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Weekly Newsletter

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Keynote Address for International Advisory Board (IAB) Forum by Keun Young Lee, Chairman of FSC and Governor of FSS(2001. 5. 29)

On behalf of everyone at the Financial Supervisory Commission and Financial Supervisory Service, I thank and welcome all of you to the Second International Advisory Board Forum here in Seoul.

The International Advisory Board (IAB) was established in 2000 through a collaborative effort between the World Bank and the Financial Supervisory Service and, for the second time since the financial crisis, the Board is providing its valuable counsel on the Korean economy, the financial system, and our future directions. The IAB has also played an important role in advocating our reform and restructuring efforts as well as other positive changes to the international community.

I have no doubt that today's forum, which will discuss the challenges that lie ahead and the policies we should earnestly explore, will once again provide an invaluable opportunity to push forward and shed new light on Korea's financial markets.

Looking back, the Asian financial crisis clearly demonstrated what can happen to financial markets when countries fail to meet the expectations of global investors and lose their confidence amid the transformation of the world economy into a single, seamless marketplace by the forces of globalization.

Much has changed since the Korean government signed the Stand-By Loan Arrangement with the International Monetary Fund (IMF) on December 3, 1997. In many aspects, the Korean economy no longer resembles what it once was. With the assistance from the IMF and the international community, the government has adopted robust restructuring policies for the corporate and financial sectors not only to overcome the financial crisis, but also resolve long-overdue structural weaknesses in the economy.

As expected, the restructuring has exacted heavy sacrifices from every Korean citizen, including businesses and households, as a significant number of companies and financial institutions were closed or merged with others and unemployment reached unprecedented levels. The restructuring in the financial sector led to a sharp decrease in the number of financial institutions from 2,103 at the end of 1997 to 1,619 at the end of 2000 – a 23% reduction. During the same period, the number of people employed by financial institutions also fell by more than one-third.

Moreover, as a result of injections of public funds and the uncompromising restructuring efforts, the total amount of non-performing loans was reduced by more than 50% from 112 trillion won in March 1998, to 50 trillion won in December 2000. In addition, the average BIS capital adequacy ratio of domestic banks also rose above 10% in 2000 from 7.04% in 1997. Due to their inter-dependent and inter-connected natures, restructuring of the financial sector was conducted in tandem with that of the corporate sector. In the corporate sector, restructuring efforts helped bring an end to the cycle of corporate failures leading to distressed lenders, while financial sector reforms successfully restored the intermediary role of banks. As a result, restructuring laid strong foundations for renewed growth in the real sector.

In two years following the onset of the financial crisis, Korea achieved 10.7% GDP growth in 1999 and replenished its foreign currency reserves to US$ 74 billion. And by the end of 2000, the nation's foreign currency reserves increased to a record US$96.2 billion – more than sufficient to declare a recovery from the foreign exchange shortage in late-1997 that sparked the financial crisis.

It was somewhat inevitable that the government would assume the leading role in the first phase of reforms, not only because of the need to overcome the crisis as quickly as possible, but also due to the scope and severity of the problems. But while financial markets enjoyed an impressive rebound, the overall competitive position of domestic firms and financial companies did not improve significantly in terms of the "software" aspects of reform, such as profitability levels, credit business and risk management practices.

The collapse of the Daewoo Group, rising oil prices, falling semi-conductor prices, and the fear of a hard landing and recession in the US economy also added to concerns of another severe economic downturn in Korea as local financial institutions continued to face adverse market conditions, and as liquidity crunches became more serious.

In response, the government initiated the second phase of restructuring in September 2000 to eliminate market uncertainties and normalize financial markets. In the second phase of restructuring, the focus shifted to completing the unfinished task of resolving potential bad assets left over from the first phase and improving the overall competitiveness of the financial sector through more forward-looking policy initiatives. In particular, the government stressed the need to complete structural reforms so that restructuring could move forward continuously in the private sector by the market participants themselves under market principles and discipline.

For these purposes, the government allocated 40 trillion won in additional public funds to support under-capitalized banks and worked to remove the lingering uncertainties and problems in the financial and corporate sectors. The government also continued to reinforce supervision of the entire financial sector and instituted a partial deposit protection system along with other market-based regulatory reinforcement measures to eliminate moral hazards and build the basic framework for continuous restructuring guided by market principles.

