

ASIAN DEVELOPMENT BANK

PCR: KOR 31651

PROJECT COMPLETION REPORT

ON

**INSTITUTIONAL STRENGTHENING OF THE FINANCIAL SECTOR
(Loan 1602-KOR)**

TO THE

REPUBLIC OF KOREA

August 2003

CURRENCY EQUIVALENTS

(as of 30 April 2003)

Currency Unit – won (W)

		At Appraisal	At Project Completion
		10 December 1997	25 April 2003
W1.00	=	\$0.00068	\$0.00081
\$1.00	=	W1,462	W1,232

ABBREVIATIONS

ADB	–	Asian Development Bank
ATM	–	automated teller machines
BCBS	–	Basle Committee of Banking Supervision
CAR	–	capital adequacy ratio
CDIC	–	Canada Deposit Insurance Corporation
DIF	–	deposit insurance fund
DPA	–	Deposit Protection Act
FCRP	–	Financial and Corporate Restructuring Project
FDIC	–	Federal Deposit Insurance Corporation
FEDRESERVE	–	Federal Reserve Bank of New York
FSA	–	Financial Supervisory Agency
FSC	–	Financial Supervisory Commission
FSP	–	financial sector program
ICR	–	intermediation cost ratio
IBRD	–	International Bank for Reconstruction and Development
IMF	–	International Monetary Fund
IPAB	–	Institute of Protection of Bank Savings of Mexico (Instituto Proteccion del Ahorro Bancario)
KAMCO	–	Korea Asset Management Corporation
KB	–	Kookmin Bank
KCB	–	Korea Commercial Bank
KDB	–	Korea Development Bank
KDIC	–	Korea Deposit Insurance Corporation
KDI	–	Korea Development Institute
KHCB	–	Korea Housing and Commercial Bank
KLB	–	Korea Long-Term Credit Bank
LDR	–	loan to deposit ratio
MIS	–	management information systems
MOFE	–	Ministry of Finance and Economy
NPL	–	nonperforming loan
NYSE	–	New York Stock Exchange
OCC	–	Office of Comptroller of Currency
OECD	–	Organization of Economic Cooperation and Development
PFOSA	–	Public Fund Oversight Special Act
REIT	–	real estate investment trust
ROA	–	return on assets
S&P	–	Standard & Poor

SEC	–	Securities and Exchange Commission
SLA	–	subsidiary loan agreement
SMC	–	Securities Management Committee
SME	–	small and medium enterprises
TA	–	technical assistance
TOR	–	terms of reference
WB	–	Woori Bank

NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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BASIC DATA

A. Loan Identification

1.	Country	Republic of Korea
2.	Loan Number	1602-KOR
3.	Project Title	Institutional Strengthening of the Financial Sector
4.	Borrower	Republic of Korea
5.	Executing Agency	Ministry of Finance and Economy
6.	Amount of Loan	
	Original Amount	\$15.00 million
	Amount Cancelled	\$7.13 million
	Net Loan Amount	\$7.87 million
7.	Project Completion Report Number	KOR 756

B. Loan Data

1.	Appraisal	
	– Date Started	29 November 1997
	– Date Completed	09 December 1997
2.	Loan Negotiations	
	– Date Started	10 December 1997
	– Date Completed	11 December 1997
3.	Date of Board Approval	19 December 1997
4.	Date of Loan Agreement	23 December 1997
5.	Date of Loan Effectiveness	
	– In Loan Agreement	23 December 1997
	– Actual	23 December 1997
	– Number of Extensions	None
6.	Closing Date	
	– In Loan Agreement	31 December 2000
	– Actual	31 October 2002
	– Number of Extensions	One ¹
7.	Terms of Loan	
	– Interest Rate	Variable
	– Maturity	15 years
	– Grace Period	3 years

¹ In January 1999, the Asian Development Bank (ADB) approved an extension of the loan closing date until 31 December 2002. The loan account, however, was closed on 31 October 2002 upon settlement of \$14,545 the refund for the remaining balance of advances to the Korea Deposit Insurance Corporation, and at the request of the Ministry of Finance and Economy to proceed with the final cancellation.

