December 1998, 60 percent by June 1999 and 70 percent by December 1999. Long-term borrowing will exceed 40 percent of long-term assets by June 1999 and 50 percent by December 1999.	August 1, 1998
	Announce guidelines for merchant banks to apply the maturity ladder approach.	August 31, 1998
	Implement requirements for commercial and merchant banks to: • Maintain internal liquidity control systems based on a maturity ladder approach; • Report maturity mismatches for sight to 7 days; 7 days to 1 month; 1 to 3 months; 3 to 6 months; 6 months to 1 year; and over 1 year. (For commercial banks, reporting commenced in July 1998); • Maintain positive mismatches for the first period. From sight to 1 month, any negative mismatch should not exceed 10 percent of total foreign currency assets;	January 1, 1999 (commercial banks) and July 1, 1999 (merchant banks)

	• Publicly disclose statistics on foreign currency liquidity. The FSC will monitor implementation of internal liquidity controls on a monthly basis.	
	• Introduce amendments to the Foreign Exchange Regulations to entrust all responsibility for the setting of foreign exchange exposure limits, as well as the supervision of foreign exchange risk, to the FSC. • The BOK will provide regularly information it collects on foreign exchange positions to the FSC. • Introduce a new measurement system for foreign exchange exposures that recognizes positions between foreign currencies, in calculating limits based on banks' capital.	November 15, 1998
Specialized and development banks	Issue regulations to extend, effective January 1, 1999, prudential rules applied to commercial banks to specialized and development banks taking into account the specific characteristics of the institutions. On the basis of their examinations at the delegation of MOFE, FSC will make recommendations to MOFE as to any consequential remedial action required.	November 15, 1998 Ongoing
Connected lending	The limit of 25 percent of equity capital for lending to large shareholders and their affiliates, and other restrictions on connected lending, that apply to commercial banks will be applied to merchant banks. The excess over the 25 percent limit will be progressively reduced by 20 percent by January 1, 1999, an additional 40 percent by January 1, 2000, and eliminated by January 1, 2001.	January 1, 1999
	All connected lending, and the terms on which it is provided, will be audited and disclosed in the annual financial statements.	January 1, 1999
Large exposures	For commercial banks, the government will submit legislation to the National Assembly to amend the General Banking Act, to redefine single borrower and group exposure limits. The new definition will include all off-balance sheet exposures • As from July 2000, both limits will be reduced from 45 percent to 25 percent of total capital, using the new definition. The exposure to each borrower or group of borrowers in excess of 45 percent outstanding at end-June 1998, will be reduced by 50 percent by end-June 1999 and eliminated by end-June 2000. • Exposures in excess of 25 percent at end-June 2000 will be subject to progressive reduction over the following four years, that is, one quarter of the excess over 25 percent will be reduced in each of the years ending end-June 2001, end-June 2002, and end-June 2003, with the remaining excess eliminated by end-June 2004. • In addition, the authorities will limit the aggregate of exposures (with the new definition) in excess of 10 percent of total capital to 500 percent. • Banks with aggregate large exposures in excess of this limit as of December 31, 1998 will be set an interim benchmark of 800 percent by end-March 1999. Subsequent benchmarks will be set at forthcoming reviews.	October 31, 1998
	For merchant banks, amending legislation will be submitted to the National Assembly to redefine large exposures to include all off-balance sheet exposures. • The current limit of 100 percent will be reduced to 25 percent as of end-June 2000. Exposures to borrowers or groups of borrowers in excess of 45 percent at end-June 1998, will be reduced by 40 percent by end-June 1999, and eliminated by end-June 2000.	October 31, 1998

