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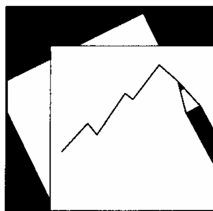

IMF Working Paper

From the Front Lines at Seoul Bank: Restructuring and Reprivatization

Chungwon Kang

INTERNATIONAL MONETARY FUND

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IMF Working Paper

Asia and Pacific Department

From the Front Lines at Seoul Bank: Restructuring and Reprivatization

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Authorized for distribution by David T. Coe

December 2003

Abstract

This Working Paper should not be reported as representing the views of the IMF.
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Soon after Korea agreed to an IMF-supported program, Seoul Bank and Korea First Bank were nationalized through an injection of public funds by the government. The two banks were singled out early in the IMF-supported program to be sold to foreign investors. Korea First Bank was sold to foreign investors at the end of 1999. Seoul Bank, however, remained a government-owned bank, managed by a team of professionals recruited from outside of the traditional banking sector. This paper describes the restructuring of Seoul Bank by the new management team between June 2000 and October 2002, when the bank was sold to Hana Bank in a merger transaction.

JEL Classification Numbers: G21, N25

Keywords: Korea, bank restructuring

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[1] I am indebted to David T. Coe, Paul Gruenwald, and Peter Hayward of the IMF; to Dong-Won Kim of *Maeil Business Newspaper* for encouragement and useful comments; and to Maryse Dubé for assistance. I am also thankful to the Asia and Pacific Department and the Monetary and Financial Policy Department for inviting me to visit the IMF in early 2003 to write this paper.

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I. Introduction

This paper is a personal account of a banker who was given the rare opportunity to apply his knowledge of western banking and management practices to a distressed Korean commercial bank. Before joining Seoul Bank, I had worked at major international banks for two decades, mostly in Seoul—five years at Citibank, 15 years at Bankers Trust Company, and one year at Deutsche Bank after its acquisition of Bankers Trust in June 1999. Early in the 1997–98 financial crisis, the Korean government recapitalized Seoul Bank, effectively nationalizing it. Following several unsuccessful attempts to sell or transfer management responsibilities for Seoul Bank, the government appointed me CEO on May 24, 2000. I became the first professional banker from a non-Korean bank to assume leadership of a Korean bank. My mission was to fix the bank and prepare it for reprivatization.

Two and a half years later, on November 1, 2002, I left Seoul Bank after signing a merger agreement with the Korea Deposit Insurance Corporation (KDIC) and Hana Bank, which bought 100 percent of the shares of Seoul Bank, at terms satisfactory to KDIC, the government shareholder. I was pleased that the fruits of Seoul Bank's two-year restructuring efforts attracted enough commercial interest that the government could finally negotiate the terms of sale from a position of strength. This was accomplished more or less within the time frame that I had set when I assumed the position. And I was grateful to the management team I had assembled at Seoul Bank and to the members of Seoul Bank's Board of Directors for sharing with me the sense of mission throughout the bumpy ride; and to those Seoul Bank employees and government officials who had trusted in my professional judgment and common sense, and persevered with me to the end.

To write about my Seoul Bank experience during a visit to the IMF in early 2003 seems a fitting end to that experience, partly because I took the job with a sense of public service. I am thankful to the IMF's Asia and Pacific Department and Monetary and Financial Systems Department, not only for this opportunity to record my experience but also for the keen interest Fund staff took in Seoul Bank's progress during my tenure. The continuing interest in the bank by the IMF Resident Representative office in Seoul and Fund missions to Korea was a source of significant encouragement to the management team at Seoul Bank, particularly in the early stage of our efforts.

What follows is mainly a record of Seoul Bank's restructuring efforts in the context of the Korean government's financial sector restructuring program, which was supported by the IMF after the 1997–98 crisis. I hope that this account of how a particular bank was turned around will be useful to policymakers and practitioners struggling to fix distressed banks in crisis situations.

II. Background

To understand the challenge of restructuring Seoul Bank, it is important to know some of the history of Seoul Bank and the previous attempts to deal with Seoul Bank's problems.

A. Seoul Bank Before the Crisis

In 1959, local entrepreneurs established the Bank of Seoul as a regional bank. Following a merger with Korea Trust Bank in 1976—the first bank merger in Korea—the new Bank of Seoul and Trust Company grew to become one of the largest commercial banks in terms of asset size by the late 1980s. However, the merger also left a lasting scar on the bank as cloak-and-dagger rivalry between the two factions continued well into the mid-1990s, disrupting management coherence and distracting employees from their work. The bank's name was changed to Seoul Bank in 1995, the year the bank recorded a small net income before sinking into a financial quagmire.[2]

Seoul Bank's financial problems surfaced in 1996 with the bankruptcies of several second tier business groups, for which Seoul Bank was the main creditor bank. At the end of 1996, Seoul Bank's stated nonperforming assets amounted to 9 percent of total assets, and it recorded a W 167 billion loss for the year.[3] In November 1996, the CEO of Seoul Bank was arrested on bribery charges and the managing director was appointed interim CEO. The fall of Daenong group in May 1997 further squeezed the bank. After nine months with an interim management team, the government appointed a former Deputy Superintendent of Banks as the new CEO in August 1997. The bank closed the year with a W 917 billion net loss.

In the second half of 1998, two large construction Companies—Dong-Ah Construction and Woobang Construction—were put into "voluntary" work-out programs in the context of the government's corporate restructuring program. Seoul Bank was the main creditor bank for both, with exposures amounting to W 984 billion and W 171 billion, respectively, at the end of 1998, and only puny reserves set aside for both exposures. In August 1999, 12 Daewoo Group companies were also put into "voluntary" work-out programs. The bank's net loss swelled to W 2.2 trillion in 1998 and stayed at that level in 1999 as charges related to nonperforming loans (NPLs) mounted. Accumulated losses from 1996 to the end of 1999 were W 5.5 trillion.

Seoul Bank's NPL-related charges in 1998–99 totaled W 4.7 trillion: W 3.4 trillion for higher provisioning requirements from more strict standards for loan classifications, including the introduction of forward-looking criteria in 1999 (W 1.7 trillion) and from new bankruptcies (W 1.7 trillion); and W 1.3 trillion loss from sales of under-reserved NPLs to Korea Asset Management Company (KAMCO). Two recapitalizations by the government in January 1998 and September 1999, totaling W 4.8 trillion, covered reserve shortfalls and losses from NPL sales.

Seoul Bank's failure may be traced to the accumulated damages from:

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[2] A historical summary of Seoul Bank's financials and overall size is presented in the attached table.

[3] This was not based on the forward-looking criteria (FLC) introduced after the crisis.

- Structurally weak management from two decades of factional in-fighting;
- The tradition in Korean banking that emphasized the role of banks as providers of credit for industrial development, which resulted in banks with weak commercial orientation and limited risk management discipline for self protection; and
- Generally lax prudential regulations. For example, the Bank of Korea's Bank Supervision Office had general supervisory authority, but the legal lending limit for single obligor did not apply to banks' lending through Trust Accounts, which were supervised by the Ministry of Finance.
- The absence of a governance structure for banking, except for the role of the government as supervisor, regulator, and policymaker. The government's ability to exercise control of the banking industry, including the ability to appoint bank CEO's, was facilitated by the Banking Law, which prevented controlling ownership by limiting single-investor ownership in banks to 4 percent.

Given the environment in which it operated, Seoul Bank was a not-so-innocent victim of unfortunate circumstances.

B. Seoul Bank in the IMF-Supported Program

Seoul Bank was singled out from the very beginning of Korea's IMF-supported program as one of the two most distressed nationwide commercial banks that needed to be nationalized first and then sold. In the addendum to the letter of intent (LOI) dated December 24, 1997, the Korean government committed to place Seoul Bank and Korea First Bank (KFB) under intensive supervision by the Bank Supervision Office, and to assume control of both banks and remove management responsible for losses by February 25, 1998.[4]

Both banks were nationalized through a mandatory reduction of capital and subsequent government recapitalization in January 1998. After an 8 to 1 reverse stock split, KDIC and the Ministry of Finance and Economy (MOFE) injected W 750 billion each, for a total of W 1.5 trillion, to each of the two banks, resulting in 93.4 percent government ownership.

The first quarterly review of the program in February 1998 noted the following agreement between the Korean government and the IMF with respect to the two banks: "to appoint a lead manager/advisor to develop privatization strategy for the two banks by March 31 and to

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[4] For a comprehensive background discussion on the causes of the financial crisis in Korea crisis and the subsequent recovery, see Ajai Chopra and others (2002), "From Crisis to Recovery in Korea: Strategy, Achievements, and Lessons," in David T. Coe and Se-Jik Kim, eds., *Korean Crisis and Recovery*, (Washington, D.C.: IMF; Seoul, Korea: KIEP). The LOIs are available on www.mofe.go.kr and www.imf.org.

obtain bids for both banks by November 15, 1998, coinciding with the seventh drawdown date of the IMF facility and the Fourth Quarter Review date." In almost all subsequent quarterly reviews, the IMF and the government would address the timing issue regarding the reprivatization of the two banks, almost always setting a very tight deadline.

In May 1998, Morgan Stanley was appointed as lead manager/advisor for the privatization of both banks. KDIC and Newbridge Consortium signed a terms of investment agreement in September 1999 and the transaction was closed in December 1999. This was, in substance, a 51:49 joint-venture transaction with full management control of KFB given to Newbridge. KDIC, the government partner, provided full protection against the old loan portfolio of the bank—often referred to as a "put-back option"—for a maximum of three years. A new CEO for KFB—the first foreign CEO of a Korean bank—was appointed in January 2000. Coming two years after the nationalization of KFB, this was a relatively quick sale that required the government to protect Newbridge against the uncertain quality of the old portfolio.

In contrast, negotiations with HSBC for Seoul Bank, which started in February 1999, officially broke down in early September 1999, reportedly due to HSBC's insistence on taking much more than a 51 percent share in the bank and unbridgeable differences in the valuation and classifications of Seoul Bank's loan portfolio. In late September, the government injected a second round of new capital into the bank to fill the hole that had grown much larger since the initial recapitalization one and a half years earlier. With this second recapitalization, and in the absence of interested buyers capable of meeting the government's minimum requirements, Seoul Bank, by default, drifted slowly into a fix and sell mode.

In April 2000, Deutsche Bank was appointed as financial and restructuring advisor for Seoul Bank, and in May a new CEO was appointed. In the combined seventh and eighth reviews on July 12, 2000, which were the final reviews of Korea's IMF-supported program, the Korean government defined the role of the new management as follows: "The new management of Seoul Bank, on the basis of the review currently being conducted by Deutsche Bank, will prepare the bank for privatization." In the same review, the government also assured the IMF that: "While under government ownership, banks will be operated on a fully commercial basis and the government will not be involved in the day-to-day management."

