

Corporate Restructuring

– Performance and Future Plan

December 4, 1998

Financial Supervisory Commission

* *This is unofficial translation of the document announced on October 16, 1998 with some updates thereafter, and thus should be used for reference purpose only.*

Contents

I. Underlying Principles and Direction

1. Underlying Principles
2. Vision for Corporate Restructuring

II. Basic Framework of Workout

1. The Workout Concept
2. Implementation Strategy
3. Guidelines of Workout

III. Current Status of Corporate Restructuring

1. Reform of Corporate Structure
2. Progress of Workout Programs
3. Improvement of Capital Structure
4. Business Restructuring of the Top Five *Chaebol* and Support for SMEs
5. Improvement in Institutional Setting

IV. Interim Assessment and Some Issues

1. Assessment
2. Issues of Concern

V. Future Policy Plan

1. The Top Five *Chaebol*
2. 6-64 *Chaebol* and Large-sized Companies
3. Small-and-Medium Enterprises

APPENDIX: Glossaries

I. Underlying Principles and Direction

1. Underlying Principles

1.1 Complete Implementation of Five Major Tasks

On January 13, 1998 then President-elect Kim Dae-Jung together with major *chaebol* owners announced the implementation of five major tasks for corporate restructuring. These goals have been pushed forward aggressively with the aim to enhance transparency of corporate business practices to bring them into compliance with international best practices, thereby enhancing the global competitiveness of the Korean corporate sector.

The Five Underlying Tasks

- ① Enhancement of management transparency
- ② Elimination of cross guarantees
- ③ Improvement of capital structure
- ④ Selection of core competence
- ⑤ Strengthening of accountability of controlling shareholders and management

1.2 Corporate Restructuring to Be Driven by Financial Institutions

Major creditors financial institutions will take the leading role in implementing corporate restructuring policy.

For this purpose, the creditors and debtors, i.e., the lead creditor banks (LBs) and the largest sixty-four *chaebol*, signed capital structure improvement plans (CSIPs).

1.3 Establishment of Fair Loss Sharing Practices

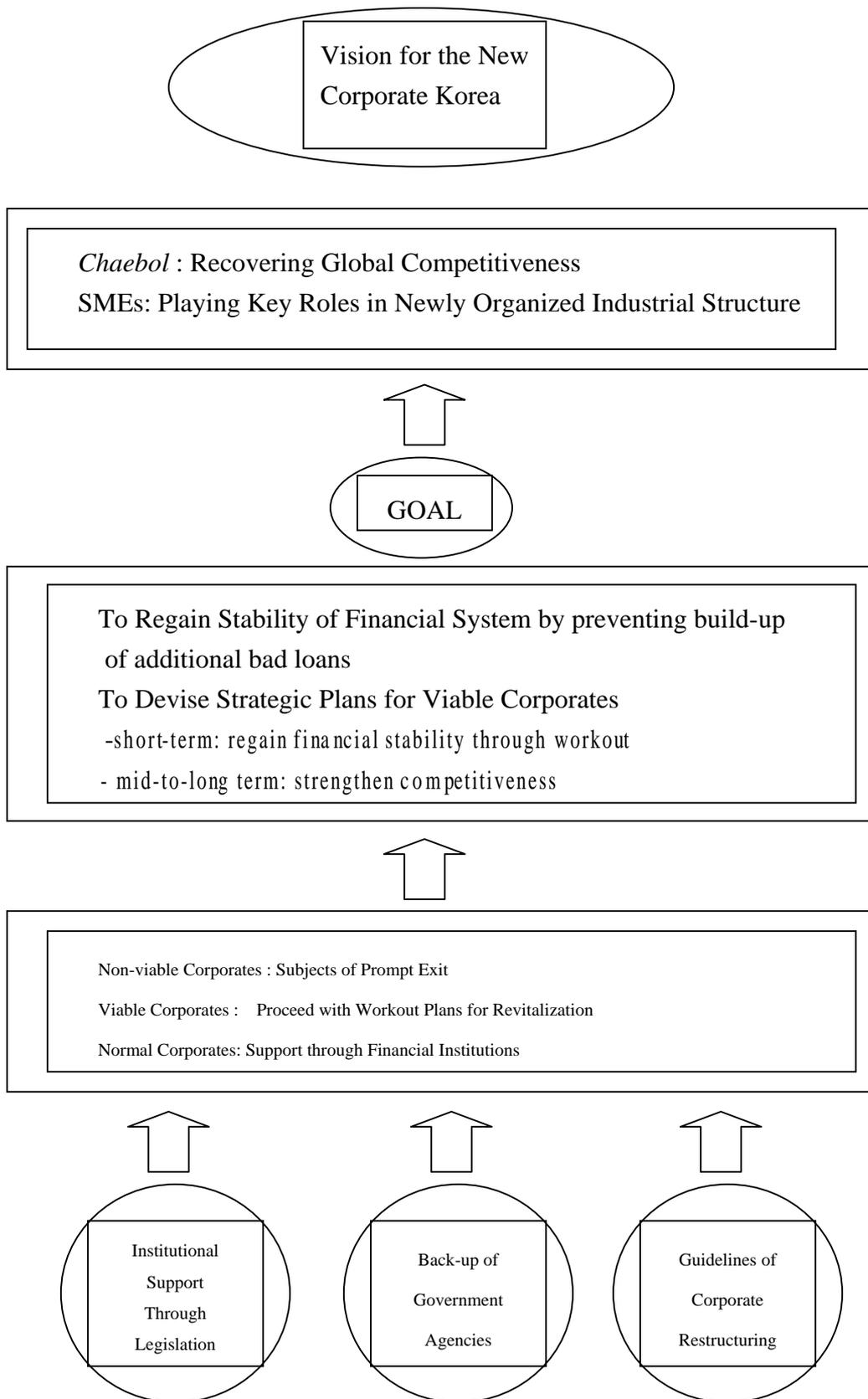
- The Top Five *chaebol* (*Hyundai, Samsung, Daewoo, LG, and SK*) which have the capacity to absorb losses arising during the course of restructuring are expected to bear the associated costs which restructuring entails. Small and Medium Enterprises (SMEs) which are much too weak financially to take on such a burden will be supported by the creditor financial institutions with which they are affiliated.

- The government will help improve banks' capacity to push forward corporate restructuring efforts through various measures intended to facilitate restructuring within the financial institutions themselves, such as the disposal of non-performing loans (NPLs) as well as through support for mergers and acquisitions of financial institutions.

