

for creditor financial institutions to work together. In April 2002, the Banking Act was revised to relax restrictions placed on bank ownership.

As is evidenced by the above-noted changes in the ROK financial system since the 1997 financial crisis, the GOK has taken many steps to reform the financial system in the ROK, steps for which the GOK has been widely praised. However, despite the changes noted above, events in the ROK financial system have led the GOK to continue its involvement there. Specifically, in the aftermath of the financial crisis, many corporations have suffered from liquidity problems, especially as loans and other debt incurred during or after the financial crisis have begun to mature. These financial problems in the corporate sector necessarily have had a great impact on the creditors holding the outstanding liabilities of these corporations. Because many banks have suffered their own liquidity crises in light of the troubles in the corporate sector due to their debt holdings in these troubled companies, record evidence indicates that the GOK has inevitably had to stay closely involved in the financial system in order to ensure stability while corporate restructuring continues, and that the GOK's role exceeded the understandable function of financial supervision.

For example, record evidence indicates that the GOK had to inject trillions of won into ROK banks to keep them solvent following the financial crisis. According to an August 2001 Bank for International Settlements paper, this type of support was "inevitable and necessary in order to ensure the soundness of the financial system and to prevent systematic risk in the process of financial sector restructuring." As a result of these recapitalizations, many commercial banks have been nationalized by the GOK, and the GOK has become (and continued to be throughout the POI) the majority owner of several of the large ROK commercial banks, including Seoul Bank, the banks under the Woori Financial Holding Company umbrella (including Peace, Kwangju, and Kyongnam banks), Woori Bank (formerly Hanvit Bank), and Cho Hung Bank (although we note that there is conflicting information on the record with respect to bank ownership by the GOK during the POI). Moreover, in 2001, the BOK increased the aggregate credit ceiling in order to provide more funds to financial institutions to encourage the financial institutions to provide loans to the corporate sector. In doing so, the BOK also adjusted the

method of allocation in such a way as to supply more aggregate credit at low interest rates to financial institutions that expanded corporate lending.

While we do not contend that the GOK's ownership of ROK banks is by itself dispositive of the GOK's involvement in the banks' lending decisions, banks that are owned, in whole or in part, by the GOK are subject to the influence of their majority or minority shareholders. This point was made, for example, by a Morgan Stanley executive director and ROK chief, who stated in a September 2001 *Asiamoney* article regarding ongoing discussions relating to a potential debt-for-equity swap involving Hynix and its creditors (which eventually took place in Hynix's October 2001 restructuring) that "if creditor banks go down that road, there would be speculation that the decision was made in conjunction with the government." He continued, "{a}lthough Hynix argues that the creditors arrived at their decision {to participate in the debt-to-equity conversion} purely on economic grounds, the fact that most of them are state-owned does infer government intervention." Thus, the GOK's ownership position in certain banks indicates that the GOK does have an impact on lending decisions of certain government-owned banks.

Along with its increased ownership in the banks, the GOK's dual role as owner and regulator can also be seen as evidence of the GOK's influence over bank lending decisions. For instance, in July 2001 articles in the *International Herald Tribune* and the *New York Times*, Stanley Fischer, an IMF official who was an architect of the IMF's restructuring plan in the ROK, was quoted as saying that the GOK needed to get itself out of the financial sector and should stop supporting failing banks and corporations. With regard to the GOK, he stated that "they have got to get themselves out of the financial sector" and that "{t}here is a conflict of interest between the government as an owner and the government as a supervisor." This view was also reflected in the August 2, 2001 IMF Public Information Notice (No. 01/79), which is included as an appendix to the *Direction Citations Memo* on file in the Department's CRU. In the notice, which was prepared as part of the IMF's post-crisis monitoring program, IMF directors expressed concern that "the role of the government as part-owner and supervisor of financial institutions, coupled with a significant role as guarantor of corporate debt, would hinder the pace of restructuring and risk impeding the development of a sound

commercial banking system and a thriving capital market." There is also evidence on the record that the GOK has given authoritative instructions to financial institutions, including those involved in supporting Hynix. According to a November 2001 paper prepared by a World Bank employee, "press reports that the {Financial Supervisory Service ("FSS")} (the FSC's enforcement body)) had instructed creditor banks to classify Hynix loans as normal further highlight the conflicts of interest that can arise when a financial supervisor is tasked with managing corporate/financial sector restructuring in a systemic crisis." The same World Bank report states that "it is reported in the press that the FSS—in contravention of its duty to safeguard the soundness of {the ROK's} financial sector—has been pressuring financial institutions to extend credits to distressed companies as promised in {out-of-court} workout {Memoranda of Understanding ("MOU")}."

Additional information on the record suggests that the corporate restructuring mechanism for distressed firms in the ROK would continue to require additional reforms to ensure that corporate workouts are conducted on commercial terms and without government intervention. In particular, the IMF took issue with the ROK's record with "out-of-court" workouts, suggesting that greater reliance should be put on court-supervised insolvency in order to accelerate the restructuring of distressed companies, and stressing the need for additional insolvency reform. In this context, the IMF directors "urged the authorities to refrain from pushing creditors into bailing out troubled companies * * *." See February 1, 2001 IMF Public Information Notice (No. 01/8), which is included as an appendix to the *Direction Citations Memo* on file in the Department's CRU. The directors noted that some government intervention in the financial markets may have been justified as long as these measures were transitory, kept distortions to a minimum, were limited to viable firms with temporary problems, and avoided the perception that some companies are "too big too fail." *Id.* The Directors concluded that the basic restructuring framework was largely in place, but that it was now critical "for the government to step back from intervening in the operation of markets and economic decision making, and instead rely in the future on markets in imposing discipline." *Id.*

Even a year later, the IMF directors found that, while some progress in corporate restructuring had been made,