However, despite the progress that we have achieved thus far, the overall competitiveness of Korea‘s financial sector still lags behind that of the leading international financial markets. For example, Korean banks still struggle to manage half of the productivity or profitability achieved by the leading international banks. Likewise, although Korea‘s securities market ranks in the world’s top 10 in terms of transaction volume, Korea still lacks leading international securities firm, and many suffer from poor profitability due to the dearth of investment banking capability.

Therefore, if Korea is to achieve a truly competitive position in the global financial markets, domestic financial institutions must focus on profitability and continuously embrace the kinds of advanced credit practices and risk management techniques used by the leading global players.

More importantly, I see a need to do away with anachronistic ways of thinking and business practices, which seriously hinder innovation and market forces. If the structural reforms implemented during the first phase of restructuring are considered the reform of “hardware” side, then changing the attitudes, mentality, and business practices of Korean companies are the reform of “software” side that will enhance the long-term real competitiveness of financial companies. Now that much of the "hardware" reforms are more or less in place and behind us, I believe that it is the "software" reforms that Korea's businesses and financial institutions now must carry out to ensure their competitive position in the global marketplace.

For this, I believe that our future policies should be headed in the direction of enhancing the overall competitiveness of the financial sector through management reform and other "software" reforms, the full adoption of a continuous restructuring system guided by market principles, and balanced growth among the financial industries. In particular, I see a need to overhaul or deregulate regulatory regimes that hamper the growth of the capital markets and the securities industry. To realize these goals, we must first move forward with the "software" reforms I noted earlier and create an environment that facilitates them, including significant increases in transparency and accountability, and development of a performance-based management culture.

I also believe that we will have to rethink our supervisory approaches toward banks to enable them to move away from their passive reliance on meeting the BIS capital adequacy ratio and towards the active expansion of profit-motivated banking businesses. We are already beginning to do so, and I believe our future supervisory posture will reflect such thinking. Second, to support the goal of continuous restructuring in the financial sector, we will reinforce prudential supervisory procedures prior to the enforcement of Prompt Corrective Actions against potentially ailing financial companies to prevent further deterioration in their asset status and to support rehabilitation efforts.

We will also regularly inspect banks in order to ensure compliance with the continuous credit risk assessment of corporate borrowers. And to support market-led restructuring of "workout" companies, we will also encourage corporate restructuring vehicles (CRV) as a way to ensure the prompt and transparent resolution of distressed corporate borrowers.

I should add that the government is fully committed to re-privatizing the financial companies that were nationalized in the process of restructuring. The banks have been given autonomy under a MOU with the government, and we will ensure that the commercial banks will boast independent and innovative management by selling off the government-held equity stakes in nationalized financial companies as soon as market conditions mature.

Pushed by relentless advances in information, telecommunications, and network technologies, the global economy is rapidly transforming into a single market, and the pace of globalization of financial markets is accelerating at an unprecedented speed. Not surprisingly, the international flow of capital and the capital market's role in the domestic economy is rapidly growing, and the opportunities of businesses to tap into the global financial market are expanding rapidly as well. Already, we are seeing the active convergence and consolidation of major capital markets and financial companies in order to strengthen their competitive positions in the global marketplace. If Korea's financial markets and businesses are to survive and succeed in today's intensely competitive world, they must aggressively adapt to the rapidly changing market environment and not shy away from innovation.

When we look at Korea's capital markets, we continue to see excessive regulatory intrusion in the securities industry that lead to inefficiencies in the market. I also see much room for improvement in the level of transparency and investor protection. I believe that it is also time for the Korea Stock Exchange, KOSDAQ, and the Korea Futures Exchange to advance to another level. More specifically, the markets need to be refined and consolidated to become more compatible with leading international securities exchanges, enter into strategic alliances and other cooperative arrangements to secure their competitive positions, and offer efficient, low-cost transaction services.

The unintended regulatory intrusions have also limited the incentives of securities firms to offer more than brokerage and underwriting services. However, by freeing them from the regulatory shackles, we can encourage the firms to engage in more value-added financial services as well as more sophisticated corporate financing activities, including investment banking activities for corporate.