	• Exposures in excess of 25 percent as of end-June 2000 will be subject to progressive reduction over the following three years, that is, one third of the excess over 25 percent will be reduced by end-June 2001, and two thirds by end-June 2002, with the excess eliminated by end-June 2003. • The aggregate of exposures in excess of 10 percent of total capital will be limited to 500 percent of total capital by end-June 2000. Merchant banks will be set interim benchmarks at the next review.	
	The aggregate excess exposure for each commercial bank and for each merchant bank, will be published quarterly, as from end-December 1998.	Early 1999
Consolidated supervision	Upon completion of the unification of supervisory organizations: • Enhance consolidated supervision to encompass the full range of banking risks, including foreign exchange risk, whether carried on in the principal bank or its foreign branches and domestic affiliates and subsidiaries; and • extend the supervisory arrangements for commercial banks to all nonbank financial institutions, including merchant banks, securities companies, and investment trust companies as appropriate.	January 1, 1999 January 1, 1999
Disclosure, auditing, and accounting standards	The MOFE, the FSC, and the relevant regulatory bodies should work to improve disclosure, auditing, and accounting standards. These steps involve: • Introducing regulations that will ensure that accounting standards for financial institutions fully comply with the minimum requirements of IAS 30. • Reviewing regulation of the auditing profession to ensure that auditing standards reflect international best practices. • Improving reporting requirements for banks, in order to strengthen the ability of supervisors to be forewarned of potential problems. • Ensuring that published financial statements, including off-balance sheet positions, are fully in line with international standards of disclosure.	

Capital Market Development and Trade and Capital Account Liberalization		
Type of Measure	**Measure**	**Timing**
Private Capital Markets	• Submit legislation to the National Assembly to allow for the creation of mutual funds. • Submit legislation to allow the issuance of asset-backed securities.	August 31, 1998 August 31, 1998
Accountability to shareholders	• Remove restrictions on voting rights of institutional investors (Investment Trust Companies and trust account of banks).	August 31, 1998
Import Liberalization	Phase out Import Diversification Program (presently covering 44 items) (committed to WTO by end-1999): • Liberalization of additional 32 items; and • Liberalization of remaining items.	December 1998 June 1999
	Review existing import certification procedures and present a plan to streamline them and bring them in line with international practice.	August 15, 1998

	Review all existing subsidy programs and their economic rationale. Present a proposal for rationalizing existing subsidy programs.	November 15, 1998
Services	Permit foreigners to engage in deep sea foreign freight transport. Increase foreign ownership ceilings on: • publishing of newspapers (to up to 33 percent); • publishing of periodicals (to up to 50 percent).	January 1, 1999 January 1, 1999 January 1, 1999
Six capital account liberalization measures initially envisaged to be completed by December 31, 1998 have been completed ahead of schedule. Remaining measures are:		
Foreign exchange liberalization	• Review Foreign Exchange Law, in consultation with the IMF, and submit legislation to amend the law to accelerate liberalization of foreign exchange transactions, including changing the regulatory framework to a negative list system.	September 1998

Transparency, Monitoring, and Data Reporting		
Type of Measure	**Measure**	**Timing**
Financial sector	• The BOK and the MOFE will record all public support for financial sector restructuring on a transparent basis, including by KAMCO and KDIC.	Ongoing
	• Develop a set of indicators to monitor the soundness of the financial system, including regular reporting of such data to the IMF.	Ongoing
External debt	• Continue developing the external debt reporting system to enhance debt management and monitoring. • Develop external vulnerability indicators as an "early warning system." • Introduce improvements to the reporting of off-balance sheet foreign currency denominated exposure of financial institutions. • Submit the necessary legislation to ensure compliance with reporting on external liabilities of the corporate sector.	Ongoing Ongoing October 31, 1998; (Done July 1998) September 30, 1998
Foreign reserves	• Data on usable reserves of the BOK will be published twice monthly (for 15th and the last day of each month) within five business days. Data on net forward position of the BOK is being published monthly. All of these data will be placed on the BOK Web site.	Started May 15, 1998

Seoul, Korea
July 23, 1998

Memorandum of Understanding

Agreement was reached today between the Government of Korea and the World Bank on a corporate restructuring program as set out in the attached policy matrix. The Government of Korea expresses its firm commitment to implement the corporate restructuring program effectively and in accordance with the timetable indicated in the attached agreed policy matrix. This program will be included in the overall policy matrix for the Structural Adjustment Loan II to be negotiated between the Government of Korea and the World Bank.