However, as illustrated below, the trappings that came with government ownership did not allow the management to operate the bank on a fully commercial basis.

C. Seoul Bank in the Context of Banking Sector Restructuring

With the inauguration of the new President in late February 1998, the government's message to the weakened commercial banks was loud and clear: in order to receive government help and survive, they either had to raise new capital or merge, while undertaking serious internal restructuring. Based on the fifth LOI dated February 7, twelve banks not meeting the 8 percent BIS capital adequacy ratio at the end of 1997 were asked to submit management improvement plans, including capital raising plans, by the end of April. Following a review by an independent management evaluation committee, the newly created Financial

Supervisory Commission (FSC) closed five regional banks at the end of June by transferring their assets and liabilities to stronger banks in a purchase and assumption transaction (P&A). These were the first bank closures in the country's history. Subsequently, there were four merger announcements and one FSC-ordered merger by February 1999. The largest merger during this period was between Hanil Bank and the Commercial Bank of Korea. KDIC injected W 3.3 trillion into the two banks in September 1998, and the merger was completed in January 1999, creating Hanvit Bank. This first stage of banking sector restructuring saw five bank closures and five bank mergers.

By early 1999, the Korean government had become a major shareholder of five nationwide commercial banks—Seoul Bank, KFB, Chohung Bank, Hanvit Bank, and Korea Exchange Bank. Seoul Bank and KFB, in agreement with the IMF, were on a separate track for an early sale to foreign investors. Of the three remaining banks, Hanvit Bank's new CEO, from Koram Bank, struggled during most of 1999 with integration issues; Chohung Bank's management was allowed to stay on and acquired two regional banks during the first stage of banking sector restructuring; and Korea Exchange Bank, which raised new capital of W 350 billion from Commerz Bank in July 1998, received matching support from the government in November, but struggled with its large exposures to the Hyundai Group.

In late August 2000, the FSC launched a second stage of banking sector restructuring by instructing six banks to submit management improvement plans by the end of September. The six banks were Hanvit, Chohung Bank, Korea Exchange Bank, Peace Bank, Kwangju Bank, and Cheju Bank. These banks either had less than the 8 percent BIS capital adequacy ratio as of June 30, 2000, or had received public funds but were still considered weak. The majority of KFB had already been reprivatized, and Seoul Bank was exempted from this process because of the ongoing Deutsche Bank restructuring advisory process and in view of the rehabilitation plan being drawn up by the two-month-old management team. However, some time before October 2000 when the Financial Holding Company Act was legislated, Seoul Bank's journey on a separate track started to be challenged in the context of Korea's "graduation" from the IMF program with the early repayment of IMF loans in July 2000; growing criticism of the government for having sold KFB too cheaply to foreign investors; continuing pressure to consolidate banks; and the resulting new question: "Is Seoul Bank big enough to survive, even when it is sold?" Rumors that Seoul Bank might be put into a bank holding company started to circulate.

The review of the six banks' management improvement plans was completed in October. In early November, the FSC announced that Hanvit Bank, Peace Bank, Kwangju Bank, and Cheju Bank were nonviable without an additional injection of public funds. KDIC conducted a separate financial due diligence on Seoul Bank based on the end-September balance sheet to determine the amount of recapitalization necessary. Gyungnam Bank was also determined nonviable in an FSS inspection in late November. All six banks were determined insolvent as

of end of September 2000 and KDIC injected a total of W 4.1 trillion at the end of 2000 to raise their BIS capital adequacy ratios to 10 percent, following a complete reduction of capital for each bank.

Table 1. Recapitalization of Korean Banks–December 2000
(In billions of won)

	Hanvit	Seoul	Kwangju	Cheju	Peace	Gyungnam	Total
Capital injection	2,764.4	610.8	170.4	53.1	273.0	259.0	4,130.7
Contributions*	1,877.6	221.6	273.1	161.5	338.9	94.0	2,970.3
Total	4,642.0	832.4	443.5	214.6	611.9	353.0	7,101.0

* Contributions covered the deficiency in net worth as of end of September 2000 as well as any stock valuation and trading losses of each bank between end of September and end of November 2000. KDIC issued IOUs for the contribution portion and funded the IOUs in September 2001.This two-step recapitalization was required by the Special Law for Public Funds Management, legislated in December 2000.

Korea Exchange Bank and Chohung Bank, which did not ask for additional public funds in their management improvement plans, were given conditional approvals to pursue their plans.

The government announced in late December that, in conjunction with the upcoming recapitalizations for the six banks, a financial holding company would be established in early 2001, and that Hanvit Bank, Peace Bank, Kwangju Bank, and Gyungnam Bank would be included in it. The four banks became subsidiaries of Woori Finance Holding Company in April 2001.[5] Cheju Bank was put under management supervision of Shinhan Bank until Shinhan Bank created its own holding company.

In the same announcement, the government gave Seoul Bank a six-month window in which to escape inclusion in the financial holding company: if the bank was not sold to foreign investors by end of June 2001, Seoul Bank would be put in the financial holding company. Seoul Bank was coming off its separate track.

[5] The market generally perceived Woori as a vehicle for collecting bad banks. As Seoul Bank had already started its restructuring efforts in June 2000 with a new management, Seoul Bank employees and management viewed inclusion in the holding company as self-defeating. For the employees, it meant heightened job insecurity. For the management, it meant compromised autonomy as it created another layer of management. For the government, the bank holding company was a way to reduce the number of problem banks in what is considered to be an “over-banked” sector, albeit at the cost of increasing the magnitude of the restructuring task.

D. Korean Government Efforts to Deal with Seoul Bank

Up until September 1999, when negotiations with HSBC for the sale of Seoul Bank broke down, the IMF and the Korean government treated both Seoul Bank and Korea First Bank as nonviable banks earmarked for early sale. The government's financial support to keep the two banks afloat was also similar in form and substance:

Table 2. Korean Government Financial Support
(In billions of won)

	Seoul Bank				Korea First Bank			
	Recap.	NPL Purchase	Sub-debt Purchase	Total	Recap.	NPL Purchase	Sub-debt Purchase	Total
1997								
November*		1,383		1,383		1,527		1,527
December			270	270			142	142
1998								
January	1,500			1,500	1,500			1,500
July		499		499		607		607
1999								
July					4,209	897		5,106
September	3,320	1,154		4,474				
Total	4,820	3,036	270	8,126	5,709	3,031	142	8,882

*The November 1997 purchase of NPLs by KAMCO from the two banks represented the first KAMCO purchases from the newly created "Nonperforming Assets Fund."

On December 22, 1997, both Seoul Bank and KFB were placed under prompt corrective action in preparation for recapitalization. Later in December, the government purchased some subordinate debt issued by the two banks to raise the banks' year-end BIS ratios.

The initial W 1.5 trillion recapitalization in January 1998 was made jointly and equally by KDIC (in cash) and MOFE (in shares of government-owned corporations). This was preceded by an 8 to 1 share reduction of existing public shareholders, resulting in post-recapitalization shareholding in each bank of 46.7 percent by KDIC, 46.7 percent by MOFE, and 6.6 percent by the public.

Morgan Stanley, appointed in May 1998 as the government's advisor for privatization strategy and sale of both banks, offered both banks for sale in the same auction process. Only HSBC and the Newbridge Consortium showed interest, but only in KFB. The potential investors considered KFB to have a better branch network, a better corporate client list, and better manpower than Seoul Bank. On December 31, 1998, an MOU was signed with Newbridge for the sale of KFB, and the transaction was closed at the end of December 1999. Newbridge paid about W 500 billion to take a 51 percent share and management control,

while the government kept 49 percent and provided a put-back option for the existing portfolio of KFB. In February 1999, the government signed an MOU with HSBC for the sale of Seoul Bank. However, negotiations with HSBC fell through in August 1999.[6]

Seoul Bank was insolvent again by June 1999. And immediately after the breakdown of discussions with HSBC in August, the government undertook a second round of recapitalization, twice the size of the first one, in September 1999. Following a complete share reduction for public shareholders, KDIC injected W 3.3 trillion in Seoul Bank, resulting in a 93.6 percent ownership. MOFE did not participate in this recapitalization, and its share was diluted to 6.4 percent. The incumbent CEO resigned after the second recapitalization and his deputy was appointed as interim CEO. Not by design, the strategy for Seoul Bank was changing to something like “fix and sell.”

In October, Morgan Stanley started to contact large international banks for interest in a management contract, with a small minority stake in the bank, to operate Seoul Bank. At the same time, Morgan Stanley subcontracted the search for a CEO to an international human resources firm. In the absence of any serious interest, the idea of a management contract was scrapped in January 2000, and the search for a CEO intensified. Also in January, Deutsche Bank began to market the idea of a restructuring advisory for Seoul Bank to the government. Deutsche Bank had already been engaged by the Indonesian government to restructure Bank Mandiri, a government-owned bank created by the merger of four banks. This track record gave credibility to its proposal.

On March 23, 2000, newspapers reported that President Kim had instructed the FSC chairman to achieve a prompt normalization of Seoul Bank. The following day, Seoul Bank’s interim CEO resigned and the next officer in the hierarchy became the interim CEO. Having exhausted most alternatives, and under pressure from the very top to “normalize” the problem of Seoul Bank, the government decided to hire Deutsche Bank as restructuring advisors. On April 16, KDIC and Seoul Bank signed a Financial and Restructuring Advisory Agreement with Deutsche Bank. Deutsche Bank was also mandated to find a new CEO. Deutsche Bank contracted a human resources firm to search and evaluate the candidates. In late May a new CEO was appointed, after an eight-month vacuum in management.

* * *

What emerges from this background is a picture of a bank that had lacked stable management and direction since November 1996. There were three interim CEOs and one regular CEO in the four-and-a-half-year period to May 2000. Interim CEOs are by definition temporary

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[6] For a detailed account of the government’s negotiations with Newbridge and HSBC, see Su-Gil Kim, Jung-Jae Lee, Kyung-Min Chung, Sang-Ryul Lee, “The Vault is Empty: A Documentary of Korean Economy during Five Years of DJ Government,” January 2003, Chung-Ang M&B, pp. 138–147.

caretakers without authority to provide a vision for the bank. Frequent changes at the top exacerbated instability. Since the initial bailout in January 1998, the bank had been completely dependent on the government's continuing financial support for its survival. Indeed, the government's commitment to the survival of Seoul Bank was the only positive attribute of the bank in the market place during this period. And the government shareholder, under pressure from, and in conjunction with the IMF and the World Bank, struggled to find a viable strategy and direction for the bank until the spring of 2000.