1.4 Adoption of Workout Concept as Core Principle

- In pursuing corporate restructuring, nonviable corporates will be forced to exit promptly, whereas viable corporates will be supported through workout program.

2.1 Vision for Corporate Restructuring



II. Basic Framework of Workout

1. The Workout Concept

1.1 Definition

- Generally “workout” refers to a process of developing revitalization plans for viable corporates through a series of negotiations involving varying stakeholders who include, among others, creditor financial institutions and corporates.
- As a workout is initiated before the corporate reaches a state of complete distress and is a process of stakeholders pursuing ways to bring back viability to a given corporate, it is much more effective than placing the corporate under legal proceedings such as court receivership and composition, which usually take considerable time, require high cost burdens and have a little chance of inducing a turnaround.

1.2 Working Processes

- A comprehensive analysis on medium to long term cash flow of the workout corporate will be conducted. Utilizing input from this analysis, debt obligations that go beyond the workout corporate's capacity will be restructured.

Debt restructuring devices include, but are not limited to: debt/equity conversion, term extension, deferred payment of principal or interest, interest rate cut, waiver of indebtedness, provision of new credits, cancellation of existing guarantee obligations, etc.

- Along with the debt restructuring process stakeholders are expected to complement these workouts with other self-rescue efforts in such a way that both losses and benefits are shared as a result.

Benefits of loss sharing by stakeholders are:

- creditor institutions : improved recovery ratios on existing credit due to higher possibility of the corporate's survival
- shareholders : possibility of higher returns on investment due to rise in share price
- employees : enhanced job security albeit following some removal of redundancies

2. Implementation Strategy

2.1 Differentiation Strategy Based on Corporate Size

- With the capacity to pursue restructuring efforts on their own, the Top Five *chaebol* have been allowed to pursue self-directed business restructuring. Also the Top Five *chaebol* were to revise their original capital structure improvement plans in a way that would make the plans reflect more detail and workable action steps.

Vital to the restructuring processes of the Top Five *chaebol* are;

- cutting intra-*chaebol* financial assistance in order to prevent the deterioration of the financial status of sound affiliates,
 - reducing the dominance of the Top Five *chaebol* in local financial market,
 - continuous evaluation of viability of affiliates for early identification of problems in servicing debt on a stand-alone basis.
- The “6-64” *chaebol* and other large corporates do not possess the capacity to pursue restructuring on their own. Because they maintain affiliations with multiple creditor financial institutions, this group of corporates will be subject to workout programs led by their respective creditor financial institutions. These workouts will involve close consultation within the group of creditor financial institutions.
 - Due to structural size and limitations, SMEs do not possess the capacity to pursue restructuring on their own. As they are linked with a limited number of financial institutions their restructuring will be handled by a lead creditor financial institution. This class of corporates will be provided with more targeted financial assistance under workout programs.

2.2 Corporate Restructuring Agreement as a Main Vehicle

A “Corporate Restructuring Agreement” (CRA) was signed by 210 financial institutions on July 25, 1998 to coordinate diverse interests among creditor institutions and to facilitate cooperation between them. Workouts will be carried out in accordance with procedures laid out in the CRA.

In cases where “creditor’s councils (CCs) are unable to reach agreements on a workout plan, arbitration will be provided by the “Corporate Restructuring Coordination Committee”(CRCC), which was set up in accordance with CRA provisions.

- In addition, a “Lead Creditor Council Agreement” applicable to restructuring of the Top Five *chaebol* and an “SME Workout Guideline” applicable to restructuring of SMEs, each of which emulates the CRA was devised.

2.3 Close Linkage with Financial Sector Restructuring

Corporate restructuring is closely tied to financial restructuring of the banking system.

The ultimate goal of financial restructuring is to strengthen the capital structure of financial institutions. It is therefore vital to the long-term health of the financial sector to have proper and accurate estimation of future losses arising from the deterioration of asset quality in bank portfolios.

An integral part of a workout program is the categorization of assets held by financial institutions into either normal, recoverable or bad. By doing so, expected losses in the future can be accurately estimated.

< Workout versus Bailout >

Bailout is assistance to the corporate which, if evaluated by market principles, would have been exited from the marketplace if not for such financial assistance.

By doing this, self-rescue efforts such as loss sharing are not incorporated. Moreover, related policy decisions are usually not disclosed, hence carry a very slim chance of revitalization.

Workout, unlike bailout, is a process involving creditor financial institutions working closely with and providing support to the viable corporate.

Workout is a result of object assessment of viability, based on transparent and fair procedures. Due to the level of integrity in the decision process, varying measures

of support can be devised and a consensus more easily obtained, since most options are designed by experts in restructuring.

3. Guidelines of Workout

3.1 Loss Minimization

- Workout should not be understood as a process of exiting problem corporates or as a process to postpone a near-bankruptcy situation, but rather as a process to help viable corporates with temporary management and financial problems to improve their ability in securing a competitive edge in the medium to long term.

3.2 Fairness

- During the course of a workout, creditor financial institutions will be treated equally in proportion to their claims. A level of fairness should also be upheld when making decisions relating to loss sharing in the context of debt restructuring of a given corporate.

It is the responsibility of the lead creditor bank to maintain and provide all information related to workout process and making it available to all creditor financial institutions.

- The lead creditor bank should maintain a sense of balance throughout the workout process. That is, while the lead creditor bank should make sure that the creditor financial institutions feel assured that the process is being pursued in a proper manner, it will not dominate the negotiations but rather act as a mediator to any conflict of interests that may arise.

3.3 Promptness and Cost Minimization

To the extent possible costs associated with the implementation of workout programs should be minimized. For this purpose, workout should be carried out expeditiously.

- Although there is no denying the complexity and difficulty of decisions needed to be made in connection with workouts, there is a need to reach an agreement within a reasonable time frame, otherwise the problems of the workout corporate will only worsen and the eventual cost of restructuring will increase.

III. Current Status of Corporate Restructuring

1. Reform of Corporate Structure

Full Implementation of Five Tasks in Corporate Restructuring

1.1 Enhanced Corporate Transparency of Corporate Management

Consolidated financial statements will be required for the 30 largest *chaebol* from the beginning of 1999 to enhance transparency of corporate finances.

An “External Auditors Committee” has been established whose function is to ensure that external auditors employed by corporations conform to new transparency standards. External auditors cannot be selected without the consent of this committee.