On behalf of the Republic of Korea

/s/

Mr. Kim Woo-Suk

On behalf of the World Bank

/s/

Mr. Zia Qureshi

World Bank SAL II
Policy Matrix on Corporate Restructuring

* = Completed
** = In process

Objectives/Policy Measures	First Tranche	Second Tranche
1. Develop framework and capacity to do voluntary corporate workouts		
a) Provide an overall framework of principles and procedures.	FSC provides guidelines on the following: —selection of corporate restructuring candidates; —a Corporate Restructuring Agreement ("Agreement") to provide a structure for creditor/debtor negotiations; —creation and operation of a Corporate Restructuring Coordination Committee ("Coordination Committee") to resolve inter-creditor disputes; and —"London rules" type principles to guide voluntary corporate workouts (July).* FSC to monitor workouts under Agreement to ensure consistency with the issued guidelines for workouts (August).	Continued monitoring of the implementation of the framework and guidelines.
b) Assign responsibility for leading voluntary corporate workouts.	FSC identifies Lead Banks (July).*	
c) Gain creditor support for approach to voluntary corporate workouts.	FSC obtains adherence of major creditors to Corporate Restructuring Agreement (July).*	

d) Provide necessary professional resources for Lead Banks.	Lead Banks to establish workout units (July).* Lead Banks to retain internationally accredited advisors by September 15.	
e) Provide means to resolve inter-creditor disputes.	Facilitated by FSC, banks to establish a Coordination Committee (July).* Coordination Committee to hire staff by August 15 and, as necessary, retain internationally accredited advisors.	
2. Provide policy support for corporate restructuring		
a) Curtail emergency loans.	While financial institutions may provide new or additional loans to distressed but viable corporates as part of a Corporate Restructuring Agreement workout, FSC will provide guidelines for such lending by August 15. These guidelines would include the following: —GOK will refrain from directing the banks to make such loans; —the size of any loan would normally be limited to the shortfall needed to meet interest expense and trade payables during the "standstill" period; —in return, the debtor would facilitate complete access by the Lead Bank's financial advisors (e.g., auditors) to the debtor's records; —during the standstill period, the Lead Bank's financial advisors would assess the debtor's viability, review the debtor's liabilities and cash flow projections, and —as appropriate —value assets and indicate how best to maximize the return to creditors —i.e., through voluntary workout, composition, reorganization, or liquidation. In exceptional cases, debtors due to be restructured, but not currently in the workout process, will require new loans. In such cases, if the banks are agreeable to providing such loans they will be provided per the guidelines noted above and for a maximum initial period of six months.	Monitor observance of the guidelines.
b) Facilitate use of debt/equity conversions to address excessive leverage among *chaebol* affiliates.	GOK will review if there are any tax disincentives and regulatory impediments to the conversion of corporate debt into equity or near equity and will submit legislation to National Assembly as necessary (September 15). GOK will submit legislation to National Assembly on mutual funds (August 30). FSC will meet with experienced asset managers, corporate turnaround experts, and investors in distressed securities from the private sector to assess options for "corporate restructuring vehicles" (CRVs). Privately financed and managed, CRVs would purchase and/or manage corporate equity acquired by financial institutions as a result of debt/equity conversions. Key issues for FSC to discuss with potential CRV managers would include appropriate business forms for CRVs (e.g., partnerships, blind trusts, stock funds) and potential tax, legal, and regulatory issues (August).	Based on this review, and if