During this period of extreme uncertainty and instability, which lasted more than three years, the bank was bound to become alienated and inward-looking:

- The management became alienated from its shareholder government, particularly when the bank was headed by interim CEOs, and perhaps from the employees as well, because of its inability to provide direction.

- The uncertain future and tight conditions in the rehabilitation plans that preceded each recapitalization led to many interim decisions and an extreme cut back on investments, including in people.

- Customers became alienated from the bank due to the deteriorating quality of customer service and frequent postponements in announced target dates for the sale of the bank, for a management contract, and for a new CEO.

- A general feeling of helplessness and neglect prevailed, giving rise to an increasingly active labor union.

III. RESTRUCTURING IN PRACTICE

The restructuring process began with the appointment of the new CEO and the formation of a new management team. The process encompassed all operational aspects of the bank, including relations with its employees and labor union; restructuring its balance sheet, which required a final recapitalization by KDIC in December 2000; and the creation of a new culture and image for the bank. The restructuring process was more or less complete by the middle of 2001 when the last Deutsche Bank credit specialist seconded to the bank left.

A. CEO Selection and Formation of the Management Team

Deutsche Bank initiated the search for a CEO for Seoul Bank in April 2000 through an international human resources firm, which defined the job description and evaluation process. The prospects were not promising. During Morgan Stanley's six-month search for the same position, everyone worth looking at—both Koreans and foreigners—was looked at. A few individuals whom the government wanted were not interested. The government rejected the initial list of candidates interviewed and evaluated by the human resources firm in late April. I volunteered to be included in the second round of interviews in early May. Reportedly, three new candidates were interviewed. Based on the recommendation of the human resources firm, I was selected. This was the first time that a CEO of a government-

owned bank in Korea was selected through a process managed by an international human resources firm.

Although not in writing, I requested from my government counterpart—and was assured of—complete management autonomy, including selection of the new management team, and the prompt injection of the necessary amount of public funds based on Deutsche Bank's financial due diligence on Seoul Bank.

My decision to ask for an interview for the job was based on three considerations:

- I convinced myself that I had the necessary qualifications of management experience and exposure to international best practices in banking, as well as a sense of mission.
- Deutsche Bank had already been engaged as financial and restructuring advisors for Seoul Bank; I knew Deutsche Bank, and knew that I could rely on them for the nuts and bolts of restructuring.
- I was vaguely confident that I could bring together enough professionals with appropriate expertise, background in international best practices, and shared sense of mission into my management team.

I believed that the formation of the management team would be key to successful restructuring. I had learned the importance of having a like-minded and well-qualified management team for successful banking operations in the private sector. The challenge lying ahead required massive and speedy managerial input into every aspect of the bank's existing operations, including building a new culture focused on business and performance. It would be critical to bring in as many professionals with the necessary expertise as possible, and to maintain close and unwavering teamwork.

Having been notified of the government's selection in mid-May, I did not have enough time to lock in anyone before I moved into the bank on June 1. I recruited the first member of my management team from Citibank in mid-June, and during the following six months, one of my main preoccupations was to identify and speak to the candidates.

By early December, we had a professional management team of seven, not only with the necessary skill sets required at the bank but also with enough background and commitment to international best practices: two had over 20 years of experience at Citibank, one American had been a branch manager of First Chicago in Seoul, one had experience both at JP Morgan and at a trading company, one had extensive IT experience at U.S. insurance companies and a large Korean bank, and two had worked in rating agencies. Each additional member was "interviewed" by those who had joined earlier, and only those with unanimous backing were invited to join the team. We shared the goal of fixing the bank together and turning it around quickly, so that privatization could take place as soon as possible. We also shared, at least in the initial stage, the sense that our efforts at Seoul Bank, if successful, would make a meaningful contribution to the government's own efforts in the last phase of banking sector restructuring. This somewhat naïve thought evaporated quite quickly in the face of a seeming

disregard of our efforts in most quarters of the government; but it was not altogether a false thought in hindsight.

The bank was not functionally organized before I joined. About six management team members shared the branch network based on seniority, with good areas or branches going to senior directors. Functional responsibilities were added to such geographic coverage, without much regard for required functional expertise. While such expertise was generally in short supply, the disregard for matching expertise to positions was, at times, extreme.

A week after I moved into the bank, I asked the existing directors to resign, except for one, who was kept for continuity's sake. In addition, I kept the standing auditor, who was also a member of the board and whose two-year term was to expire in March 2001. My first recruit joined in mid-June and we started to share responsibilities. In October, following a 640-person redundancy program, we made two in-house promotions to management positions. By December 2000, management responsibilities were more or less fully and functionally delegated, according to a functional organization chart drawn up with the assistance of Deutsche Bank advisors, to the management team composed of seven from outside and three from inside. The outside management team, however, frequently held separate meetings to discuss restructuring issues and kept much longer work hours.

By early 2001, the employees had generally accepted the new management team's dedication and expertise. Team work matured rapidly in the environment of intense work pressures and was effective, at least in the eyes of the employees used to factional in-fighting at the management level, and management's work hours became more normal.

Restructuring Seoul Bank required more or less a complete overhaul of the bank. In early group meetings with senior managers, I likened the work in front of us to transforming an old vacuum tube radio into a new transistor radio, referring to the need to change the control system, the circuitry, and the look and the size of the radio.

B. Operational Restructuring

As an addendum to the April 2000 Financial and Restructuring Agreement, we signed an Implementation Services Agreement with Deutsche Bank on June 30, 2000. Based on this, about 20 Deutsche Bank commercial bankers with expertise in a variety of areas were mobilized throughout the month of July to camp out in Seoul Bank.

Our operational restructuring efforts were based on Deutsche Bank advisors and their close hand-holding of Seoul Bank staff members assigned to the project teams. The success of their efforts depended on the staff members' enthusiasm to learn quickly the new systems and procedures, and propagate the knowledge to others. The new management team was fully involved in the process and supported the employees with training sessions. Management also kept the board and the shareholder updated on the progress.

The Deutsche Bank advisory group consisted of a small team of investment bankers accountable to Seoul Bank's management for the quality of the restructuring advisory work

and a large team of commercial bankers, headed by a senior banker as overall project manager. We endeavored to assign enthusiastic and smart Seoul Bank employees to the project teams. In mid-July, 13 project teams were launched with one or two Deutsche Bank advisors as project leaders and three to five Seoul Bank staff assigned to each team in the following areas: retail banking and operations, international banking, international trade operations, treasury and market risk management, trust banking, investment trust, securities service (share registrar), credit risk management, accounting and control, audit, compliance, logistics, and information technology.

We removed several items from the original list proposed by Deutsche Bank, such as strategy and branch reorganization, as we thought that we could address the items better by ourselves.

Under the guidance of the project leader, each team reviewed existing procedures and organizations of the assigned department or function, mapped out new procedures and organizational structures, presented recommendations to management, and assisted the executive in charge to implement the recommendations signed off by management. In the process, the project managers worked on a "train the trainer" concept to transfer knowledge to members of the Seoul Bank restructuring team. Most projects were completed by early 2001. The accounting and control project, which included building a system for database management and a system for management information reporting, dragged into May when the implementation service agreement expired.

Credit risk management restructuring implementation was overseen by a team of three Deutsche Bank commercial bank credit specialists seconded to work inside Seoul Bank from July 2000 to July 2001. They provided legitimacy to the many changes made to the infrastructure and the process of credit risk management, and were used as a mechanism to defend the bank against several requests for credit extension under collective arrangements, such as the System of Prompt Underwriting of Corporate Bonds introduced in late 2000 to help Hyundai Group companies.

Until December 2000, the management team met with the Deutsche Bank project team heads every Thursday to update and fine-tune the work in progress. Each Deutsche Bank project team head also had free access to the management team member responsible for the department or function. In 2001, the joint meetings became bi-weekly, with more frequent discussions between the project teams and appropriate management members. Throughout the process, periodic updates were presented to the board and the shareholder on the progress being made in operational restructuring.

By early 2001, we completed implementation of the following key concepts of international best practice in banking:

- Created a functional organization structure, consisting of three business divisions of retail banking, corporate banking, and trust business; and five support divisions of planning, operations, accounting, credit, and information technology;

- Created an independent and consolidated credit department;
- Segregated the duties between front office and back office;
- Established specialized business lines, separating retail from corporate banking business;
- Overhauled the system of branch banking by segregating front-office and back-office functions in each branch, and appointing one group of officers for corporate banking and one for retail banking business;
- Instituted process mapping and manualization of operational functions for controlled back-office operations;
- Introduced an audit system based on systems and procedures; and
- Created a management information system and strengthened the risk management system.

C. Seoul Bank Employees

Subsequent to the first government recapitalization in January 1998, the bank undertook several self-help measures. These included the sale of its training center, cutting the number of overseas branches from eight to four in 1998, and a massive redundancy program that reduced the workforce by some 35 percent from 7,500 to 4,800 by the end of 1998. The average headcount reduction among Korean commercial banks in 1998 was 34 percent.

In June 2000, the total headcount of the bank was 4,643, of which about 80 percent were union members. The bank had an effectively closed union shop, and employees in grades 4 and below (those without authorized signing power) all belonged to the union, except for a few in sensitive positions such as the CEO’s office and the human resources and planning departments. The leader of Seoul Bank’s union was a key member of the Korean Federation of Financial Unions, whose influence grew during the crisis. It was obvious that we had to deal with this internal political force in order to effect change quickly.

In spite of the significant headcount reduction in 1998, the bank’s ratio of loans (or assets) per employee was among the lowest in the industry, as the asset size of the bank had shrunk more than 40 percent, from W 40.9 trillion at the end of 1997 to W 24.2 trillion at the end of June 2000. There were internal talks about the bank being too top-heavy and a further reduction in headcount seemed generally expected. The questions were how many, who, when, and how. Answers to these questions were all subject to negotiations with the labor union.

At the first meeting with the union leader during my first few days in office, we agreed on the urgent need for a drastic change. This meeting of the minds was quite encouraging.

However, the Federation of Financial Unions was organizing a general strike and a rally for July 11. The Federation's agenda was to seek a guarantee of stable employment, to stop government intervention in bank management, and to oppose the government's plan to form a financial holding company. To my surprise, Seoul Bank's union decided to participate in the strike, albeit with the assurance that the union would cooperate so that all of our branches would remain open and running during the strike. I could not understand how the labor union of a bank that was practically bedridden, despite two heavy shots of government recapitalization and a new CEO, and was making a last desperate effort to stand up, could join a street protest against the government and still expect customers to use the bank. The government and supervisors, on the other hand, were not surprised that Seoul Bank's union, which had earned a reputation as being very active, was participating.