We are carefully looking at ways to ease the excessive regulatory burden that securities firms face. The aim is to create a market environment that encourages securities firms to come up with a wide array of sophisticated financial services, such as M&As and global financing, as well as the development of new financial products.

I do not believe innovation and creativity in the financial market can be over-emphasized for I believe it is the ability to innovate and create that will dictate who and what becomes competitive in the future. Therefore, while we will continue to exercise our regulatory authority to ensure soundness and stability in financial markets, we will also seek to eliminate any regulatory regime that impedes innovation or hinders competition in the marketplace.

When we succeed in this and other endeavors, I am confident that Korea's financial industry will ultimately contribute to stable and balanced growth, form the basis for other knowledge and information-based industries, and make Korea one of the most vibrant financial markets in Asia. And when this happens, I believe Korea will then truly join the ranks of the advanced economies of the world. From these perspectives, this forum will give us an opportunity to examine where we are as we explore the diverse policy initiatives that will advance our financial markets.

I very much look forward to hearing many insightful suggestions and advice from the members of the IAB and other distinguished participants.

Once again, I would like to thank each and every one of you for making the long trip to Korea to participate in the second International Advisory Forum.

Thank you and welcome to Korea.

FSS Holds Second Meeting of International Advisory Board (IAB) in Seoul

The FSS hosted the second Meeting of the International Advisory Board (IAB) in Seoul for two days from May 28 to May 29, 2001. The IAB is a joint effort between the World Bank and the FSS and serves as an advisory forum for the FSC/FSS on Korea's financial markets and future financial supervisory policies. The first IAB meeting was held in September 2000 in Seoul.

The theme for this year's meeting was "Continuing Efforts to Design a New Financial Architecture," and several prominent experts and policy makers from abroad presented their views on the problems and prospects for Korea's financial markets as well as the challenges ahead for the FSS as Korea's supervisory authority.

In his opening remarks at the open forum held on the second day of the meeting, Mr. Keun-Young Lee, the Chairman of the FSC and Governor of the FSS, spoke of restructuring and other developments in Korea's financial markets. In particular, Mr. Lee stressed the need for "software" reform—focusing on profitability and competitiveness, and embracing advanced lending practices and risk management techniques—to enhance their competitive position in the global marketplace. He also expressed support for continuous restructuring led by market participants under market principles and emphasized the importance of developing a strong capital market in Korea.

Dr. Robert Glauber, President and CEO of NASD Inc., opened the first session with a presentation on financial reform and policy directions for Korea. In his presentation, Dr. Glauber stressed the need for Korean businesses to become less dependent on bank financing and to rely more on equity and debt financing. In his argument, Dr. Glauber cited the benefits and advantages of cheaper, long-term capital that equity and debt financing can provide and the ability of debt and equity markets to more efficiently raise and allocate capital and better withstand external shocks than banks. Noting the US experience of S&L crisis in the 1980s, Dr. Glauber also suggested that prompt resolution of bad assets by domestic financial institutions will prove to be far more cost-effective than protracted inaction in the end and contribute significantly to Korea's economic recovery.

Following Dr. Glauber, Mr. Dominic Barton, who is Director of the Seoul Office of McKinsey & Co., presented his views on the need for more effective response to the lingering problem of non-performing loans at domestic financial institutions and suggested that, by setting appropriate priorities within the problematic loan portfolio and treating them as potential business opportunities, domestic financial institutions may be able to better cope with the bad loans. While acknowledging significant improvement in the domestic financial sector since the financial crisis, Mr. Barton also cautioned that non-performing loans are yet to be fully resolved and will require additional commitment for full resolution.

Mr. George Wittich, President of the German Federal Securities Office (BAWe), delivered the third presentation entitled "Strategies for Shaping Efficient Capital Markets—Determinants of Capital Markets for Long-term Investment." Focusing on the framework and strategies underlying an efficient capital market, Mr. Wittich directed his comments mainly at the development of long-term bond markets. By offering long-term financing opportunities and improving risk management in both the public and private sectors, Mr. Wittich argued that bonds and other fixed-income securities represent a very important tool to help strengthen and stabilize financial markets and the overall economy.