	GOK will identify legal, tax, and regulatory impediments—if any—to the establishment of CRVs (September 15).	necessary, GOK will submit legislation to the National Assembly enabling and regulating the formation of CRVs and removing tax, legal, and regulatory impediments to CRV formation and operation (December 15).
c) Reduce cross guarantees.	FSC will encourage creditors to reduce cross guarantees through voluntary workouts conducted under the Corporate Restructuring Agreement (August). FSC will issue a communication to banks suggesting market-based approaches for "buying out" cross guarantees. These approaches could include, for example, conversion of cross guarantees into guarantor's equity or equity warrants or into a non-guaranteed loan at a higher interest rate (August). FSC will require financial institutions to report on the stock of guaranteed loans to the 64 *chaebol* as of June 30, 1998, by September 15; and ,starting with the fourth quarter of 1998, FSC will require quarterly progress reports from banks on progress in reducing cross guarantees for the 64 *chaebol* (August 15).	Ongoing FSC will establish appropriate internal interim benchmarks to monitor progress toward the reduction of cross guarantees (October).
d) Provide additional encouragement for corporate mergers and acquisitions, debt restructuring, and asset dispositions as means of corporate restructuring.	GOK to submit to National Assembly proposed package of tax measures to encourage corporate M&As, asset sales and debt restructuring (September 15).	GOK will submit additional legislation to National Assembly removing tax disincentives to corporate M&As, asset disposals, and debt restructuring (December 15).
e) Improve procedures and coordination for court-supervised insolvency.	GOK will establish a Task Force under TORs acceptable to the Bank to review existing insolvency laws for further improvement, focusing on expedited procedures (e.g., pre-packaged bankruptcies resulting from the workout process) (September 15). FSC and MOJ, subject to agreement with the Supreme Court, will establish a liaison committee comprising these three entities to ensure prompt resolution of issues that affect both voluntary restructuring and court-supervised insolvency (September 15).	MOJ will agree to announce, based on the review, its draft amendments to existing insolvency laws designed to promote expedited insolvency procedures for public hearing and subsequent submission to the National Assembly by February 1999 (December 15).
3. Accelerate implementation of corporate restructuring		
a) Complete "triage" analysis.	Lead Banks will complete their assessment of *chaebol* affiliates (including those from the top 5) that have received "anti-bankruptcy" loans or which are on bank "watch" lists and will indicate whether each is best suited for court supervision, voluntary workout under the Corporate Restructuring Agreement, or normal operation (July).** A special Task Force has been convened amongst four of the Lead Banks to focus on a system for	Monitor follow-up. Monitor follow-up.

	monitoring the top five *chaebol*. The Task Force will also examine the workout programs of the top five *chaebol*. The Task Force will complete its assessment by end-September.**	
b) Pursue inter-creditor agreements, under the Business Restructuring Agreement, on corporates to be restructured.	First Creditors Council meetings will be convened by each of the Lead Banks under terms of the Agreement (July/August).** FSC will direct each Lead Bank to provide monthly reports on the status of corporate workouts (September 15).	Ongoing Ongoing FSC will direct the Coordination Committee to provide monthly reports to FSC on inter-creditor disputes and their resolution (October).
c) Pursue a timely exit strategy for the 55 non-viable corporates.	FSC will direct Lead Banks to stop new lending and withdraw existing loans for each of the 55 (July).	Lead Banks to provide monthly reports to FSC on progress in exiting the 55.
d) Identify additional non-viable corporates.	FSC will require monthly updates from Lead Banks on additional corporates identified as non-viable during the course of Corporate Restructuring Agreement workouts (August).	Ongoing
e) Initiate resolution of corporates that are not under corporate supervision, but which have received emergency loans.	FSC will direct Lead Banks to send auditors into *chaebol* affiliates that have received emergency loans—but which are not operating under court supervision—and give the auditors 60 days to review corporate liabilities, cash flow projections, and asset values, assess viability, and indicate how to maximize the return to creditors—e.g., through voluntary workout, composition, reorganization, or bankruptcy (August).	Monitor follow-up.
f) Expedite resolution of corporates under court supervision in which the GOK is a major shareholder.	KDB will invite international bids under transparent and fair procedures for Kia (July). KFB will invite such bids for Hanbo by September.	Monitor next steps.
g) Develop an ability to anticipate corporate default or insolvency.	FSC will establish a "situation room" to monitor corporate/financial sector solvency (July).*	
h) Promote self-restructuring by the top 5 *chaebol.*	FSC will provide guidelines to Lead Banks to strengthen the "capital structure improvement plans" of the top 5 *chaebol*, including decreases in debt/equity ratios, disposal of non-viable affiliates, and reductions in cross guarantees (July).** Fair Trade Commission will monitor and take actions against the top 5 *chaebol* that engage in anti-competitive intra-group transactions (July).	Monitor implementation of the guidelines. Continued monitoring and enforcement.