Almost all commercial banks joined the strike on July 11, with banks having public funds and facing the possibility of being put into the financial holding company taking particularly active roles. The strike was over by the end of the day; the Seoul Bank union was one of the last unions to withdraw. This was a very frustrating moment for the new management. A few days later, we assembled senior managers in the Seoul area and I gave a "show-me-your-will-to-live" speech: the new management team was prepared to operate on the bank—a sick patient—but would not start the operation until the patient demonstrated a will to live. It was a very awkward meeting; I just had to shock them back to reality. They did not know what was expected of them and I did not know what to expect. The next day, the union leader came by to confirm his support for the new management's restructuring efforts, and we agreed in principle to implement an early retirement program (ERP) as soon as possible.

Table 3. Seoul Bank: Early Retirement Program, September 2000
(Number of employees)

	Grade 1	Grade 2	Grade 3	Grade 4	Clerical	Others	Total
Pre-ERP	32	172	440	1,821	2,082	80	4,627
Number of reduction	30	78	135	345	56	1	645
Post-ERP	2	94	305	1,476	2,026	79	3,982
Reduction ratio (in percent)	94	45	31	19	3	1	14

The ERP included an informal arrangement in which all employees born in or before 1948—most of the head office general managers and regional managers—would take the redundancy package, which averaged about 15 additional months pay. Cruel as it seemed, this was accepted as a practical way of avoiding the difficult process of selecting who was to stay and who was to leave among the most senior employees—most grade-one and quite a few grade-two officers. The program was completed in late September, preceded by a massive personnel change throughout the organization. Some 80 percent of the department heads left through the program and were replaced by younger grade-two or grade-three officers; 275 of 290 branch managers were replaced.

Toward the end of September, a training center in the head office building was completed, a project started in late July. Conveniently located on the second floor, the training center had a capacity for 340 people in eight rooms. It also had a mock branch layout for customer service training. With the new training center and the completion of the redundancy program, we were set to train staff. Initially, the training center offered a mandatory class in basic English for all head office department heads (as the bank was then supposed to be sold to foreign investors), and a four-hour class in international best practices, a program developed and tailored to Seoul Bank's needs by a professional corporate-culture building firm. The program was essentially an initiation course in market-orientation, highlighting the relationships among shareholders, management, employees, and customers—the key message being that the bank owed its existence to the shareholders and depended on customers for business and growth—and providing examples of international best practice organizations and behaviors that we needed to embrace going forward. In a room large enough to hold about 100 people, we started with the management team and head office department heads and then ran the program for the remaining work force, including security guards. In all, 40 sessions were held between October and early November. As a result, international best practice, or IBP, became a common phrase of substance among Seoul Bank employees.

D. Balance Sheet Restructuring

The speedy and thorough clean up of NPLs and minimization of market risks on the bank's balance sheet were top priorities for the management team, particularly the chief credit office and the chief financial officer. The bank had the highest NPL ratio among banks at the end of June 2000—20 percent—and insufficient reserves. To regain credibility in the market and earn customer confidence, we had to clean up the balance sheet quickly. This priority was also dictated by the need for additional and final recapitalization by the government, for which management had to prepare. After instructing to liquidate immediately W 50 billion worth of Korean stock in the trading portfolio in late June, it became my weekly routine for the remainder of 2000 to press the chief credit officer and the chief financial officer for speedy disposition of impaired assets, for strict loan classifications, and for provisioning of adequate reserves. During the second half of 2000, we charged close to W 1 trillion to credit reserves. The credit reserve balance for the whole year 2000 was W 1.4 trillion, enough to write off most of the bad assets in 2001. The July 2000 LOI with the IMF, which included termination of forbearance regarding loan loss reserves related to "voluntary" workout credits by December 31, 2000, also helped this process. By allowing a below-market rate of provisioning for workout credits—between 2 and 20 percent regardless of the true credit risk—the forbearance had encouraged banks to put bad companies into workout programs. As this forbearance was lifted, we began to reclassify workout credits and charge appropriate reserve amounts for the 2000 year-end book closing.

The first sale of impaired assets consisted of foreign currency loans and securities for non-Korean obligors. Through secondary-market brokers, an exposure of US$128 million to obligors in eight different countries was disposed starting in October, leaving US$104 million exposure in three countries, mostly Yen exposure to Korean-Japanese businesses in

Japan, with a 56 percent provision, by the end of 2000. In addition, US$128 million of securities issued by Korean companies was sold or redeemed during the second half of 2000, with the remaining balance in this portfolio category valued at US$52 million at the end of 2000.

In June 2000, Seoul Bank was a main bank for, and had exposure to, five companies in "voluntary" workout programs. These companies had been put into the programs between 1998 and early 1999. Creditor institutions followed a 75 percent consent rule regarding proposals by and for these companies. The lead bank for each company was expected to take a leading role within each creditor committee. Seoul Bank's total exposure to the five companies amounted to W 705 billion, against which W 241 billion was provisioned at the end of 1999. Dong-Ah Construction, which was managing the last phase of the Great Man Made River project in Lybia, and Woobang Construction, which was the major surviving company in the Daegu area, were the two largest exposures among the five. No companies had been let go by bank creditors since the inception of the workout program.

Woobang Construction had total borrowings of W 1.2 trillion in June 2000. Seoul Bank was owed W 181 billion, and had a 26 percent voting share among bank creditors. Woobang suffered severe cash flow problems in late June, and in early July it requested new loans of W 155 billion from creditor banks. The bank creditor group decided to make a partial advance of W 44.4 billion to meet the company's immediate cash flow requirements and, in late July, engaged an accounting firm to issue a due diligence report that would be used to decide on the remainder of the request. The due diligence report in late August indicated that the company had not provided full accounting information requested by the due diligence team, and that the best-effort estimate of the survival value of the company was less than the liquidation value. It was also learned that the company's audit firm had refused to sign off on the company's first-half financials for 2000. On August 28, the bank creditor group voted to reject the remaining W 111 billion loan request, with only 54.8 percent consent votes, about 20 percentage points short of the required 75 percent. The company filed for court receivership a few days later, becoming the first company to be unplugged from the protection of a workout program.

Woobang Construction was the largest surviving company in the Daegu area, Korea's third largest city, which had been hit harder than most other major cities by the economic contraction during the crisis. Because of this, the case attracted press and political attention and was painted as a conflict between the social interests of the regional economy and the individual commercial interests of the creditor banks. And Seoul Bank, holding a pivotal 26 percent voting share, was put on the spot. It was a difficult, but necessary, decision to make in this context.

On September 27, President Kim, Dae-Jung announced that the government would complete the second-stage restructuring in corporate and financial sectors by end of 2000. In early October, the Financial Supervisory Service (FSS) instructed banks to submit lists of nonviable companies that needed to be exited from the market. Instructions were quite

specific: among companies whose borrowings from financial institutions amounted to W 50 billion or more, banks were instructed to select those firms whose loans were classified as precautionary and below on the basis of forward-looking criteria, and those whose interest coverage ratio was below 100 percent for the past three consecutive years. Banks were also asked to select companies that were classified as potential problems according to each bank's internal standards, regardless of the companies' borrowing size. The pool of companies selected based on the above criteria was then classified as one of the following: "Normal," "Temporary Liquidity Problem," "Structural Liquidity Problem," and "Exit." The FSS reviewed the initial lists submitted by banks in mid-October and asked them to redo the lists using tougher standards, warning the banks that they would be accountable for letting weak companies survive.

Under this new regulatory posture, the creditors met on October 30 to vote on Dong-Ah Construction's request for W 346 billion in new loans. With total borrowings of W 2.3 trillion, the company was much larger than Woobang Construction, and the decision was more decisive. The request received only 25.3 percent consenting votes. Seoul Bank had 16.7 percent voting share and did not consent. The outside directors of the board of Seoul Bank volunteered to be involved in the decision regarding Dong-Ah Construction. A few days before October 30, the board passed a resolution endorsing management's decision not to consent to Dong-Ah's request. At this point, the board had begun to get actively engaged for the protection of the bank and in support of management's restructuring efforts.

Table 4. Seoul Bank: Disposition of Nonperforming Loans
(In billions of won)

	2000	2001				
	2nd Half	1Q	2Q	3Q	4Q	Total
Sale to KAMCO		655.7	143.3	4.9	64.4	868.3
Sale to private buyers	360.0	–	35.5	–	8.5	404.0
Write-offs	109.6	198.6	221.2	102.9	189.6	821.9
ABS issue	–	–	–	446.8	–	446.8
Collateral sales and others	274.5	80.6	124.7	166.5	48.6	694.9
Total	744.1	934.9	524.7	721.1	311.1	3,235.9

In December 2000, NPLs totaling W 404 billion were sold, through an auction, to Lone Star and GE Capital Consortium. Unlike the previous NPL sales to KAMCO, the bank did not incur any loss, as we had charged sufficient provisioning for the NPLs.

Despite the initial disposition of NPLs of more than W 700 billion during the second half of 2000, the NPL ratio did not fall at the end of 2000 because a significant amount of loans were downgraded from the categories of normal and precautionary to the categories of substandard and below during the same period. As companies in workout programs, both Woobang and Dong-Ah Construction, for example, had been classified as precautionary at

the end of 1999. The bank's exposure to Woobang (W 191 billion) and Dong-Ah Construction (W 380 billion), both pending court receivership, was the main piece of a W 670 billion NPL sale for W 312 billion to KAMCO in January 2001, the first NPL sale to KAMCO by the new management. The bank again did not incur any loss against the net book value of the NPL sold.

Beginning in the first quarter of 2001, Seoul Bank also started to write NPLs off aggressively and created an asset-backed securities (ABS) structure in September to take W 447 billion of NPLs off our books. The credits transferred to ABS for W 158 billion had W 309 billion in reserve, resulting in a gain of W 20 billion, which we did not recognize as income but kept in reserve. Most of our NPL disposition took place during the first year and a half.