The second session of the IAB Forum opened with the presentation by Dr. Brian Quinn, former Deputy Governor of the Bank of England, on "Human Resource Investment and Skill Base Development—How to foster fit and proper financiers." Dr. Quinn argued that, regardless of geography, the root causes of financial crisis are essentially the same, i.e., "exposed to new competition from domestic and external sources, the institutions, the infrastructure, the systems and controls in both the public and private sectors were found to be incapable of withstanding the shocks that the radical change in the environment brought." Because most financial crises arise from the banks, he argued that improving the skills of bank managers—operational managers, top-layer managers, and directors—are just as critical as improving the institutions and infrastructure. Dr. Quinn also discussed the skill set required of supervisors, which must be constantly upgraded and updated to keep up with environmental changes, and those of other related players including the legal specialists, accountants and external auditors, and IT specialists.

Mr. Michael Mackenzie, former Superintendent of the Financial Institutions in Canada, delivered the final presentation entitled “Upgrading the Financial Supervisory Framework: Supervisory Frameworks for a Changing Financial Market.” In his presentation, Mr. Mackenzie stressed the importance of the independence of supervisors and the need to design supervisory legal structures in light of changes taking place and those anticipated in the financial markets.

Korean Futures Market Records Continuing Growth

Since the opening of the Korea Futures Exchange (KFE) in April 1999, the average daily trading volume in the domestic futures market has risen from 5,688 contracts in 1999 to 34,478 between January and April this year. The figure for the month of April was 40,521, which made KFE the 30th largest futures market in the world.

KFE Average Daily Trade Volume

(unit: contracts)

	1999	2000	Jan.—Apr., 2001	Apr., 2001
Daily Average Volume	5,688	12,200	34,478	40,521

Futures traded on the KFE include US Dollar Futures, US Dollar Options, Korea Treasury Bond Futures, Gold Futures, CD Interest Rate Futures and KOSDAQ 50 Futures. Korea Treasury Bond Futures account for the majority of the market transactions, making up 68.5% of the total futures contracts traded during the first quarter of 2001.

The strong growth of the futures trading has helped the KFE to post 500 million won in profit this year, compared to the 13 billion won losses it recorded during the 1999-2000 period. Pre-tax income at 14 futures companies also increased to 4.7 billion won in fiscal year 2000, up from 2.2 billion won in fiscal year 1999.

The growth of Korea’s futures market is expected to accelerate in the second half of this year with the scheduled listing of KOSDAQ 50 Options and start of brokerage businesses in the KFE by securities companies.

All Companies Under Court Receivership or Composition to Become Subject to Continuous Credit-Risk Assessment

In accordance with FSS guidelines encouraging banks to put corporate borrowers that are undergoing court receivership or composition proceedings under Continuous Credit-Risk Assessment (CCRA), 22 creditor banks placed 357 companies under their CCRA out of the 479 companies that were in court receivership or composition proceedings as of the end of April. The other 122 companies were already under CCRA by their creditor banks under the existing criteria set up by the banks when creditor banks placed 1,187 companies under CCRA on May 8, 2001.

The addition of the 357 companies brings the total number of companies under creditor bank CCRA to 1,544 from 1,187. The creditor banks are expected to complete CCRA of the 357 newly designated companies by the end of September 2001. A table of the 479 companies under court receivership or composition proceedings grouped by the total amount of credit extended by their creditor banks is presented below.

Companies Under Court Receivership or Composition

	Less than 10 billion won	10 to 100 billion won	100 to 300 billion won	300 to 500 billion won	Greater than 500 billion won	**Total**
Court Receivership	52	72	17	4	4	149
Composition	221	102	6	1	0	330
Total	273	174	23	5	4	479

(Appendix)

1. Major Financial Statistics

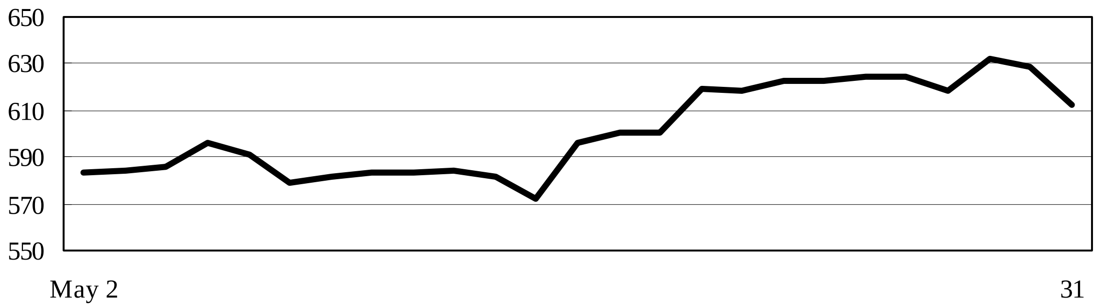
(unit: point, percent, won)