Penalties for fraudulent audit reports, whether external or internal, have been strengthened significantly.

Revision of “Law concerning the External Auditing of Joint-stock Companies” :
February 1998

Publicly listed companies are now required to appoint outside directors. If they do not meet this requirement, they are vulnerable to expulsion from the Korea Stock Exchange (KSE).

Revision of “Listing Regulation of Securities”: February 1998

1.2 Elimination of Cross Guarantees

No new cross guarantees between affiliates belonging to one of the 30 largest *chaebol* are allowed as of April 1998. Also, existing cross guarantees should be resolved by March 2000.

Revision of “Fair Trade Act” : February 1998

Financial institutions are prohibited from demanding cross guarantees from affiliates when extending loans.

Revision of “Credit Management Regulation” : April 1998

1.3 Improvement of Financial Structure

Chaebol and their lead creditor banks completed an agreement called “Capital Structure Improvement Plan (CSIP)” which entails the following (February through April 1998):

annual debt/equity ratio reduction plan
divestiture plans for affiliate companies, assets, and business segments, etc.

The corporates, which are viable, but suffer temporarily from management and financial difficulties, would be subjects to workout with the aim to significantly improve their capital structure.

Interest payments on borrowings that are more than five times the equity capital are excluded from income tax deduction from the year 2000.

Revision of “Corporate Income Tax Law” : February 1998

1.4 Streamlining Business Activities

Each *chaebol* are to identify their core business segments, which should be reflected in their CSIPs (February through April 1988).

Non-core affiliates will be reorganized through various measures such as spin-off, liquidation, employees' purchases, etc.

1.5 Strengthening Accountability

Minority shareholders rights, through revision of related laws, have been increased significantly.

The ownership requirement, which allows challenge to corporate governance and management through lawsuit was eased.

- derivative lawsuit : 0.01% from 1.0%
- dismissal of directors or auditors : 0.5% from 1%
- reviewing the financial accounting books : 1% from 3%

Revision of "Securities and Exchange Act": February and May 1998

Institutional investors, as de facto major shareholders, are allowed to vote, providing new checks on management of companies.

Revision of "Securities Investment Trust Business Act": September 1998

The legal liability of controlling owners has been broadened:

The controlling owners are to register as directors and they will bear liabilities arising during the course of management.

Planning and coordination offices or dedicated chairmen's offices, which have functioned to maintain owners' control within each *chaebol*, will be eliminated as a way to prevent decisions within the corporate from being influenced by them.

2. Progress of Workout Programs

2.1 Preparation Stage : Viability Assessment

On May 9, 1998, “Corporate Viability Assessment Committee” was formed in each bank. Altogether they reviewed the viability of 313 companies.

Each bank without any interference from the government prepared a guideline for assessment.

Assessment was focused on individual company’s business prospects in terms of factors such as profitability and cash flow rather than its affiliation with other companies in the parent group.

Role of FSC was limited to providing the banks with guidelines for determining solvency and economic viability

As a result, 55 corporates were classified as nonviable on June 18, 1998.

Among them, 20 companies were affiliate companies belong of the Top Five *chaebol*, whereas 32 companies belonged to largest 6 to 64 *chaebol*.

Current status of the 55 corporate to be exited:

- 29 companies were liquidated
- 12 were sold off
- 11 were merged into other affiliates
- 3 are seeking legal proceedings such as court receivership or composition.

< Special Measures for Supporting SMEs >

“Special Task Force Team for SMEs”(“task force team” in this section hereafter) was established within each bank to support SMEs in May 1998.

Task force teams report directly to the president of each bank.

By the end of June 1998, these task force teams completed a triage analysis of 23,345 SMEs with bank credits over 1 billion won for purpose of classifying SMEs in terms of the support they would require. Results are: priority support (39.3%), conditional support (55.7%) and others (5.2%).

For those who were classified for priority support and conditional support,

frameworks for such support were produced and action plans are being executed.

To facilitate these support plans, some policy incentives such as unconditional rolling over the loans maturing until December 1998 will be provided to the SMEs classified for receiving priority support or conditional support.

< **Additional Selection of Non-viable Affiliates of Top Five *Chaebol*** >

Major creditor banks have already reviewed the Top Five *chaebol* affiliates to select distressed corporates which cannot survive without intra group assistance.

For those that are selected for exit, confidential and non-public negotiation between creditor banks and them will be held to minimize negative effects on overall Top Five restructuring efforts and on viable affiliates.

2.2 Implementation Framework

2.2.1 Establishment of Workout Teams within Banks

Each bank organized a workout team to handle workout processes by June 1998. Each team will be operated under the direction of the president's office of each bank.

Along with workout teams, a "Special Task Force Team for the Top Five *chaebol*" within the main creditor banks was organized in July 1998. These teams will specially engage in restructuring processes of the Top Five *chaebol*.

As mentioned above, an "Special Task Force for SMEs" was established for the workout of SMEs.

Those teams were augmented to enhance efficiency of activities in August 1998. These efforts include increasing the number and quality of staff members, guaranteeing job security of team members and so on.

2.2.2 Signing the “Corporate Restructuring Agreement”

The “Corporate Restructuring Agreement” (CRA), which is the main vehicle of corporate workout, was signed by the financial institutions and is in effect.

210 financial institutions participated in CRA on June 25, 1998.

In accordance with the CRA, a “Corporate Restructuring Coordination Committee” (CRCC) was established to coordinate the conflict of interest between them.

CRCC developed and published “Workout Model for SMEs” on August 31, 1998.

As a separate effort from the CRA, a “Major Creditors Council Agreement for the Top Five *chaebol*” was signed among the lead banks of the Top Five *chaebol* on September 19, 1998.

2.2.3 Selection of Advisory Group

Outside consortia of experts in restructuring (“Advisory Group”) were selected and allocated to six major banks (“lead banks”) to provide technical assistance to them.

The main role of the advisory group is to give the banks independent evaluation of, and advice on workout and to provide assistance to induce foreign capital if necessary.

Advisory groups are composed of experts in investment banking, consulting, accounting and legal affairs.

2.2.4 Special Committee for the Top Five *chaebol* Business Restructuring

“Special Committee for the Top Five *chaebol* Business Restructuring” was formulated to evaluate appropriateness and feasibility of business restructuring plans and implementation schemes suggested by the Top Five *chaebol* in October 1998.