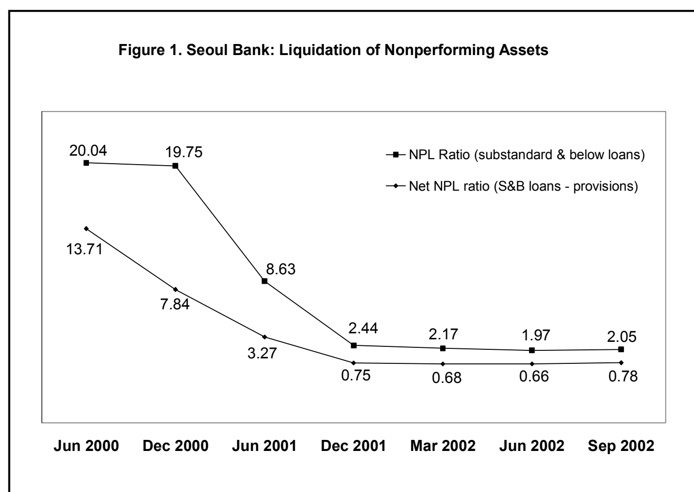


Figure 1. Seoul Bank: Liquidation of Nonperforming Assets

With these efforts, the NPL ratio declined rapidly from June 30, 2001. By the end of 2001, Seoul Bank's loan portfolio was among the cleanest in the market; and by the end of June 2002, its net NPL ratio was lower than that of all other banks. At last, Seoul Bank was a clean bank. In early 2002, we became confident that the bank was prepared to be sold, without the put-back option or protection of the legacy portfolio becoming an issue in upcoming discussions with potential investors.

Table 5. Nonperforming Loans in Korean Banks
(In billions of won)

	June 2000		June 2001		September 2001		December 2001	
	NPLs	Ratio	NPLs	Ratio	NPLs	Ratio	NPLs	Ratio
Seoul Bank	2,285.3	20.0	1,027.6	8.6	435.7	3.6	320.0	2.4
Hanvit	7,288.4	14.0	3,686.2	7.7	2,950.1	6.0	981.4	2.1
Hana	1,713.7	5.6	1,154.3	3.9	988.0	3.2	650.0	2.5
Shinban	1,316.3	4.0	924.1	2.7	1,279.5	3.6	868.6	2.4
KEB	3,455.7	10.3	1,535.9	4.7	1,662.7	4.7	1,186.0	3.6
Chohung	3,612.9	10.2	2,014.3	5.8	2,097.0	5.7	1,200.0	3.2
Hanmi	1,695.9	9.0	1,233.7	6.7	1,236.6	6.3	650.0	2.7
IBK	1,398.3	4.5	1,286.2	3.9	1,414.7	4.1	1,240.8	3.5
Kookmin	3,833.4	7.0	3,161.9	5.4	3,347.8	5.7	4,000.0	3.5

Source: FSS.

E. Rebuilding Business: New Focus, Culture Change, and New Image

The simple vision that I brought to the bank, with the help of a communications consulting firm, and enunciated at the inaugural speech on June 1, 2000, was "Small but Strong and Clean Bank" (it sounds much better in Korean). Most employees did not seem to like the emphasis on small, as their remaining pride was associated with the bank having been one of the largest banks. But small was important because it meant we would be able to change more quickly than the larger banks and would be closer to our customers, providing more personalized services. Strength was to come from a new culture of working together toward the common goal of becoming Korea's first international best-practice bank. Cleanness was of the utmost importance, in view of the bank's tainted reputation and in view of the bad loans still in our portfolio. I appealed that we should recover the bank's reputation through clean practices, much improved customer service, and a clean balance sheet.

New Business Focus

Like most other banks in Korea prior to the crisis, Seoul Bank was principally in the business of extending credit to corporate clients. It traditionally had more than 80 percent of its portfolio in corporate loans. Even after a 30 percent decline in assets between end of 1997 and June 2000, mostly from sales and write-offs of corporate loans, the bank's loan portfolio was still 80 percent corporate as of end of June 2000. The bank once had a dominant market share of the custody business for local investment trust companies and foreign investors in the Korean market. The custody business for foreign investors practically disappeared with the onset of the crisis as the bank's rating plummeted. Local customers remained, but competition was growing and the bank had about a 30 percent market share. Seoul Bank's credit card business was small and was losing money. What we called investment trust business—effectively asset management business for a fee through the trust account—was still going through the last phase of clean up of the guaranteed trust accounts. With only four overseas branches, there was no advantage in the business of trade finance. Treasury was supposed to be active, but we could not expose our income to market risk.

Housing and Commercial Bank, which merged with Kookmin Bank in late 2001, was the dominant retail bank, due to its well- established franchise in the household mortgage loan market. Most banks were talking about focusing on retail banking, a natural focus in an environment of slow demand for loans from creditworthy corporations coupled with a culture of credit aversion at most banks. But action to change focus was slow. We decided early on that retail banking, particularly household mortgage loans, would be our primary business focus, followed by credit cards. We would brush up the custody business and prepare it to regain business from foreign investors, but that would be subject to a rating upgrade. In the meantime, custody business would be a "defend" business in terms of local market share. Market risk business was to be minimized. Corporate banking business was difficult to address. We soon found that, despite the traditional reliance on corporate credit business, only a few bankers had basic skills in corporate banking. We hired a former foreign bank corporate banker to train our people in financial analysis and other corporate banking skills for about a year. We transferred as many people as we could out of the Credit Department and into the branches to cover corporate banking.

With this business strategy, we built an organization for retail banking, starting with a separate Retail Banking Division headed by a former Citibanker with experience in branch banking and small and medium-size industry business. The Credit Card Business Department was made a part of the Retail Banking Division. Within the Retail Division, we built a new Marketing Department to create and coordinate marketing activities. Fortunately, a very able grade-four officer was managing the bank's small and neglected Call Center, which needed to play an important role in the expansion of retail business.[7] He had a long reporting line to the head office. We made him report directly to the head of the Retail Banking Division and supported him with people and investment to quickly increase volume. Perhaps as important as the new organization for the retail business was the role of the chief operations officer and her consolidated back office departments. The consolidation of back office functions under the chief operations officer allowed the Retail Banking Division to focus on business expansion. The IT Division and Controllers also contributed to building this separate Division quickly. The management information system report with a separate line for retail banking became available in the first quarter of 2001.

Table 6. Retail Loan Growth in Korean Banks
(In billions of won)

	Total Retail Loans		Percentage Increase	Mortgage Loans		Percentage Increase
	2000	2001		2000	2001	
Seoul Bank	1,752.9	5,351.1	206	716.9	2,890.7	303
KFB	5,032.6	7,887.4	57	188.0	1,465.5	680
Hanvit	7,068.5	11,823.2	67	2,595.0	6,488.4	150
Chohung	5,385.5	9,072.3	68	2,251.6	4,394.0	95
Shinhan	6,458.4	11,140.9	72	2,232.3	6,958.0	211
Hana	5,982.0	10,751.7	80	2,630.3	5,682.4	116
KEB	3,843.9	6,464.5	68	1,588.9	3,888.3	144
Hanmi	3,482.6	4,746.9	36	1,549.0	2,704.0	74
Kookmin	48,874.3	60,153.6	23	n.a.	n.a.	—

Seoul Bank was the fastest growing retail bank throughout 2001. By the middle of 2001, we overtook Hanmi Bank in household mortgage business volume. By the end of 2001, our loan portfolio was balanced between corporate and retail exposures, with about half of retail in mortgage loans. By the first quarter of 2002, only Housing and Commercial and Seoul Bank had a retail portfolio that was larger than their corporate portfolio. This was an attractive portfolio for any potential investor.

[7] As noted above, the hierarchy of employees is determined by grades. Grade four is the lowest ranking officer with authorized signing power; it takes between five to eight years to obtain this level. All employees in grade four and below are union members. When grade-one officers become executives, they get their accumulated severance payments and sign a new one- to two-year contract that may or may not be renewable.

Achievement of the rapid growth in retail business and the rebalancing of the loan portfolio would have been more difficult without the underlying growth in the retail market. However, the fact that Seoul Bank outpaced all other banks during this period and was able to overtake other banks in volume while keeping a low NPL ratio may be proof that Seoul Bank worked harder, our new organization and systems supported the rapid growth, and due to the small size, we could effect the changes faster.

Culture Change: To Become a "Small but Strong and Clean Bank"

During the first months in the office, the new management team made the following changes to show that management was serious about change and that informality, open communication, transparency, and a relentless focus on work were the new values of Seoul Bank:

- Opened the CEO's bank e-mail address to employees and encouraged them to provide direct input;

- Abolished the tradition of an "accompanying" male secretary, who followed the CEO throughout work hours, including evening functions;

- Reduced the CEO's office space by a third by converting an adjacent guest receiving room to an office for the chief financial officer and an adjacent mini-board room to an office for the chief credit officer;

- Corrected the name of the daily management meeting from "management tea time" to "management meeting;"

- Freed the CEO-only elevator for general use;

- Closed the executive dining room and converted it to a dining room for team lunches or lunches with guests; had executives line up in the general cafeteria to lunch with other employees;

- Issued a CEO decree prohibiting stock trading and nonbusiness-related internet surfing during office hours;

- Issued a CEO decree on "insider reporting" making the failure to report wrong-doing punishable (initially only real name reports were accepted, but this was later modified to include anonymous reports); and

- Instituted an open door policy for all head office department heads' rooms and removed televisions since department heads should not have time to watch television.

In late July, after 50 days in office, I summarized my frank impression of the bank in a three-page memo to the staff. Although some progress had been made, the following issues persisted:

- There was still too much emphasis on formalities at the expense of substance;
- The bank continued to operate like a "public" institution, not a commercial bank;
- The bank was not yet attuned to the pace of change in the market and its demands. I reminded employees that some W 3 trillion in deposits had shifted from striking banks to nonstriking banks during the July strike; and
- The urgent need for change was not yet widely accepted.

This was how it had looked in the beginning.

In the spring of 2001, we engaged a consulting firm specializing in employee perception surveys. Through questionnaires and interviews, this firm surveyed 840 employees and produced a report in June. The survey confirmed a good acceptance of the new leadership and the restructuring process, employees' support of the restructuring efforts, and general acceptance of the new branch system, in which employees were assigned specialized functions of relationship managers, personal bankers, and operation officers or clerks. It also showed that employees in grades three and below still depended on the labor union quite a bit.

There were some other interesting results. For example, respondents gave themselves higher marks on international best practice than they gave their peers, superiors, and even the management. In general, employees perceived that the bank had become more commercially oriented and customer oriented, had greater concern for employees' career development and equal opportunities, and showed longer-term concerns than before.

Shortcomings included lagging investment in equipment and premises, and not much change in employee welfare. These shortcomings were mostly due to cost-related restrictions imposed on the bank by the shareholder through memorandums of understanding.

New Image

The bank had acquired a bad reputation even before the crisis as a result of factional infighting and poor service. The stigma of having received public funds during the crisis worsened the image of the bank. We addressed this problem first by changing the bank's logo. In October, we launched the "Green Square" logo: the square was for being a simple, no-nonsense bank; the green was for cleanliness and youth. It was intended to convey that Seoul Bank was a new bank, not the old Seoul Bank. Some board members even wanted to change the name of the bank, but we decided that the name was simple enough and had good representational value.