	Equity Indexes			Interest Rates				Exchange Rates	
	KOSPI Index	KOSPI 200 Index	KOSDAQ Index	Corp. Bond Yields (3 years)	Gov't Bond Yields (3 years)	Call Rate (1day)	CD Yields (91days)	Won/ USD	Won/ 100 JPY
May 2	583.70	73.29	81.00	7.87	6.57	5.01	5.90	1,304.0	1,069.29
3	584.40	73.37	79.99	7.81	6.50	5.00	5.90	1,294.0	1,064.14
4	585.60	73.51	80.48	7.79	6.45	4.99	5.89	1,298.0	1,070.07
7	596.50	74.86	82.84	7.81	6.50	5.07	5.89	1,299.0	1,070.90
8	590.91	74.09	82.27	7.78	6.47	5.00	5.89	1,299.0	1,067.82
9	578.84	72.53	79.59	7.73	6.42	5.00	5.89	1,304.0	1,071.49
10	581.38	72.77	81.41	7.74	6.43	5.01	5.89	1,307.0	1,067.81
11	583.06	72.95	81.72	7.76	6.44	5.10	5.89	1,302.0	1,059.83
12	583.06	72.95	81.72	7.76	6.44	5.10	5.89	1,298.0	1,059.16
14	584.08	72.99	82.93	7.79	6.54	5.00	5.89	1,297.0	1,056.19
15	581.30	72.61	81.48	7.84	6.65	5.00	5.89	1,303.0	1,056.77
16	572.40	71.46	80.12	7.83	6.61	4.99	5.88	1,309.0	1,056.50
17	596.39	74.72	83.32	7.82	6.61	4.99	5.87	1,300.0	1,056.91
18	600.54	75.25	83.03	7.79	6.59	4.85	5.85	1,290.2	1,045.05
19	600.54	75.25	83.03	7.79	6.59	5.10	5.84	1,305.0	1,055.83
21	618.96	77.51	83.81	7.73	6.54	5.00	5.83	1,301.0	1,056.01
22	617.99	77.37	83.78	7.72	6.53	5.06	5.83	1,295.0	1,053.70
23	622.60	77.83	82.86	7.71	6.53	5.00	5.83	1,288.0	1,060.08
24	622.28	77.66	83.01	7.61	6.40	5.01	5.82	1,282.0	1,069.22
25	624.11	77.81	83.43	7.60	6.42	4.96	5.82	1,290.0	1,070.10
26	624.11	77.81	83.43	7.60	6.42	4.92	5.82	1,292.0	1069.54
28	618.47	77.05	83.22	7.47	6.26	4.99	5.81	1,296.0	1,071.07
29	632.05	78.85	83.81	7.48	6.30	4.99	5.80	1,292.0	1,067.77
30	628.42	78.33	83.22	7.36	6.16	4.99	5.78	1,292.0	1,072.00
31	612.16	76.09	81.35	7.37	6.17	5.00	5.77	1,283.0	1,073.64

