

The Banking Industry in the ROK After the Financial and Currency Crises(Summary)

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Although, as with Southeast Asian countries that suffered economic crises, the ROK's economic crisis can be seen as a currency crisis or a foreign currency crisis, this only takes into account economic phenomena that arose at the time from the crisis. In particular, if we analyze the development of the ROK's economic crisis, it seems apparent that the fragile banking system that was distorted by governmental policies was one of the basic factors behind the crisis.

The ROK government regarded structural problems that had accumulated in the ROK's economy as a whole, in particular the fragile banking system, as the basic factors behind the crisis; with the improvement of the soundness of banks a target of the highest priority, the government chose banks as subjects for structural adjustment based on their BIS capital-to-asset ratio and took steps aimed at the structural adjustment of banks by such means as withdrawal, mergers, sales of foreign holdings, and the introduction of foreign capital. Such structural adjustment

of banks is unusual in that it was carried out at the initiative of the government, by means of the investment of large amounts of public money; moreover, although the various merger methods differed, what they all have in common is that the mergers were carried out with the aim of restoring the security and improving the soundness of banks.

The effects leading to an improvement in the operation of the restructured banks and problem areas can be summarized as follows:

Firstly, the BIS capital-to-asset ratio, which is used to judge banks' capital soundness, of all banks exceeds the international standard of 8%; in particular, that of banks that have been merged by means of P&A has improved considerably in comparison with the situation before the structural adjustments, exceeding 10%. Accordingly, looking at such BIS ratio improvements, it can be said that the capital soundness of merged banks has improved considerably.

Secondly, other than in the cases of a few banks, the

non-performing loans ratio, which is used to judge asset soundness, can also be seen to have improved compared with the situation before the structural adjustments. However, the main reasons why the rate of improvement is low despite the purchase of bad loans on a large scale via the KAMCO (Korea Asset Management Corporation) seem to be that credit to insolvent enterprises was concentrated in the hands of merged banks, and also that the rules regarding the classification of non-performing loans ratio have been tightened. In the future, there is a distinct possibility that, if the rules for calculating non-performing loans ratio are further tightened by means of the application of FLC (Forward Looking Criteria), which is a standard for the classification of the soundness of new assets, asset soundness will decline further.

Thirdly, other than in the cases of a few banks, the ROA/ROE, which are used to judge banks' profitability, have improved overall in comparison with the situation before the mergers, and the profitability index seems to be stabilizing. This corresponds with the shift to current net income, and can be understood to mean that the operations of banks have stabilized to some extent.

There are differences in the extent of the above, but seen in terms of financial data, the ROK's banks can be said to have achieved the improvement in their soundness that was their original aim.

While the ROK government began revising the classification system for assessing asset soundness and strengthening the rules for bad loans in July 1998, it also introduced FLC, which reflect potential problematic factors that could arise in the future, and began implementing this in December 1999. Furthermore, in late 2000, it introduced and implemented a new BIS equity capital regulatory system that takes all risks into consideration, from credit to

market risks.

With regard to the introduction of the new BIS equity fund regulations and the FLC system, ROK banks will have to deal with the following issues in the future:

Firstly, it is necessary to change the supplementary capital that makes up equity capital into short-term asset. Under the new BIS equity capital regulations, as short-term lower-ranked bonds with a maturity date more than two years hence are permitted as supplementary capital, it is necessary quickly to reimburse high-interest lower-ranked bonds with a maturity date more than five years hence, increase the weighting of supplementary capital that can be issued at lower interest rates, and reduce the borrowing cost of supplementary capital.

Secondly, it is necessary further to increase the ability to assess trustworthiness. Arrears periods and the advisability of nonpayment are included in the FLC introduced by the Financial Supervisory Service, so banks will have to consider these factors and classify assets; to this end, an evaluation of trustworthiness based on a model for assessing this will be essential. Accordingly, it will be necessary for banks to move away from the credit practices employed hitherto, i.e. practices that focused on collateral and large businesses, and implement credit by means of a rational system for evaluating trustworthiness.

Thirdly, it is necessary further to increase asset soundness. Until now, ROK banks have been able to improve their asset soundness by purchasing bad loans bonds via the KAMCO. However, the newly-introduced BIS equity fund regulations and the FLC system have strengthened classification standards, so it is necessary for ROK banks to respond to these changes and increase asset soundness.