Under the Committee, working-level committees were also established in each industry.

The Committee is composed of officers from lead creditor banks, four accounting

firms that reviewed the Top Five *chaebol*, and the chairman of CRCC, who also chairs this Committee.

The working-level committees are made up of bank staff and accountants in each industry.

2.2.5 Introduction of Dedicated SME Assistance Officer

Some experts with experience in the banking industry, were hired by banks as “Dedicated SME Assistance Officers” to assist these corporates.

These specialists will engage in workout procedure, management of restructuring funds, assistance in financing and accounting, etc.

2.3 Full Stage of Workout Process

2.3.1 Outline

Kohap group, one of the largest 30 conglomerates in Korea, applied for workout in accordance with the CRA on July 6, 1998, and since then many corporates have followed in its steps. Currently 77 companies including 65 affiliate companies belonging to 24 *chaebol* are undertaking workout processes as of November 26, 1998.

Among them, agreements have been reached on workout plans:

Dong-Ah Construction(1)

Sepoong (2)

Kabool(2)

Buyck San(3)

Shin-Ho(3)

Shinwon(3)

Jindo(3)

Woobang(1)

Kangwon Industries(4)

Peeress(1)

* Figure in parenthesis means number of affiliates in workout

In addition, when creditor institutions of Keopyung group and Kohap failed to reach agreements as to workout plan, CRCC issued an arbitration opinion for the both cases that finalized the workout agreement.

Other corporates are engaging in producing their workout plans now.

< Example of Workout Plan – Dong-Ah Construction Case >*

Time Span of Plan : September 1998 to May 2002 (3 years and 9 months)

Self-rescue plan of corporate

sale of corporate affiliates : 18 out of 19 affiliates, leaving Dong-Ah Construction Company as an independent and sole company without spin-offs(estimate sales price : 740 billion won)

sale of real estate : 21 properties(estimate price : 1.18 trillion won)

surrender of management and ownership by the owner

donation of owners personal properties to the corporate(estimate value : 11 billion won)

adequate reduction of capital to maintain par value in case of debt/equity conversion

Financial support

new money(160 billion won) and debt/equity conversion(80 billion won)

grace period of a certain amount of debt(4.8 trillion won until May 2002)

cut in interest rate to a certain amount of debt(applying prime rate for 2.9 trillion won, cost reduction of 200 billion won/annum)

* Dong-Ah case was settled voluntarily by negotiations between the corporate and creditor institutions

2.3.2 Workout in Progress

Among the “6 to 64” *chaebol*
43 corporates of 16 *chaebol*

| Lead Bank | Name | Company | Selection | Due Date |
|------------|----------------------|--|-------------------|-------------------------------|
| Cho Hung | Keopyung | Keopyung Chemical, Keopyung Steel, Keopyung Sygnetics | July 16, 1998 | Completed |
| | Sepoong | Sepoong Corporation, Sepoong Engineering | July 18, 1998 | Completed |
| | Kangwon Industries | Kangwon Ind., Sampyo Co., Sampyo Ind., Sampyo Heavy Ind. | July 18, 1998 | Completed |
| | Anam | Anam Semiconductor, Anam Electronics, Anam Environment | October 24, 1998 | January 23, 1999 |
| | Ssangyong | Ssangyong Construction, Namkwang Construction | November 3, 1998 | February 2, 1999 |
| CBK | Kabool | Kabool, Kabool Textile | July 14, 1998 | Completed |
| | Byuck San | Byuck San, Byuck San Const., Tongyang Mulsan | August 6, 1998 | Completed |
| First Bank | Shin-Ho | Shin-Ho Paper, Shin-Ho Petro-Chemical, Tong-Yang Steel | July 9, 1998 | Completed |
| | Tongil | Tongil Heavy Ind., Il-Sung Construction, Il Shin Stone, Hankook Titanium | July 20, 1998 | Filed for Arbitration to CRCC |
| | Tongkook | Tongkook Co., Tongkook Fiber, Tongkook Spinning | October 17, 1998 | January 16, 1999 |
| Hanil | Kohap | Kohap Co., Kohap Inc., Kohap Petro Chemical, Kohap Chemical | July 6, 1998 | Completed |
| Seoul | Jindo | Jindo Co., Jindo Inc., Jindo Construction | July 14, 1998 | Completed |
| | Woobang | Woobang Housing | July 16, 1998 | Completed |
| | Dong-Ah Construction | Dong-Ah Construction | August 21, 1998 | Completed |
| KEB | Shinwon | Shinwon, Shinwon JMC, Shinwon Distribution | July 18, 1998 | Completed |
| Daegu | Taegu Department | Taegu Department, Taeback Shopping | September 1, 1998 | November 30, 1998 |

Others

22 corporates of 8 groups, 12 large corporates

| Lead Bank | Name | Company | Selection | Due Date |
|--------------|---------------------|--|--|---|
| Cho Hung | Dongwha Duty Free | Yoojin Tour, Dongwha D.F., Dongwha Devel. | August 18, 1998 | December 17, 1998 |
| | Dongbang | Dongbang Co., Dongbang T&C, Dongbang Steel | September 15, 1998 | December 14, 1998 |
| | Choong Nam | Choong Nam Spinning, Choong Bang Co | November 4, 1998 | February 3, 1999 |
| CBK | ---- | Peeress | August 17, 1998 | Completed |
| | Shinwoo | Shinwoo, Shinwoo Ind., Shinwoo Teleco. | November 11, 1998 | January 11, 1999 |
| | ---- | Xetex | October 28, 1998 | December 29 |
| First Bank | Maxon Electronics | Maxon Electro., Il-Dong Pharm. | July 31, 1998 September 9 | November 30 December 8 |
| Hanil | ---- | Sung Chang Co | October 16, 1998 | January 15, 1999 |
| KEB | ---- | Young Chang Piano | September 19 | December 18 |
| Shinhan Bank | ---- | Korea Computer | August 29, 1998 | December 6 |
| Pusan Bank | Han-Chang | Han-Chang Co., Booil Mobil, Han-Chang Paper, Trad Club, Han-Chang Chemical | August 24, 1998 September 3, 1998 | November 23, 1998/11/16 December 2, 1998 |
| | | ---- | Seshin | September 14 |
| | Taegu | ---- | Seohan | November 9 |
| | | Whasung Ind. | November 17 | Undecided |
| Kyungnam | ---- | Muhack | October 10, 1998 | Jan. 9, 1999 |
| KDB | Kyunggi Chemical | Kyunggi Chem., Daljay Chem. | September 12, 1998 | December 11, 1998 |
| | ---- | Samil Kongsu | September 9 | November 8 |
| | ---- | Namsun Alum. | September 11 | December 10 |
| | ---- | Dae Kyung Steel | September 14 | December 12 |
| Housing Bank | Dongbo Construction | Dongbo Const., Dongbo Industry | October 1, 1998 | December 31, 1998 |

2.3.3 Workout for the SMEs in Progress

187 corporates were selected for workout among the SMEs reviewed. As of November 15, 1998, 92 corporates and their lead banks finalized agreement to pursue workout programs.

