

the corporate sector remained "beleaguered" by the continued operation of loss-making companies. In particular, the directors "stressed that the orderly exit of nonviable companies should be accelerated, and that state-owned banks, in particular, need to accept reductions on their claims, including by allowing a company to be liquidated if losses become unmanageable." See February 12, 2002 IMF Public Information Notice (No. 02/09), which is included as an appendix to the *Direction Citations Memo* on file in the Department's CRU.

The GOK has claimed that the GOK-owned banks make their lending and credit decisions based on commercial criteria. However, there is information on the record indicating that the GOK continues to direct, and otherwise apply pressure to, certain ROK lenders with regard to their lending and credit decisions. Specifically, there are numerous reports on the record that indicate that the GOK was involved in certain bank lending and credit decisions during the POI to ensure that debt-ridden companies, particularly Hynix and other current or former Hyundai Group affiliates, would have access to financing or other funds provided by the banks.

For example, in September 2002, an ROK National Assembly member chastised the GOK in a press statement for compelling financial institutions to support the Hyundai Group and Hynix since the beginning of Hyundai's liquidity crisis in mid-2000. The report stated "{f}or two years following the outbreak of liquidity crisis in the Hyundai Group, the government of Dae-Joong Kim has provided astronomical sums of special support to the Hyundai Group, amounting to a total of 33.6 trillion won by mobilizing the resources of financial and government-run institutions."

A January 2001 *Wall Street Journal* article states that ROK banks have "been more accustomed to following government orders than making sound credit decisions." It further states that, when KFB (a bank that is 51 percent foreign-owned) refused to participate in a GOK debt restructuring program (that was focused primarily on Hyundai Group companies) at the request of the FSS, the FSS applied pressure to KFB and "strongly urged" KFB to participate in the plan lest it risk losing some of its clients. Commenting on this, an executive at a GOK-owned bank said that the nationalized banks were "green with envy," as "nobody wants to increase their exposure to these corporations that still have a long way to get their acts together." The article

states that the FSS asked creditor banks to participate in this program, and only KFB refused.

An April 2001 *Korea Herald* article notes that the FSS threatened to fine Hana Bank if it failed to provide emergency liquidity to Hyundai Petrochemical, which was a part of the Hyundai Group that was going through the corporate workout process. In a June 2001 *Dow Jones International* news article, it was reported that KorAm Bank reversed its decision not to participate in the Hynix June 2001 convertible bond offering after the FSS warned of a possible sanction against KorAm if it did not participate. In February 2001, the managing director at UBS Warburg in Seoul stated that "the impression that we get is that while the government claims {the banks} are totally independent, behind-the-scenes pressure is being applied so that they lend to certain entities." In July 2001, with regard to corporate restructuring packages, an official at the MOFE stated that "we've decided to force all creditor financial institutions {both local and foreign} to take part in {creditor} meetings in order to prevent some of them from refusing to attend and pursuing their own interests by taking advantage of bailout programs."

According to a July 2002 *Institutional Investor International* article, "{among the biggest concerns is the true extent of banking independence. Yes, there are plenty of signs that this autonomy holds sway—notably, KFB's stance toward the *chaebol*." The article continues, stating that although GOK officials state that there is no government pressure at all, not everyone is convinced. "The government has changed its policies quite a bit, but it still may assert influence," said a Credit Suisse First Boston ("CSFB") senior economist in Hong Kong. "Nobody can rule out intervention." According to a March 2002 *New York Times* article, "{m}any analysts say that privatization is needed to foster management independence and lending discipline. 'There's a suspicion that the government mucks around with the banks,'" said an analyst at the IMF. With one-quarter of Korean companies losing money, he said, banks often face political pressure to keep them on life support." Finally, an April 2001 *Korea Times* article notes: "{W}hether the Kim administration likes it or not, the Korean banks are now under tight state control. The government jawboned banks to bail out insolvent firms, including Hyundai Engineering and Construction ({'HEC'}). The independence of the central bank was compromised, as the {BOK} must get

approval for its budget from the {MOFE}."

(For a more detailed list of record information on the issue of direction, see *Direction Citations Memo*, noted above, which is on file in the Department's CRU.)

Moreover, although the GOK states that it has taken affirmative measures, such as the *Prime Minister's Decree*, to ensure that government officials at financial supervisory organizations do not interfere in the operations of commercial and specialized banks, record evidence indicates that GOK interference has continued, in some instances, and that the *de jure* measures contain sufficient ambiguities which would allow the GOK to become involved in the banking system. For instance, the *Prime Minister's Decree* at Article 5 states that the financial supervisory agencies can request cooperation from financial institutions for the purpose of the stability of the financial market, or to attain the goals of financial policies. As noted above, the financial system in the ROK has been going through a crisis that could be the type of situation in which this exception would be applied. A further exception that would allow GOK influence over the banks is included in Article 6 of the *Prime Minister's Decree*. Article 6 states that "the Minister of MOFE and KDIC shall, *unless they exercise their rights as shareholders of any of the Financial Institutions*, procure that the Financial institution, which was invested by the {GOK} or KDIC, can be operated independently under the direction of the Board of Directors thereof" (emphasis added). As noted above, because the GOK is part-owner in many commercial banks, an exercise of its shareholder rights could allow the GOK an opportunity to become involved in the operations of the banks.

Finally, Article 17 of the Public Fund Oversight Special Act stipulates that when the GOK provides public funds to a financial institution (such as the recapitalization of a bank as occurred several times during this period), the GOK will enter into an MOU which will set financial soundness, profitability, and asset quality targets, and will consist of a detailed implementation plan for implementation of these targets. Pursuant to Article 14, the GOK will review the implementation of this plan on a quarterly basis. The GOK in this manner can be directly involved in the fiscal operations of the bank.

Thus, although record evidence does indicate that the GOK's financial system reforms have been positive and are beginning to take hold, evidence on the