ATTACHMENT
ANNEX A

Structural Performance Criteria

March 31, 1998

1. Complete second-round evaluation of the remaining 20 merchant banks and suspend operations of those banks which fail to pass the evaluation. **Completed February 26, 1998.**

2. Allow foreign banks and brokerage houses to establish subsidiaries. **Came into effect on March 31, 1998.**

June 30, 1998

1. Complete assessment of the recapitalization plans of commercial banks. **Completed June 29, 1998**.

2. Establish a unit for bank restructuring under the FSC with adequate powers and resources to coordinate and monitor bank restructuring and the provision of public funds. **Unit established on April 1, 1998.**

September 30, 1998

1. Submit legislation to allow for the creation of mutual funds (by August 31, 1998).

2. Require listed companies to publish half yearly financial statements prepared and reviewed by external auditors in accordance with international standards (by August 31, 1998). **Done.**

December 31, 1998

1. Obtain bids for Korea First Bank and Seoul Bank (by November 15, 1998).

2. Introduce consolidated foreign exchange exposure limits for banks, including their offshore branches (by November 15, 1998).

ANNEX B

Monetary Sector

Outstanding Stock as of:	Limit (In billions of won)
Net domestic assets	
End-June 1998	
Performance criterion	4,080
Actual[1]	-5,382
End-September 1998[2]	2,480
End-December 1998[2]	-7,770
Reserve money	
End-June 1998	
Indicative limit under the program	23,540
Actual	20,798
End-September 1998[3]	25,430
End-December 1998[3]	25,640

[1]With net foreign assets valued at program exchange rates.
[2]Performance criterion.
[3]Indicative limit.

Net domestic assets (NDA) is defined as the difference between reserve money and the won equivalent (converted at the program exchange rate) of net international reserves (NIR) as defined in the program. The NDA target will be adjusted down by the amount of any upward adjustment to the NIR target, made necessary by an increase in the net forward position over the end-June level.

The ceiling on NDA and the indicative limit on reserve money will be increased (decreased) for any increase (decline) in required reserve ratios.

ANNEX C

Net International Reserves of the Bank of Korea

	Floor (In billions of U.S. dollars)
End-June 1998	
Performance criterion	13.9
Actual	18.7
End-September 1998[1]	15.0
End-December 1998[1]	23.7

[1]Performance criteria.

For monitoring purposes, net international reserves (NIR) of the Bank of Korea (BOK) is defined as the U.S. dollar value of gross foreign assets in foreign currencies minus gross foreign liabilities.

Gross foreign assets will include all foreign currency denominated claims, including monetary gold, holdings of SDRs, and the reserve position in the Fund. Excluded from gross foreign assets will be participation in international financial institutions, as well as holdings of nonconvertible currencies, claims on residents, and deposits of the BOK at overseas branches and subsidiaries of Korean banks. Gross foreign liabilities are all foreign currency denominated liabilities of contracted maturity up to and including one year plus the use of Fund credit. All assets and liabilities will be valued at program exchange rates.

The net forward position is defined as the difference between the face value of foreign currency denominated BOK off-balance sheet (forwards, swaps, options, and any futures market contracts) claims on nonresidents and foreign currency obligations to both residents and nonresidents. However, the amounts of swaps included in the definition will exclude swaps entered into with regard to any support provided as part of the second line of defense.

The floor on NIR will be adjusted upward for any increase in the net forward position over the end-June 1998 position of US$4.8 billion (including swaps of US$2.4 billion).

ANNEX D

Fiscal Sector

	Ceiling (In trillions of won)
Cumulative deficit from January 1, 1998 through June 30, 1998	
Program[1]	6.0
Estimated actual [2]	. . .
Cumulative deficit from January 1, 1998 to:	
End-September 1998[1]	10.0
End-December 1998[1]	17.5

[1]Indicative ceiling.
[2]Second quarter outcome not known until August.

The consolidated central government overall deficit is defined as the consolidated balance of the central government (comprising the general account, the special accounts, and the special budgetary funds) and the public enterprises special accounts.

The consolidated central government overall deficit will be measured through the government treasury accounts. It is defined as the change in the central government's deposits and treasury cash with the BOK; plus the change in deposits with commercial banks and nonbank financial institutions; plus the change in central government bonds outstanding; plus foreign borrowing by the government.