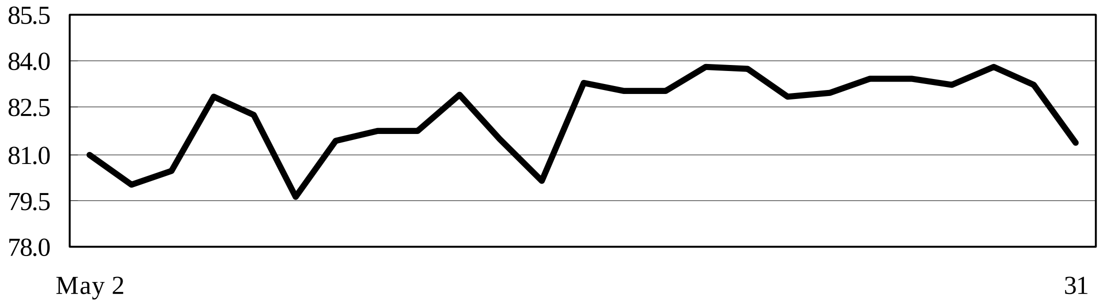
Note : End of Period

2. Daily Trends

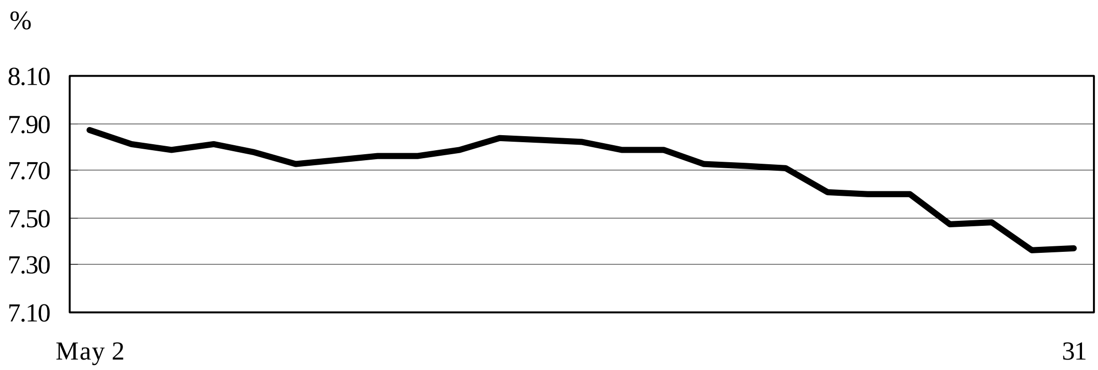
1) KOSPI



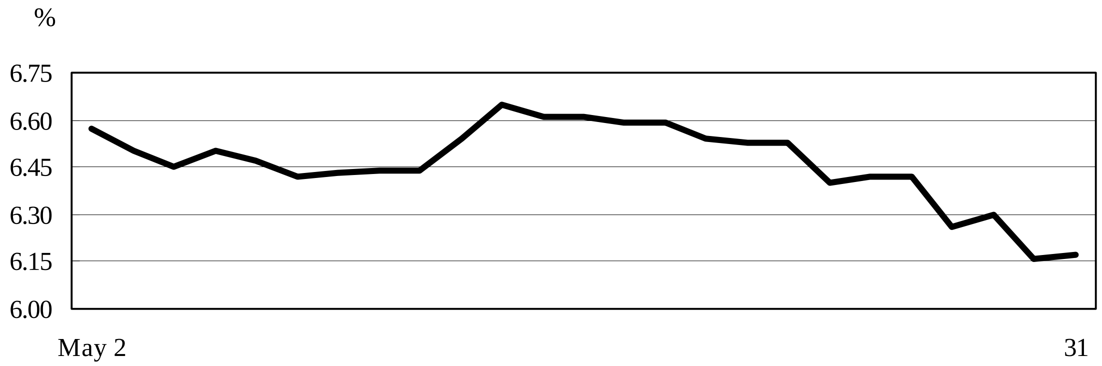
2) KOSDAQ Index



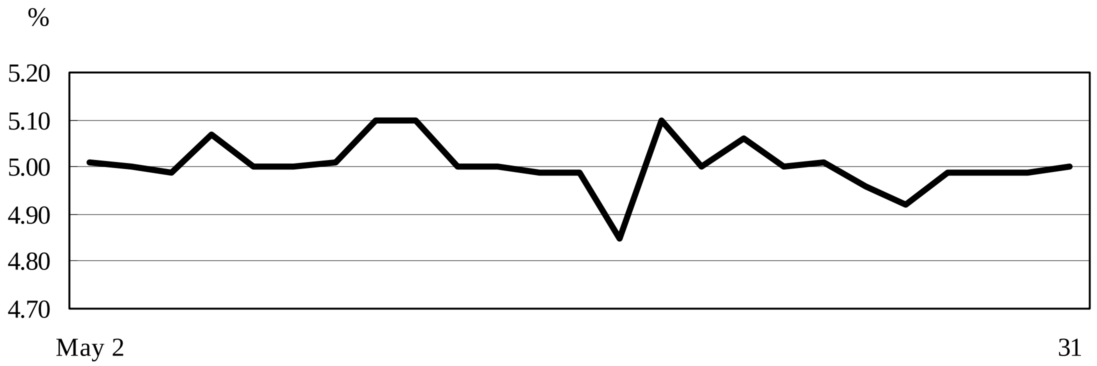
3) Yields on Corporate Bond (3 Years)