3. Improvement of Capital Structure

3.1 Implementation under CSIP

Implementation measures have been taken in accordance with CSIP submitted by the 64 largest *chaebol* to their lead banks. Special attention was focused on enhancing transparency of management, resolving cross guarantees, streamlining core competence and strengthening responsibility of management for corporate governance.

In response to their CSIPs, self-help efforts to improve their capital structure have been made by the corporates.

Self-help efforts by the Top Five *chaebol* have been estimated at over 8.5 trillion won by the end of October 1998. These efforts include sale of assets, business transfers, foreign capital inducement, and so on.

The 6 to 30th large *chaebol* also achieved self-help efforts estimated at over 8 trillion won.

3.2 Modification of CSIP for Top Five *Chaebol*

On October 17, 1998, major creditor banks received revised CSIPs from the Top Five *chaebol*, which major creditor banks required for proper analysis and projections. The new CSIPs, after negotiations between the lead creditor banks and the Top Five *chaebol*, will lead to agreements around mid-December 1998.

In addition, lead creditor banks hired independent accounting firms to review *chaebol* financial statements in order to evaluate the appropriateness and to provide better valuation estimates.

3. Business Restructuring of the Top Five *chaebol* and Support for SMEs

3.1 Business Restructuring of the Top Five *chaebol*

As part of their overall restructuring efforts, the Top Five *chaebol* announced on September 3, 1998 that they would restructure seven business segments. According to latest announcement by *Chaebol* leaders on October 7, 1998, restructuring were to be achieved by mergers and business swaps among top *chaebol* or other big corporates. Following is the outline of their business restructuring plans:

Petrochemicals : separation from the *chaebol* and establishment of a new corporate entity

Aerospace : same as the case of petrochemicals

Train car manufacturing : merger of Hanjin and Daewoo affiliates

Vessel engines: transferring business of Samsung to Korea Heavy Industry Co.

Power plant equipment : transferring asset of Samsung affiliate to KHIC

Semi-conductor : merger of LG and Hyundai affiliates

Oil refinery : Hyundai to takeover Hanwha

3.2 Support for SMEs

After completion of triage analysis on June 1998, support measures such as increasing credit, expanding credit guarantee facilities and expanding trade finance are being taken on behalf of the corporates classified as priority support and conditional support.

4. Improvement in Institutional Setting

4.1 Establishment of Corporate Restructuring Fund

25 financial institutions including Korea Development Bank (KDB) invested and set up “Corporate Restructuring Fund” (CRF) to facilitate restructuring of non-*chaebol* companies.

Debt fund (600 billion won) will mainly serve as a vehicle for debt restructuring. The fund aims to convert debt to be matured within one year into long-term debt with two or three year maturity.

Consolidated fund (one trillion won) will be used to support the corporate by aiding underwriting equities as well as debt rescheduling.

The scope of CRF investment is strictly limited. In its use of these funds:

Targets for priority investment include corporates with considerable involvement in export, venture businesses in high technology industry, and corporates that are temporarily suffering due to exit of creditor institutions, etc.

These funds will not be used for the Top Five *chaebol*, government-invested corporations, etc.

The CRF was actualized by enactment of “Securities Investment Company Act” in September 1998.

4.2 Facilitation of Exit of Distressed Corporate

Institutional procedures for dealing with weak corporates was improved. Improvements were designed to enhance prompt response to problems, foster specialization, and to strengthen the role of creditor institutions. Details are as follows:

Unless a final reorganization plan is produced within one year from the date of the court order placing a firm in receivership, the court may annul its previous decision. This rule aims to shorten the planning period, which in the past usually took two to three years. Also, the longest possible grace period on loan to distressed firms was shortened to ten years from the previous twenty years at maximums.

The new rule clarifies that a court receivership order can be effected only when the economic value of a going concern is greater than its liquidation value.

“Management Committee” composed of experts in legal field, accounting, or economists, is established to enhance efficiency of procedures in the court.

The right to revoke the court receivership is given to the creditors, who also can form a “Creditors Committee” among themselves to allow them to participate in

the decision processes of the court receivership.

- Revision of “Court Receivership Law”: February 1998

Eligibility to apply for composition is strengthened to avoid abuse by management. Also the court may refuse to accept the composition application if it finds it inappropriate to initiate composition after consideration of amount of assets, number of creditors, etc.

Revision of “Composition Law” : February 1998

4.3 Facilitation of Merger and Acquisition

Tender offer obligation and limitation on equity investment amount were abolished in merger cases. In the past, an acquirer wishing to purchase more than 25% of issued shares would have had to purchase more than 50% of such from the public. On the other hand, subscribing amounts of other companies was limited to within 25% of net asset value of acquiring companies.

Revision of “Securities and Exchange Act” and “Fair Trade Act” : February 1998

Tax laws related with M&A were revised favorably to facilitate M&A. One of them is to allow the acquirer to defer tax imposed on merger profits.

Revision of “Corporate Income Tax Law” : December 1997

Restrictions on the friendly take-over of domestic companies with asset size over 2 billion won, was abolished, and government approval is no longer required. Also, hostile takeover will be allowed in certain contexts. Currently foreign investors need to acquire consent from the board of directors of targeted companies only if they wish to hold more than one third of total shares. Before the revision, consent was required for foreigners purchasing more than 10% of total shares.