In late December, the renovation of the main branch in the head office building was completed in line with the new identity. Instead of one long counter for indiscriminate customer service, the new concept incorporated the restructured branch banking system, with separated space for corporate and retail banking as well as segregation of front office and back office. Glass walls surrounded the outside for a transparent look, and we built a small stage in the main lobby for customer events. A small coffee stand was also placed in the lobby, and free coffee was served to customers. Starting on January 1, 2001 we joined other banks by advertising on television for first time since 1997.

F. Final Recapitalization and the Memorandum of Understanding

In mid-December 2000, the amount of recapitalization needed to increase the bank's BIS ratio to 10 percent was agreed with KDIC. In late December, the government announced that, with the recapitalization, Seoul Bank had to be sold within six months (the end of June 2001) or be included in the financial holding company. Although it seemed a mindless decision to us, this was considered a favor to the new management. Reportedly, some policy makers wanted to give only three months for the sale, before putting the bank in the financial holding company.

In accordance with the procedures for the governance of public funds, the management had to prepare a two-year memorandum of understanding (MOU) in order to receive the planned recapitalization. In late December, the management finalized a two-year financial projection of the bank, in consultation with Deutsche Bank investment bankers, who began to prepare an information memorandum for the sale of the bank. Based on the financial projection, we derived the key quarterly management indicators required in the MOU. The indicators were the BIS ratio, return on asset ratio, cost ratio, adjusted revenue per employee, NPL ratio, and net NPL ratio. The two-year projection as well as a draft MOU with KDIC was presented to the board on December 27 for approval. After a lengthy deliberation, the board approved the plans more or less as presented, and we submitted the draft MOU to KDIC. However, KDIC did not accept our key management indicators and sent a revised set of indicators to be used. The revised targets for the cost ratio and adjusted revenue per employee targets were simply impossible to achieve, even during the first two quarters of 2001. We first asked KDIC to take a closer look at the condition of the bank and come up with achievable indicators, but the discussion soon deteriorated into arguments. Their bottom line was that, as a bank injected with public funds, Seoul Bank should achieve such numbers as minimum requirements. My bottom line was that KDIC had to either change the numbers to what management could achieve or change the management.

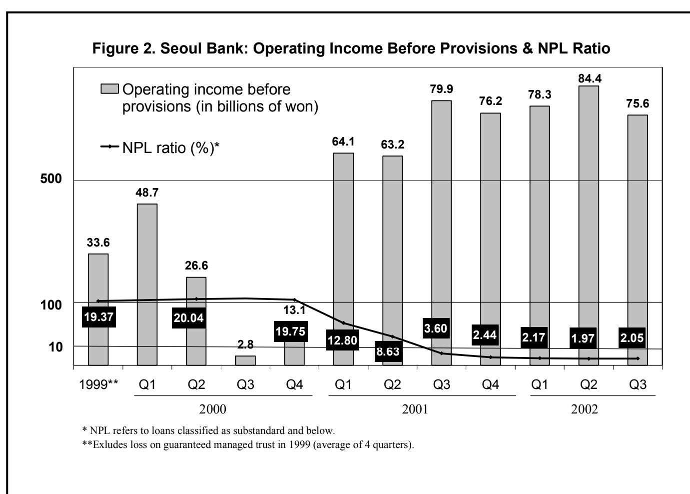
Higher authorities intervened. They were sympathetic to our position that we could not commit to targets that were not possible to achieve, particularly as the upcoming sales process would require full disclosure of our financials and plans, including financial targets. With the blessing of the higher authorities and with the understanding from the management team and the board, a compromise solution was reached on December 30: KDIC agreed to accept the management numbers for the first two quarters of 2001, on the condition that if the

sale of the bank is not successful by end of June 2001, the new management would resign from the bank, and the management agreed that KDIC's revised numbers would be used beginning in the third quarter of 2001.

This episode illustrates the extreme differences of opinion between KDIC, the government shareholder, and the commercially oriented management of Seoul Bank, and highlights the disregard of the board by the shareholder. The resulting compromise haunted management until the bank was finally sold in September 2002. As expected, from the third quarter of 2001, our cost ratio and the adjusted revenue per employee number fell short of the MOU targets. KDIC asked the management to stay after the unsuccessful first sales attempt, but did not adjust the MOU targets.

IV. Performance Summary

From the first quarter of 2001, the bank started to show growing quarterly operating income, before provision for credit losses, while the bank's NPL ratio nose dived. By the first quarter of 2002, the bank had a very credible track record of consistent earnings and a relatively clean balance sheet.



Most of the new income came from the growing retail business (as interest income) and credit card business (as fee income). Net interest income fell in 2001 due to substantial reduction in interest paying NPLs and high cost deposits renewed in late 2000, despite the growth in retail loans. From late September 2000, the government's announced plan to revert to a limited deposit insurance scheme put pressure on the deposit gathering of distressed banks. During the fourth quarter of 2000, Seoul Bank had to pay significantly higher rates to roll over maturing deposits into 2001. By mid 2001, much of the high rate deposits had matured.

The main components of fee income were credit card business and trust business (custody and trust fees). The problem of guaranteed trust accounts, which required the bank to pay out from its capital, had been resolved by the end of 2000 through write-offs and reserves. The bank also showed a good balance between interest income and fee income.

The second half of 2001 saw the unfolding of Hynix's—the former Hyundai Semiconductor —difficulties, which almost wiped out the bank's 2001 income. Our policy was to reduce Hynix credit whenever possible. The bank did not participate in either the Citibank-arranged W 800 billion local-currency syndication loan in late 2000 or in the Rapid Bond Underwriting Program in December 2000, which was used to refinance Hynix's maturing bonds. The board passed a resolution supporting the management's decision not to

participate in the underwriting program for Hynix. Our Hynix exposure, about W 260 billion, was classified as precautionary, with a 19 percent reserve at the time of government recapitalization at the end of 2000. In June 2001, Hynix raised US$1.25 billion by issuing a global depository receipt, and its problem appeared to stabilize. However, with the rapid decline in semiconductor prices, the company's problems resurfaced around September, and in December another debt restructuring proposal was made. Creditors were given the choice of either participating in the new credit facility or forgiving 76 percent of outstanding loans and converting the remaining into convertible bonds. Again with the involvement of the board, Seoul Bank decided not to participate in the new credit facility but to take the haircut and write-off the exposure. Seoul Bank was the only bank among public-funds-injected banks to do so. As a result, the bank had to charge an additional W 150 billion to credit reserve in December; we were fortunate to show a small operating income in 2001. The loan exposure was completely written off at the end of 2001, and the bank was left with W 71 billion convertibles, which were converted in May 2001 and completely sold in the market with a small loss.

Table 7. Seoul Bank: Profit and Loss
(In billions of won)

	1999.12	2000.12	2001.12	2002.3	2002.6	2002.9
Operating income before provision	329.4	91.2	283.4	78.3	162.7	238.3
Net interest income	284.9	387.1	337.2	98.6	198.7	306.0
Non-interest income	250.4	69.4	301.9	74.9	145.7	209.5
Operating expenses	363.9	365.3	355.7	95.2	181.7	277.2
Provision (new/refund)	440.2	942.1	277.3	21.2	59.0	95.8
Operating income	110.8	850.9	6.1	57.2	103.7	142.5
Non-operating income (incl. tax)	2,343.9	331.1	54.6	0.6	4.6	6.1
Net income	2,233.1	519.8	101.4*	56.6	108.3	136.4

*Including deferred tax income of W 40.7 billion.

Quite a number of our efforts to implement international best practices at Seoul Bank were the first attempted by Korean banks. We also received several ISO certifications ahead of other Korean banks thanks to the clear procedures and systems established with the help of Deutsche Bank advisors:

- Segregated duties between the front office and the back office and consolidated back-office functions in the chief operations officer (the first Korean bank to do so);
- Established an Operations Center in the head office (in June 2001), centralizing the branch back office functions of clearing, cash delivery, and management of delinquent assets (the first Korean bank to do so);
- Received the highest honor in Customer Satisfaction Management category (November 2001) and Best Quality Service Certificate (April 2002) from the Korea Management

Association (the first time Seoul Bank had received customer service-related awards in the memory of most employees);

- Established the only ISO 9001-certified domestic call center (March 2002);
- Received ISO 9001 certification for Custody operations (the first for a Korean bank in June 2002);
- Received ISO 9002 certification for Share Restrar operations (the first for a Korean bank in September 2002); and
- Achieved the same rating as Korea First Bank and Hanmi Bank by early 2002 (in June 2000, Seoul Bank's rating by Moody's was two notches below that of Korea First Bank and one notch below that of Hanmi Bank).

Table 8. Seoul Bank: Balance Sheet
(In billions of won)

	1999.12	2000.12	2001.12	2002.3	2002.6	2002.9
Total assets	26,797.3	20,437.4	23,373.8	25,868.1	25,881.6	26,724.2
Bank account	22,128.4	19,139.5	21,731.3	24,242.5	24,188.1	25,178.1
Trust account	4,668.9	1,297.9	1,642.5	1,625.6	1,693.5	1,546.1
Total loans	12,680.3	11,570.4	13,348.0	15,155.4	16,021.8	16,810.5
Corporate loans	9,207.1	8,660.2	6,822.7	7,033.2	7,266.9	7,357.3
Household loans	2,183.2	2,258.0	6,247.9	7,808.9	8,473.7	9,210.5
Mortgage loans	459.3	716.9	2,890.5	3,761.0	4,471.8	5,329.4
Other loans	1,290.0	652.2	277.4	313.3	281.2	242.7
Total Shareholder's Equity	1,043.6	550.8	685.6	958.1*	918.2*	903.0*

*Valuation gains on FRN-typed KDIC balance—W 158.3 (March 2000), W 130.6 (June 2000), W 92.7 (September 2000).

As noted, the government and the IMF treated Seoul Bank and Korea First Bank similarly until mid-1999. A comparison of the two banks from the time new management was brought into each bank in 2000 is interesting because both banks faced similar strategic issues and restructuring needs, partly reflecting that they were two of the three smallest banks with a nationwide network.

Seoul Bank's new management consisted of mostly Koreans with a background in foreign financial institutions or rating agencies, while KFB's top management consisted mainly of foreign professionals with limited command of the local language. KFB's management was supported by commercial shareholders with full management control. Although the government shareholder had assured management autonomy, Seoul Bank's management was constrained by MOUs with the shareholder and the regulator. The prompt corrective action order was lifted from KFB at the time of the sale to Newbridge; Seoul Bank's new

management lived with it until the bank was sold to Hana Bank in December 2002. However, the performance of Seoul Bank during the 2001–June 2002 period was generally better than KFB.