8. Disbursements						
a. Dates						
		Initial Disbursement		Final Disbursement	Time Interval	
		29 June 1999		31 October 2002	40 mo.	
		Effective Date		Original Closing Date	Time Interval	
		23 December 1997		31 December 2000	36 mo.	
b. Amount (\$ thousand)						
Category or Subloan	Original Allocation	Cancellation on 25 Feb 2000	Reallocation	Further Cancellation & Refund	Amount Available	Amount Disbursed
01	6,000	241	6,241	(39)	6,202	6,202
02	2,500 ^a	(2,500)				
03	1,200	1,279	2,479	(1,227)	1,252	1,252
04	800	90	890	(474)	416	416
05	4,500 ^a	(4,500)				
Total	15,000	(5,390)	9,610	(1,740)	7,870	7,870

^a A portion of these two amounts was cancelled before the reallocation.

C. Project Data

1. Project Cost (\$ thousand)

Cost	Appraisal Estimate	Actual
Foreign Exchange Cost	11,700	7,454
Local Currency Cost	3,300	416
Total	15,000	7,870

2. Financing Plan (\$ thousand)

Cost	Appraisal Estimate	Actual
Implementation Costs		
ADB-Financed	15,000	7,870
Government/Implementation Agencies	7,700	5,700
Total	22,700	13,570

3. Project Performance Report Ratings²

Implementation Period	Ratings	
	Development Objectives	Implementation Progress
January 1998 to May 1999	Satisfactory	Partly Satisfactory
June 1999 to March 2001	Satisfactory	Satisfactory
April 2001 to January 2002	Satisfactory	Partly Satisfactory
February 2002 to October 2002	Satisfactory	Satisfactory

ADB = Asian Development Bank.

² See para. 44 of the main text for background on the history of implementation rating.

D. Data on Asian Development Bank Missions

Name of Mission	Date	Persons (no.)	Person- Days (no.)	Specialization of Members
Reconnaissance	28 Nov 97–13 Dec 97	10	121	Vice president, East Asia Director, Infrastructure, Energy and Financial Sectors Department (East) Sr. economist Resident scholar Sr. operations & admin. officer Operations & admin. officer Sr. programs officer Economist Asst. gen. counsel Sr. policy officer
Inception ³	4– 1 Feb 98	4	34	Manager, Consulting Services Division, Central Operations Services Office Sr. economist Sr. control officer Financial analyst
SPA 1	23–28 May 98	1	6	Financial analyst
SPA 2	31 Aug–4 Sep 98	2	10	Sr. financial analyst Investment officer
SPA3	9–13 Oct 98	2	10	Sr. economic advisor, Extended Mission to Korea Sr. counsel
Special Consultation	3–7 Dec 98	3	15	Sr. counsel Sr. Economic adviser Fin. sector specialist
Review 1	18 –29 Oct 99	2	4	Lead financial specialist Sr. eco. adviser, EMK
SPA 4	2–4 Dec 99	1	3	Operations analyst
Review 2	8–10 Nov 00	2	6	Sr. financial economist Operations analyst
Project Completion Review ⁴	15–25 Apr 03	2	18	Sr. portfolio management specialist Associate operations analyst

SPA=special project administration.

³ Assisted by a banking supervision expert.

⁴ This project completion report (PCR) was prepared by a PCR mission comprising R. Narasimham, senior portfolio management specialist/mission leader; and L. Lerum, associate operations analyst.

I. PROJECT DESCRIPTION

1. On 19 December 1997, the Asian Development Bank (ADB) approved, for the Republic of Korea, (i) a technical assistance (TA) loan of \$15 million for Institutional Strengthening of the Financial Sector, and (ii) the Financial Sector Program (FSP) Loan¹ of \$4 billion from its ordinary capital resources. The overall objective of the TA loan was to enhance and strengthen the regulatory and other financial sector institutions in order to promote an efficient and healthy financial sector. The two loans were processed simultaneously, and were sought to be implemented in tandem. The TA loan originally had four key components: (i) Part A: strengthening the Financial Supervisory Commission (FSC) in establishing a basic institutional framework, operational regulation procedures, and supervisory measures and practices; (ii) Part B: strengthening the Korea Asset Management Corporation (KAMCO) through estimating the amount required for the fund established to assist troubled financial institutions, reviewing its financial plan and operational strategy, and examining lessons learned from similar experiences in other countries; (iii) Part C: upgrading the credit information and rating systems; and (iv) Part D: assisting the Korea Housing and Commercial Bank (KHCB) by reviewing problems and constraints associated with the introduction of mortgage-backed securities. The Ministry of Finance and Economy (MOFE) was the executing agency (EA) for the TA loan. FSC was to be the implementing agency (IA) for Part A, KAMCO for Part B, the Securities Market Committee (SMC) for Part C, and KHCB for Part D.