Revision of “Foreign Investment Act” : February 1998

4.4 Tax Incentives for Restructuring

Favorable tax treatment will be given to corporations to induce voluntary restructuring. Followings are examples of tax benefits;

Disposal of real estate for redemption of debt

- Exemption of special value added tax until the year 1999

Donated assets from owners or others to the corporate for the purpose of reducing debt

- Exemption of transfer income tax until 1999

Transfer of real estate in relation to merger or business transfer

- 50% reduction of transfer income tax or special value added tax until 1999

Resale of real estate acquired due to restructuring within five years

- 50% reduction of transfer income tax or special value added tax

Gains from early retirement of debt based on net present value method for the court receivership or composition corporate

- Exclusion from income of the companies

All the tax benefits aforementioned were reflected in the revised “Special Law for Tax Exemption” : December 1997, February and September 1998

4.5 Tighter Regulation on Credit Concentration to *Chaebol*

Limits on financial institutions to purchase and hold CPs (Commercial Papers) issued by *chaebol* were institutionalized in July 1998 to prevent distortion of the money market. Financial institutions can only hold CPs issued by the same *chaebol* affiliates up to 5% of whole assets of their trust funds.

Along with this *chaebol*-wide restriction, limitation for the individual company was set up, that is, financial institutions cannot hold CPs of one company exceeding 1% of the total assets of their trust fund.

Credit concentration limits in corporate bond investment was strengthened. Ceilings for each *chaebol* are 10% of total holdings for banks and insurance companies and 15% for investment companies. This rule is effective from October 1998.

IV. Interim Assessment and Some Issues

1. Assessment

1.1 Summary

- Substantial progress has been made with regards to the 5 underlying tasks for corporate restructuring considering the relatively short elapsed time since embarking on corporate sector reform. Of the five, the task of improving corporate financial structure, which perhaps lags behind the other goals to some extent, will require the passage of some time before concrete results can be realized.
- Among the 6-64 *chaebol* with bank loans of more than 250 billion won (a total of 58 *chaebol*), 16 are currently undergoing serious corporate restructuring efforts through workout programs which are being met with considerable success.
- SMEs have been categorized into either priority support or conditional support and are eligible for various support measures, including rollovers or new loans by creditor banks as a way to resolve the liquidity problems they have been facing.

However, the Top Five *chaebol* who are pursuing self-directed business restructuring have failed to meet expectations to date.

1.2 Detailed Assessment

1.2.1 The Top Five *chaebol*

In terms of implementing the five underlying tasks for corporate restructuring, structural reform has already been carried out to a certain extent, and progress continues to be made.

Self-rescue efforts amounting to 8.5 trillion won have been realized since the first CSIP agreements with major creditor banks.

Contrary to efforts made in improving financial statements, efforts in business restructuring, which was pursued in an effort to realign their involvement in 7 business sectors, have fallen short of expectations to solve problems relating to excessive leverage and over-capacity.

1.2.2 6-64 *Chaebol* and Large-sized Companies

These groups of companies have seriously implemented the 5 underlying tasks for corporate restructuring by complying with conditions under CSIPs signed with major creditor banks.

- Along with the case of Dong-Ah Construction, workout plans for 20 companies were devised through voluntary negotiations between creditor financial institutions.
- During the course of carrying out workouts of 6-64 *chaebol* and large-sized companies, a total of 307 or some companies have been disposed of, numbers that clearly demonstrate the success of facilitated exit of non-viable companies.

1.2.3 Small-and-Medium Enterprises

- By providing new loans and term extensions to priority support and conditional support corporates, the credit crunch will be alleviated on a timely basis.
- In particular, in return for new funding, the conditional support corporate will be required to pursue measures to reduce debt/equity ratios and financing cost, dispose of real estate holdings and to recapitalize, thereby encouraging voluntary capital structure improvement of these companies.
- Workout programs are being drawn up for 187 companies. Also, the workouts of 92 companies have been agreed upon between creditor financial institutions and target companies.

2. Issues of Concern

The speed of corporate restructuring is far slower than that of financial sector.

- The government is responsible for the licensing and supervision of financial institutions and as such has more leverage to facilitate financial sector restructuring in accordance with intended schedules.
- On the other hand, as corporate restructuring is to be pursued on the basis of market principles, and minimal direct government involvement, it thus cannot be compared on an equal footing with the financial sector restructuring process when it comes to pace of change.
- Since excessive and direct government involvement without consideration of stakeholders' interest is not desirable under the current nationwide consensus for market-oriented economy, the government continues to exert efforts toward revising related laws and establishing an appropriate institutional setting that will expedite the ongoing process.
- Corporate restructuring involves in its essence a time consuming process to resolve differences among themselves, consult with borrowers, review business prospects and conduct due diligence etc.

Despite these natural impediments to more rapid change, corporate restructuring has been carried out according to originally set schedule, with the notable exception of the Top Five *chaebol*,

The workout process has been delayed and floating because of conflicts of interests among creditor financial institutions

- In the case of Kohap, which filed for arbitration with the Corporate Restructuring Coordination Committee to resolve the conflict of interest between creditor financial institutions, only 4 out of 24 agenda items failed to get a majority vote of 75%, whereas other 20 items got majority votes ranged from 76.1% to 96.6%.

Although an arbitration filed by the CRCC entails a delay of up to 1 month in signing-off on workout plans, the fact that creditors had the opportunity to express various opinions is a positive implication signaling a break with the past of the previously close links between the government and financial circles.

- Even though the involvement of the CRCC will inevitably be requested depending upon cases, for the most part creditor financial institutions will be able to reach mutual agreement through a process of negotiation within creditor committees.

The government is wrongfully burdening the banks with the overwhelming task of spearheading the restructuring of the Top Five chaebol.

- The suspension or calling of corporate loans extended to those with low creditworthiness should be regarded as part of a bank's intrinsic function in upholding the soundness of their respective banks.
- On the other hand, as the authority responsible for the supervision of sound management of financial institutions, the government's role becomes more proactive when financial institutions are deemed reluctant to carry out sound management on a voluntary basis. In such cases, the bank supervisory authority would induce the proper implementation of sound management practices and will perform monitoring functions as necessary.

Some of the 55 corporate that received nonviable designations are seeking mergers or court receivership and thereby attempting to escape mandates to exit the market. (refer to exhibit table following explanation for details)

- If such action were taken with the intentions to hold onto nonviable companies, it would be against the underlying objectives, that is, the prompt resolution of non-viable companies. However, such may be acceptable given that it is pursued as an interim step toward resolving the nonviable companies.
- For example, by utilizing a merger arrangement, problems likely to be confronted under immediate liquidation proceedings, such as those relating to debt guarantees of affiliated companies and resistance from shareholders, may be resolved after which appropriate exit strategies may be followed.