Table 9. Comparison of Seoul Bank and Korea First Bank
(As of June 30, 2001)

	Seoul Bank		Korea First Bank	
Number of employees		3,861		4,282
Number of branches		294		392
Paid in capital (in billions of won)		610.8		980.6
Ownership (in percent)	KDIC:	100.0	Newbridge:	51.0
			KDIC/MOFE	49.0
New Management		June 2000		January 2000

KFB's higher cost ratio during 2001–02 may well reflect its commercial ownership, including freer investment decisions. Seoul Bank's initial investment plans for information technology and branch renovation had to be postponed or scaled back several times due to constraints imposed by the MOUs.

Table 10. Key Management Ratios of Seoul Bank and Korea First Bank
(In percent; except where noted otherwise)

	Seoul Bank			Korea First Bank		
	2000	2001	2002.6	2000	2001	2002.6
BIS Capital Adequacy	10.05	9.22	10.14	13.40	13.29	12.88
Return on Assets	-2.53	0.51	0.94	1.13	0.86	0.39
before deferred tax income	n.a.	0.31	0.94	n.a.	0.47	0.32
Return on Equity	n.a.	15.6	23.3	26.8	15.2	6.8
before deferred tax income	n.a.	9.3	23.3	n.a.	8.4	5.5
Cost Ratio	66.6	59.4	53.7	58.8	68.5	72.3
Revenue/Employee (in million won)	124	152	176	159	159	168
NPL Ratio	19.75	2.44	1.97	10.38	2.51	4.57

On the business side, Seoul Bank staff generally pressed harder, and had a higher sense of urgency, as the management as well as the government made clear that the bank was on its final course of survival. This nervous energy was more or less captured through international best practice and the new specialized organization, resulting in a rapid growth in business volume and revenue. Relative to those of KFB, Seoul Bank's costs were suppressed, while its revenue and business volume were maximized during this period.

V. SALE PROCESS AND REPRIVATIZATION

The first pressure to "do something" in this area came some time in September 2000, when rumors circulated that Seoul Bank was one of the banks to be included in the financial holding company. Through a cabinet reshuffle in August 2000, both the Minister of Finance and Economy and the chairman of the FSC were changed and, along with them, most key players involved in the banking sector restructuring. Through a few visits, I learned the changing agenda of the new policymakers. Some of them had a strong view that the banking sector still suffered from an "over-banking" problem, that most of the good-quality employees at Seoul Bank had left during the crisis (but not the new management, most of them would hasten to add), and that, even with a successful restructuring, Seoul Bank was perhaps too small to survive in a post-consolidation environment.

I made my position clear: I had no interest in managing the bank if it went into the holding company. I had taken the job at Seoul Bank confident that I could turn it around, partly because of its relatively small size. I had seen a US$200 billion American bank go belly up, and I did not think size was the problem in most Korean banks. To the new team of policymakers and regulators, it seemed that Seoul Bank was still an unresolved problem, and some of them were thinking about resolving it through the financial holding company. Only four months into the job and having shed 650 employees in the name of saving the bank, this was an exasperating way of learning the discrete nature of government policies.

Several close advisors, including some outside directors, suggested contacting a few potential investors to help keep Seoul Bank off the list of holding company banks. With a 20 percent NPL ratio and a promise of recapitalization at the end of the year, we had little to show investors except for our redundancy program and the five new management team members who had joined by the end of September. We presented these to a large American private equity firm in late September. Following a few meetings, including a meeting with the management team, we received a draft proposal in October. As expected, it indicated that the firm might agree to pay the net book value on the condition of full government protection against the NPLs, which was not acceptable to the government. For the sake of process transparency and in the interest of management time, Deutsche Bank, which had the right of first refusal under the Financial and Restructuring Advisory Agreement of April 2000, was engaged as financial adviser to prepare for either a capital raising or a partial sale of the bank.

Following the government decision to allow six months for the sale of the bank and the recapitalization in December, we went on a one-week road show in early February 2001 to several cities in the U.S., followed by a visit to major Asian cities for one-on-one meetings. We met three strategic investors during the trips, with two of them actually showing interest.

On December 20, 2000, the Special Law for the Management of Public Funds was legislated, and under the law, a Public Funds Oversight Commission (PFOC) was established in February 2001 to deliberate on and coordinate matters involving the management of public funds. Within the PFOC was the Subcommittee for the Evaluation of the Sale of Public Funds Invested Companies. PFOC became the decision making authority for companies with

public funds, including Seoul Bank. In March, the subcommittee took control of the key processes of the sale, and KDIC assumed the principal role in the sale of Seoul Bank.

Under the newly formalized decision making line-up, Deutsche Bank ran a controlled auction for the sale of Seoul Bank in the spring of 2001. The information memorandum dispatched to four parties in April included the bank's financials up to first quarter 2001 and projections for the year. Although the first quarter 2001 result showed a significant jump in quarterly operating income, the NPL ratio was still 12 percent. By May, the parties were either backing out or asking for protection against the NPLs. Only one party submitted a proposal letter toward the end of June. The proposal from DBCP, a private equity arm of Deutsche Bank, included specific references to NPL protection. At the end of June, the PFOC decided to give KDIC three more months, until the end of September, to negotiate with DBCP. During the three months, the issue of NPL protection was the main point of negotiation, and it was not resolved by the new deadline. In early October, the PFOC announced that the discussion with DBCP had been terminated. Seoul Bank was to continue its normalization efforts and future sale of the bank would be open to domestic investors as well as foreign investors. Seoul Bank's management was to prepare a privatization plan by the end of the year.

Upon the announcement of the termination of the discussion with DBCP, I visited the higher authorities who intervened in the December 2000 MOU process with KDIC, and expressed my intention to be responsible for the failure of the sale by the extended deadline. Their response was that I was also responsible to finish what I had started. By this time, three of the seven new management team members had left, their positions were replaced by internal promotions, and another was preparing to leave. In the process, the management team came to have a good balance between the new and the original Seoul Bank staff. Business Divisions were headed by original Seoul Bank officers. The separate meetings among the new management team disappeared around this time. We were becoming a mixed team on the same boat.

Preparing a privatization plan entailed finding potential investors and introducing them to the government, even as the FSC was publicly expressing its preference for merging Seoul Bank with another bank. The government clearly indicated that its preference was a merger with a sound Korean bank, followed by a sale to qualified domestic or foreign investors, or, if this was not possible, a merger with another public-funds-injected bank. At least, Seoul Bank did not have to worry about being put into the financial holding company. The policymakers seemed to believe that the managers of the financial holding company had their hands full with the five entities already in it.

Around this time, MOFE was preparing a draft amendment to the Banking Act that would increase the single-shareholder limit in banks from the existing 4 percent to 10 percent, and would eliminate the limit altogether for a Korean business group qualifying as a specialized financial group. About three business groups would come close to qualifying as a specialized financial group. One of them showed a keen interest but withdrew from discussions later due to other concerns. Discussion with the second group was tentative from the beginning and did not go anywhere. A cold call on the third group, with four quarters of consistent earnings

and clean balance sheet, led to follow up meetings, and they became very interested. An unexpected, but seemingly genuine interest in the bank, came from an American private equity firm in November. The firm's managing director visited in December to confirm its interest. Another unexpected interest was shown by a consortium of some 30 Korean companies, organized by a business group for whom Seoul Bank was the main bank. By the end of December, written indications of interest were received from the three parties and delivered sealed to the government.

In late January 2002, in an announcement regarding the disposition of government-held bank shares, MOFE announced that the preparation for the sale of Seoul Bank would proceed simultaneously with discussion for a merger with a sound bank. My only comment was that we needed to put the two options in the same process to maximize the proceeds from the sale.

Parliament passed the amendment to the Banking Act in April. In May, Goldman Sachs and Samsung Securities were appointed as KDIC's advisors. With financials up to the first quarter of 2002 in the information memorandum, which showed one of the cleanest balance sheets among Korean banks and five consecutive quarters of consistent and growing operating income, the bank looked well prepared for sale. Three parties were selected for on-site due diligence in early July, but one dropped. Lonestar and Hana Bank competed till the last moment. This time, the government was prepared to sell 100 percent of the bank. Lonestar's final offer was W 950 billion cash, with the government sharing in the upside potential up to W 250 billion. Hana Bank's offer was W 1.15 trillion in shares of the new merged bank, representing about 30 percent of the new bank. Hana Bank also guaranteed to buy the government shares in the new bank within 18 months. Neither party asked for protection against the bank's NPLs.

Lonestar's valuation of Seoul Bank was W 7,776 per share, before the upside sharing, and Hana Bank's valuation was W 9,414. The government's recapitalization in December 2000 had been made at W 5,000 per share.

In August 2002, the PFOC selected Hana Bank as the preferred buyer of Seoul Bank, as recommended by the subcommittee. And in mid-September, the PFOC approved the sale of Seoul Bank to Hana Bank. A merger agreement between Seoul Bank, Hana Bank, and KDIC was signed on September 27.

VI. Broader Issues

The restructuring of Seoul Bank raises a number of broader issues, including the roles of the government and board of directors, as well as governance issues.

A. Role of Government

Five government entities were involved in banks receiving public funds:

- KDIC, the nominal shareholder and administrator of MOUs with the banks, performed at least four quarterly MOU audits a year. KDIC was a strict administrator, with a clear bias

to minimizing downside risks. KDIC closely followed Seoul Bank's restructuring process since it was also a signatory to the restructuring agreement with Deutsche Bank.

- FSS, the regulator and administrator of rehabilitation plans prepared under prompt corrective action orders, performed regular prudential audits, program audits, and quarterly rehabilitation plan audits. FSS did not treat Seoul Bank any more leniently than privately owned commercial banks. In prudential audits, FSS auditors showed interest in the progress and results of our restructuring efforts.

- FSC, the government agency charged with regulatory policymaking, but also doubling as the policymaker for troubled financial institutions, had the power to grant, suspend, and revoke licenses, a power transferred from MOFE in April 1998.

- MOFE, the parent of KDIC, was responsible for overall policy for the financial industry. As policymakers dealing with industry-wide issues, both MOFE and FSC, but particularly FSC with its mandate to deal with troubled financial institutions, showed continuing concern with the bank as a potential problem. As indicated by several premature initiatives for the sale of the bank, particularly the first deadline of end of June 2001, it appeared that few policymakers appreciated the value of restructuring.

- Korea Board of Audit (KBA), the public sector watchdog with powers to audit and inspect all government ministries, agencies, and public sector corporations, was required by the Special Law for Public Funds Management in December 2000 to audit all matters related to the management of public funds and to report to the National Assembly. It conducted an annual audit on public funds invested banks. In its audit of Seoul Bank, KBA regarded the bank as a public institution, rather than a commercial bank, by virtue of ownership through public funds. In this context, it took issue with the bank's television advertising.