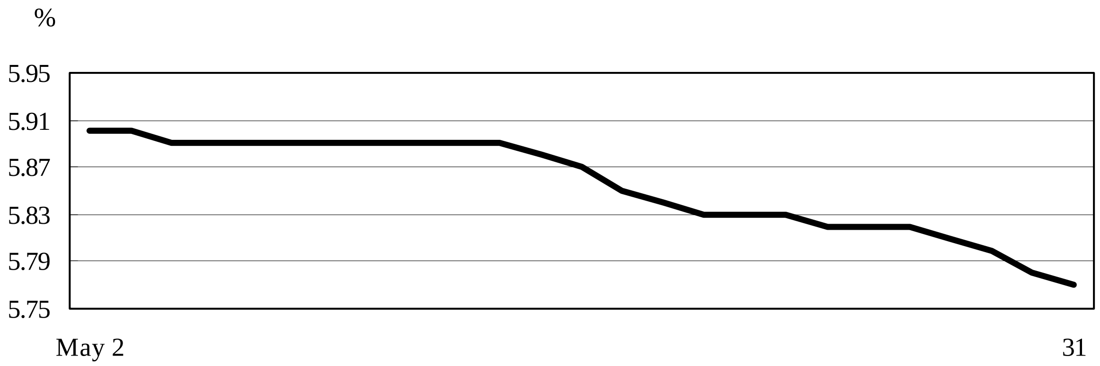
4) Yields on Government Bond (3 Years)



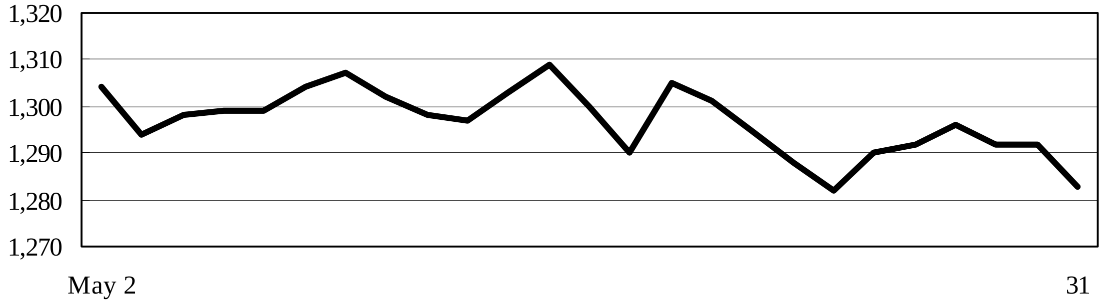
5) Call Rate (1 Day)



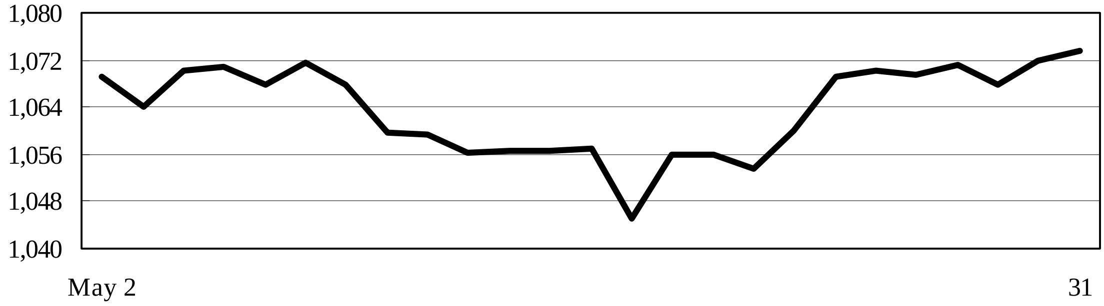
6) Yields on CD (91 Days)



7) Won/US Dollar



8) Won/100 Japanese Yen



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