- Also, if a company were to pursue disposal of corporate assets under a court receivership proceeding, in many cases a sudden drop in assets price due to distressed situation may be avoided and the seller will be in a better position to negotiate the sale under more favorable conditions.

Status of Resolution of 55 Nonviable Companies

| | The Top Five <i>chaebol</i> | | 6 th - 30 th <i>Chaebol</i> | | Others | | Total |
|---------------|--|---|---|---|------------------------------------|--|-------------|
| | Group | Company | Group | Company | Group | Company | |
| Liquidation | Hyundai Samsung Daewoo SK | Sunil Shipping, Hyundai Equipment Samsung Watch, Hanil Wire, Daedo Phar., Yichun Electric Korea Ind. System Kyongjin Shipping | Dong-Ah Hanwha Hyosung Kohap Shinho Keopyung | Dong-Ah Engineering Otron, Hanwha Travel Tongkwang Plastic, One Hyosung Number , Hyosung Media Kohap Fine Chemical Shinho Trading, Shinho Electronic, Young Jin Tech. Korea Tungsten, Keopyung Industrial Development, Keopyung Const. | Donguk Woobang ----- | Dongkuk Elec. Taesung Const. Yangyoung Paper , Daihan Textile | 25 (45%) |
| Consolidation | Hyundai LG SK | Hyundai Livart, Hyundai Aluminum LG Electro- components, Wonjeon Energy, LG ENC SK Warehousing | Kohap Haitai New Core | Kohap Textile Haitai Stores Newtown Project, Sidae Chuksan, Sidae Distribution | Kabool Hankook Synth. | Shin Han Industry E-hwa | 13 (24%) |
| Sale | Daewoo LG SK | Orion Elect. Component, Dong Woo Consulting, Daechang Enterprise LG Owens My TV Co. | Kohap Haitai | Kohap I & T, Kohap FCN Haitai Confectionery | ---- Hanil | Woojung Hospital Namju Development | 10 (18%) |
| Other | | | | | Hanil Tongil | Hanil Synthetic (court receivership) Ilhwa (court receivership) | 2 (4%) |
| Under Review | Daewoo | Korea Automotive Fuel | Ssangyong Haitai | Buma Petroleum Haitai Electronics | Hanil | Shinnam Development, Chinhae Chemical | 5 (9%) |
| Total | | 20 | | 23 | | 12 | 55 |

V. Future Policy Plan

The corporate restructuring plan set out in its early stages will be implemented accordingly. However, focus will be heavily placed on the efficient completion of the following three tasks: business restructuring of the Top Five chaebol; resolving cross guarantees; and workout for 6-64 chaebol.

1. The Top Five *chaebol*

1.1 Business restructuring

- With regards to the self-imposed business restructuring plans announced by the Top Five *chaebol* on October 19, 1998, although plans that satisfy the original goal of enhancing competitiveness of respective business lines will be fully honored, those plans that fall short in terms of providing a solution toward improving the financial structure and management of the Top Five *chaebol* will be subject to further adjustments. This process will be led by the creditor financial institutions.

- The underlying principles are as follows:
 - ① In carrying out business restructuring of the Top Five *chaebol*, the enhancement of industrial competitiveness and the complementary soundness of financial institutions are the two main goals to be kept in mind.

 - ② Business restructuring should be carried out as an integral part of the workout framework laid out in the capital structure improvement plan agreed upon between the respective *chaebol* and creditor financial institutions. Internationally recognized standards and practices especially with regards to transparency and fairness, should be incorporated into these plans.

 - ③ Government support as well as financial arrangements through creditor financial institutions will be conditioned upon self-rescue efforts and fair loss sharing on the part of majority shareholders and the *chaebol* themselves.

- ④ In principle, among the Top Five *chaebol*, business restructuring plans will be developed together with their creditor financial institutions through a voluntary negotiation process. However, if a mutually acceptable plan cannot be reached, financial institutions will suggest the alternatives or amendments to the CSIPs and take due actions as creditors, such as sale or liquidation of marginal businesses, suspension of credit extension and making claims on guarantees.

< Time Table >

By mid-November 1998

The working-level committees with each industry will evaluate the plans laid out by the Top Five *chaebol* for adequacy and feasibility. Based on findings the committee will send the results of evaluation to “Special Committee for Business Restructuring.”

Only after their plans are found to be appropriate and feasible, some financial support measures can be considered.

By end of November 1998

“Special Committee for Business Restructuring” will review the overall plans and supporting measures and send out them to “Major Creditors Council.”

By mid-December 1998

Major Creditors Council and the Top Five *chaebol* will finalize the plans through negotiations between them and the plan will be incorporated in the CSIPs.

1.2 Resolution of Cross Guarantees

It should be understood that it is very difficult to facilitate corporate restructuring under the current cross-guarantee structure, either in corporate level or at the industry level, since *chaebol* have interwoven themselves by means of cross guarantees. Therefore, any change of financial structure in a particular affiliate can

trigger serious effects on other affiliates or the *chaebol* group itself.

Thus, it is vital to resolve cross guarantees in order to prepare an atmosphere and conditions favorable to restructuring and thereafter to pursue it to completion.

The order of resolving cross guarantees will be given to the Top Five *chaebol* first, since those are capable of debt redemption and have low possibility of credit risk increase. If the Top Five *chaebol* are successful in resolving cross guarantees, the next step will be to do the same with the second tier corporates.

For this purpose, a “Cross-guarantee Task Force Team”, composed of seven experts from lead creditor banks and the CRCC, was established in October 1998.

The methodologies prepared by “Task Force Team” will be confirmed at Major Creditors Council and be finalized in negotiations with the Top Five *chaebol*.

Measures for resolving cross guarantees will be made in accordance with market principles, and the following principles and steps are to be observed:

Excessive guarantees like a double guarantee will be released immediately and unconditionally by the financial institutions.

Priority will be given to cross-guarantees that exist between industries to minimize the negative effects and induce homogeneity of *chaebol* structures.

The total amount of debt of *chaebol* should not be increased in relation to resolving cross guarantees. However, the standpoint of the *chaebol* will be fully considered through close discussion on these issues.

1.3 Facilitation of Workout

At the same time that plans for resolving cross guarantees are agreed, several lead companies representing each *chaebol* will be selected for workout to improve financial structure enough to induce foreign capital.

During the course of these efforts, especially when a spin-off, whether while in MBO (management buy out) or in EBO (employee buy out) has occurred, it will need positive supports from creditor institutions and the government.