Summarizing their roles: KDIC was the immediate shareholder under MOFE's control; FSS was the regulator and administrator of rehabilitation plans, FSC and MOFE were the policymakers; and KBA was the super auditor, not only of the public-funds-invested banks, but also of the activities of the four government entities with respect to such banks.

In terms of hierarchy, the government entities above may be lined up from the top as the policy maker (MOFE and FSC), the regulator (FSS), and the shareholder (KDIC)—with the super auditor (KBA) watching over all of them. The shareholder's position at the bottom of the hierarchy resulted from its relationship to the policymaker. KDIC reported directly to MOFE, making it a true nominal shareholder, or an administrator.

Although this arrangement ensured maximum flexibility for the policymaker, who deals with industry-wide issues (or who deals with individual bank issues on the industry level), it also eliminated the role of an active shareholder who tries to capture the upside of his equity by taking some risk, if necessary. A nominal shareholder with administrative responsibilities cannot be expected to perform this role. Instead, the arrangement has a built-in bias to

minimize the downside risk of each shareholding: KBA's audits on the government entities ensured this bias, frustrating the efforts of the restructuring manager whose interpretation of his mandate was to make a damaged bank as commercially valuable as possible for privatization.

This passive bias is understandable. The shareholding came about in reaction to the need to keep the financial system from collapsing. Several injections of public funds had been wiped out, and there was not much confidence in the practices of weak banks regarding credit extension and otherwise. Public demands to guard against moral hazards in the use and management of public funds were constant. In this context, the best solution for both the government and the restructuring manager was for the bank to be sold as soon as possible.

B. Role of the Board

The role of active shareholder was, in the case of Seoul Bank, provided by the board. In 1998, in an effort to improve corporate governance in the troubled banking sector, the government established a system of outside directors and an Audit Committee. Outside directors were required to make up more than half of each bank's board of directors and at least two thirds of the Audit Committee. Typically, outside board members were appointed for a one-year term, renewable for a maximum of three years.

During my tenure, the board consisted of five or six outside directors, at a time, and two inside directors, the CEO and the standing auditor. The outside directors, all of whom were appointed by the government, during this period included three corporate executives, two university professors (one of whom was an active member of an NGO), one lawyer, two editorial writers of economic dailies, one accounting firm adviser, and two KDIC officers. Chairmanship of the board was held by an outside director.

Although their proper function was to oversee the CEO and his management, the outside directors soon understood the value of the restructuring efforts, recognized the seriousness of the new management, and provided enormous moral support to the new management team. The board did not have full management power to delegate to the CEO. They also had to sign the KDIC MOUs in conjunction with the recapitalization at the end of 2000, and were bound by them. But within this constraint, they not only performed management oversight but also prompted the management to increase the commercial value of the bank. In this regard, they were furious when our investment plans for branch renovation were delayed due to cost targets in MOUs. The board was required to meet four times a year. In 2001, there were twenty extraordinary board meetings, usually to report and discuss rather than to seek board resolutions. The attendance rate of outside directors was close to 100 percent throughout the period. Two members of the Audit Committee, including the committee chairman, came into the bank each week for three months in early 2001 after the standing auditor abruptly resigned, to review all documents signed by the CEO, among others, until the standing auditor's replacement was appointed in March.

The outside directors were well informed and committed. They did not behave at all as an agent of the government. However, not once during my tenure did either the nominal

shareholder or the policymakers invite the outside directors to discuss the status of the bank in general or the timing of the sale in particular. For the government shareholder who appointed the outside directors, this board seemed a wasted resource. By taking the board seriously, the government—both as shareholder and as policymakers—could have benefited much with respect to timing the privatization of public funds banks, among others. In the case of Seoul Bank, premature attempts to sell the bank, which distracted management and employees from restructuring efforts, could have been avoided if the government had taken the opinions of outside directors seriously.

C. Governance Issues

Two main governance issues arose during this period. One was the need to prevent the banks from making arbitrary credit decisions, so as to minimize future credit losses, and the other was the need to check and prevent potential moral hazard of the CEO and his management. The first concern was double-edged: arbitrary decisions could be made from the inside or pushed from the outside. Credit committees, headed by CCO's with complete independence from the CEO, were institutionalized in 1997–98. CEO's simply could not interfere in credit decisions. The outside influence, which was a part of the labor union agenda during the banking strike that took place on July 11, 2000, was symbolically addressed in a labor-government agreement following the strike: the government agreed in writing not to interfere in bank management. The government agreed to the same with the IMF in the July 2000 program reviews.

The moral hazard issue was addressed by the introduction of a board structure in which outside directors outnumbered insiders and by incorporating an audit committee with a standing auditor (a full-time auditor who was simultaneously a board director). This arrangement was intended to minimize the potential for the CEO to abuse his power. In addition, the bank's management was audited by KDIC at least quarterly, and by FSS on regular regulatory audits as well as quarterly audits on the rehabilitation plan (sometimes, they were done simultaneously). KBA started its audit from 2001.

This intense oversight reflected the politics of public funds. Public criticism and suspicion regarding the use of public funds became particularly acute during the second half of 2000 as the government had to seek congressional approval for W 40 trillion of additional public funds for the second-stage restructuring, which was partly used to recapitalize the banks at the end of 2000. The Special Law for the Management of Public Funds was drafted in order to assure the National Assembly of more transparency and accountability in the use and management of public funds. Thus, the PFOC was created with more civilian members than the three ex-officio government members, and KBA's audit of matters relating to public funds was institutionalized. The law did not forget to remind the government of its responsibility to seek claims from or otherwise hold accountable those deemed to have lapsed in management and supervisory responsibilities in distressed banks. A thick layer of governance was created to address the varied demands from the public—starting from the National Assembly and ending with the standing auditor, who was next to the CEO in status on the board of directors.

While this structure may have met the political demand for governance, it is questionable whether it also served the functional needs of bank governance. Governance is a systemic structure to create good checks and balances within the organization for all stakeholders, particularly the shareholder. The new board system based on outside directors and an audit committee, most likely, was meant to perform this function. However, the structure of governance developed for public-funds-invested banks limited the power of the board in many respects. For example, KDIC, the shareholder, by imposing quite detailed MOUs not only on the CEO but also on the board, relegated the board to the position of an "extra" management team. In addition, the governance structure was too top heavy on the function of checks, with the resulting dilution of accountability at the bottom. The standing auditor is typically exempted from any reprimands when bank management has been found guilty of mismanagement by regulators and/or the super auditor. An important issue is how to strengthen bank governance through the new board system, even for public-funds-injected banks.

VII. Retrospect and Conclusion

Some time late in the process of writing this paper, I was reminded of my own comments regarding the state of the bank before my arrival: "During this period of extreme uncertainty and instability, which lasted for over three years, the bank was bound to become alienated and inward-looking." With the exception of customer behavior and the quality of customer service, the bank continued to suffer similar symptoms and syndromes in varying degrees during my tenure. The new management became alienated from the government shareholder by the end of 2000. Alienation from the employees started in the middle of 2001, following the breakup of discussions with DBCP, when I became an interim CEO. Because of the constraints imposed by the MOUs, investments were cut back and some decisions were made on an interim basis starting in late 2001. From the middle of 2002, the labor union became active again in its opposition to a merger with Hana Bank.

However, there were also differences between the two periods. From early 2001, the bank started to operate on a restructured "transistor radio" mode. Although restructuring in a broad sense may be an endless process, by mid-2001, Seoul Bank's organization, main systems, and processes, as well as culture, incorporated most of the basic international best practices in commercial banking. International best practices settled into the bank more quickly as employees associated the rapid reduction in NPLs and equally rapid growth of retail and mortgage loan portfolios with best practices. The association of best practices with the growth of retail loans and mortgages was most obvious, as the growth followed the reorganization of the Retail Business Division and the rollout of the new branch system. The association of the cleanup of NPLs with best practices was more cultural: employees regarded management's early decisions to unplug from nonviable companies as important for the protection of the bank. In many respects, what kept the bank going from late 2001 was the power of the interim management to reinforce and maintain international best practices. The first period of uncertainty and instability did not have this benefit.

Finally, the bank was blessed with good timing. If our push for the retail and mortgage loan business had been late by as much as three months, the same result would have been difficult to achieve. If the restructuring efforts were delayed by even a month, the disruption at the end of December 2000 could have shattered what had been achieved by that time, including the newly formed management team. And the most blessed timing was the timing of the sale.

As Perlin has noted, "bank restructuring is a process, not an event."[8] A former outside director of Seoul Bank has added that while the sale of a public-funds-invested-bank is an event of political significance, restructuring is of secondary concern." These two observations summarize the experience of Seoul Bank during my tenure. Bank restructuring as a process requires time for management to implement restructuring and for the organization to digest it. It is a cumulative process whose value is not obvious until a critical mass of influence is achieved over the entire organization. In contrast, the timing for the sale of public funds bank, as dictated by policymakers, can be arbitrary, with little regard for the restructuring in progress. An understanding of this seemingly inherent conflict, as it unfolded in Seoul Bank, offers a practical perspective for future "restructuring" managers as well as policymakers.

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[8] Perlin, Gary, 1996, "Foreword," In Andrew Sheng, ed., *Bank Restructuring: Lessons from the 1980s* (Washington, D.C.: World Bank).

Seoul Bank: Historical Summary Table
(In billions of won)

	1995	1996	1997	1998	1999	2000.6	2000.12	2001	2002.9
Total Assets	**35,000**	**38,300**	**40,900**	**32,800**	**26,800**	**24,200**	**20,400**	**23,400**	**26,100**
Bank account	23,400	25,300	30,000	24,900	22,100	20,300	19,100	21,700	25,200
Trust account	11,600	12,900	10,800	7,900	4,700	3,900	1,300	1,600	1,600
KAMCO sale -face amount			1,960	1,040	4,560			868	
-net proceeds			1,380	500	1,150			350	
Net worth	1,372	1,202	702	266	1,044	798	551	686	903
Government recapitalization				1,500	3,320		611		
Government contribution							222		
Net income after tax	0	-167	-917	-2,242	-2,233	0	-520	101	136
Number of employees	8,668	8,303	7,511	4,809	4,707	4,643	3,920	3,886	3,848
Number of branches	347	363	365	295	295	295	295	294	290
(Overseas branches)	8	8	8	4	4	4	4	3	3
Memorandum item:									
Won-dollar exchange rate (end of period)	775.7	844.9	1,695	1,204	1,138	1,115	1,264.5	1,313.5	1,227.8