The following steps and principles will be followed:

It will be proceed on the premise that *chaebol* are taking self-rescue efforts like reorganization of non-profitable businesses, introduction of foreign capital by joint venture, and selling off major business lines.

Subjects of workout will be selected based on discussions between the creditor institutions and *chaebol*. Nonetheless, core affiliates within each *chaebol* with excessive debt/equity ratios by the international standards may fall subject to the workout process.

It is worth while to select one or two corporates within each *chaebol* at early stage to build experience that could be applicable to other affiliates.

1.4 Revision of CSIP

Revised CSIPs, reflecting business restructuring plans submitted by *chaebol*, together with review results, will be confirmed and executed from mid-December 1998.

As a result, revised CSIPs will contain the detailed plans of business restructuring, resolving cross guarantees and workout plans.

1.5 Reorganization of *Chaebol* Structure (Example)

- 1st Phase: To pursue vertical independence between business lines through the unwinding of funding support and cross guarantees between units belonging to differing business lines. Also to unwind cross ownership of subsidiaries belonging to differing business lines.
- 2nd Phase: To pursue independence of business units within the same business line through the unwinding of funding support and cross guarantees and the liquidation of non-core business.
- 3rd Phase: To improve capital structure of core business by seeking joint venture with foreign partner or liquidation of non-competitive business.

This suggested plan will be led by the creditor financial institutions and should be regarded as an integral part of the workout framework. By doing so, the following effects are anticipated:

Exit of marginal affiliates, liquidation of non-competitive companies or businesses belonging to same business line.

Unwinding of cross guarantees between affiliates through debt sharing of guarantor and exchange of guarantees held between differing business lines.

FSC will come up with appropriate schemes and guidelines toward resolving cross guarantees between affiliates

2. 6-64 *Chaebol* and Large-sized Companies

2.1 Companies currently undergoing workout process

- These companies are being guided to abide by the following guidelines and to carry out necessary procedures effectively.
 - ① Workout programs should be regarded as a course of action undertaken by financial institutions to minimize their losses and not as an unwilling sacrifice on the part of the creditor financial institution. Thus, support and loss sharing borne by the financial institutions with regard to a viable corporate should not be understood as a preferential treatment, but as an effort to pursue their own interests by enhancing profit, i.e., upgrading recovery ratios.
 - ② The workout company is expected to be held responsible and take part in loss sharing to a degree comparable to that of the creditor financial institutions. The unconditioned sacrifice on the part of the company alone should be avoided. In this respect, the issue of changing ownership should be decided based on the degree of loss sharing by financial institutions. In the case of capital reduction, dilution of major shareholders could be resolved when the financial institutions give them buy-back options of the stakes after a certain period passes.

2.2 Selection of additional workout companies

Selection should be based on a comprehensive review of the following elements:

Enthusiasm toward self-rescue plans and their feasibility and the availability of creditor financial institutions' support.

Size of the debt associated with financial institutions that did not sign the corporate restructuring agreement and the total size of securities issued that are not included in the definition of debt under CRA, and the likelihood of such being resolved through the agreement

The degree of simplification of debt structure and the capability of servicing interest payments

Level of new funds needed and the likelihood of reducing credit risk of the creditor financial institution.

3. Small-and-Medium Enterprises

3.1 Underlying Policy Plan

By the end of October 1998, the detailed implementation plans for workout will be completed.

Such measures as Dedicated SME Assistance Officer, debt-equity swap and CRF will be fully utilized henceforth.

3.2 Detailed Policy Measures

SMEs with the greatest potential to restore their viability will be given highest priority.

These SMEs will require relatively lesser degree of loss-sharing on the part of the financial institutions and at the same time the burden to be borne by the company is also smaller, thereby making the workout process more approachable.

Make use of debt-equity swap arrangements, while protecting management control of the prevailing owners to the extent possible.

In the case where capital reduction is required before a debt-equity swap, by including owner-originated company's borrowing in the debt-equity swap arrangement, the reduction in equity stake of the owner may be minimized, thereby easing any anxiety of giving up management control.

Under the scenario that the creditor financial institution becomes the majority shareholder, the anxiety on the part of the owner may be eased if the company and the financial institution agree to sign a special pact that gives the prevailing owner management control provided that operational performance does not deteriorate.

Conditional support SMEs will utilize "Dedicated SME Assistance Officers."

Officers will be dispatched to "conditional support SMEs" and they will help in designing and implementing restructuring plans. They will also monitor fund management and accounting of the SMEs, so as to forestall the risk of moral hazard as a result of allowing management control to remain with the owner.

Companies listed on the OTC market (Korea Securities Dealers Association Automatic Quote: KOSDAQ) will be able to make use of the CRF.

Officers will arrange investment from the CRF.

For Officers who are paid on a performance basis through stock options, their performance and compensation level can be easily identifiable once the company is listed on the OTC market through workout.

APPENDIX : Glossaries

FSC

It stands for Financial Supervisory Commission.

FSC was born on April 1, 1998 as an independent and de facto sole governmental body to supervise the financial market in Korea.

Structural Reform Planning Unit (SRPU) is one of its divisions within FSC to facilitate restructuring.

Chaebol

It is a Korean word meaning large sized, family-owned or controlled conglomerate(s) with diversified business areas.

According to their size, they can be grouped into the largest size group(the Top Five *chaebol*), the “6 to 64th” largest *chaebol* and other large *chaebol*. However, the word *chaebol* commonly refers the largest 64 *chaebol* only because they have large bank loans over 250 billion won, hence are closely monitored by creditor banks or the governmental bodies for the regulation purpose.

CRA

It stands for Corporate Restructuring Agreement signed by 210 major financial institutions to proceed voluntary workouts on June 25, 1998.

The Corporate Restructuring Coordination Committee(CRCC), composed of seven members, was established in accordance with the CRA.

The CRCC can arbitrate the cases where agreements are failed, and may impose penalties on the financial institutions which violate the agreement thereupon.

CSIP

It stands for Capital Structure Improvement Plan.

CSIP is an agreement entered into by a large *chaebol* and its lead creditor bank for improving its capital structure.

Business Restructuring

It is a word for reorganization efforts of *chaebol* as a way of restructuring.

It is usually taken in the form of business swap with other *chaebol* or separation of over-capacity facilities/business segments from them, thus is often to be called as “Big Deal” in Korea.