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

2. The TA loan's objective was to assist the Government in key areas of financial sector reform, supplementing efforts of ADB and the Government under the FSP loan. To meet this objective, the TA loan's scope had four components (para. 1). The TA loan aimed to finance the training and consultancy services for institutional strengthening necessary to realize the objectives of the FSP loan. The design of the TA loan was relevant to ADB's strategy for Korea's financial sector reform in 1997. At that time, both ADB and the Government believed that the lack of market orientation in the financial sector was a major structural weakness of the economy. Until 1997, the Government exercised financial regulation on an activist basis, and did not entrust it to a truly independent agency. The nonperforming loans (NPL) of banks had also grown to a level that endangered their solvency. These factors contributed to Korea's currency and liquidity crisis. Through its various components (para. 1), the TA loan sought to address these key institutional constraints, which restricted the sound development of Korea's financial sector.

3. The TA loan's design had to be restructured considerably to remain relevant to its objectives in light of changes in the macroeconomic circumstances after its approval. On 14 September 1998, the International Bank for Reconstruction and Development (IBRD) approved its Financial and Corporate Restructuring Project (FCRP), a TA loan for \$48 million to complement its Financial Sector Adjustment Loan. The IBRD's FCRP covered Parts A and C of ADB's TA loan. Meanwhile, KHCB, the proposed IA for Part D, now privatized, declined to participate in the TA loan. KHCB was no longer willing to borrow loan funds to finance a study to

¹ ADB. 1997. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Korea for Financial Sector Program*. Manila. This loan was rated as "highly successful" in its project completion report, which was circulated in October 2001.

benefit the broader financial sector rather than KHCB directly.² SMC, (the proposed IA for Part C) ceased to exist as an independent institution when FSC absorbed it on 1 April 1998. The Government and ADB, therefore, agreed in October 1998 to change the scope of the TA loan so it would not duplicate efforts of the IBRD's FCRP. Accordingly, the Government and ADB agreed to change the scope of the TA loan, replacing its original four parts with three new ones: (i) restructuring of financial institutions, (ii) strengthening of KAMCO, and (iii) strengthening of the Korea Deposit Insurance Corporation (KDIC). These changes were necessary to broaden the coverage of end users under the TA loan so financial sector reforms in Korea could be supported better, while complementing (but not duplicating) FCRP's efforts.

4. The changes in the TA's design and implementation were necessary and timely to ensure meeting its objectives. The introduction of the component for restructuring of the financial institutions Kookmin Bank (KB) and Woori Bank (WB) facilitated the necessary inputs³ for their successful financial operations and for providing them sustainable opportunities for broad basing their ownership structures. The component for institutional strengthening of KDIC facilitated its enhanced role in restoring public confidence in the banking system. The TA loan's revised design supported its development objectives of strengthening both participants in the financial sector market and their regulators to develop a sound and efficient financial sector.

B. Project Outputs

5. The TA's outputs envisaged during appraisal had to be reformulated during implementation (paras. 3 and 4). The changes in the TA scope enhanced its development objectives, but caused time overruns and cost underruns in implementation. The revisions in the TA's scope (para. 3) concentrated on assisting in (i) the creation of two restructured banks and (ii) improving KDIC's recovery of funds spent for bailing out troubled banks. Both changes benefited reform of the Korean financial sector significantly, even though they focused specifically on the banking subsector. The restructuring of the banks created a paradigm demonstration of ADB's commitment to efficient bank restructuring and consolidation. The KDIC program for recovery of funds facilitated ADB's determination to enhance public confidence in the banking system without creating a moral hazard. Outputs under the components of the revised TA scope are detailed below.

1. Restructuring Financial Institutions

a. Kookmin Bank

6. The Government has encouraged the merger of banks since 1998 as part of its efforts to consolidate and restructure the banking system. Under this scheme, Kookmin Bank (KB) absorbed the Korea Long-Term Credit Bank (KLB) on 1 January 1999. KB took this important strategic corporate decision because it believed that the synergy created by its retail-banking network, coupled with KLB's corporate client network, would help the merged bank. KB is privately owned, with substantial foreign direct investments. The TA loan was provided to the Republic of Korea, which channeled the funds to KB through the Korea Development Bank (KDB). The TA loan covered consultancy services to KB that covered for: (i) developing a new risk management strategy for the merged bank; (ii) establishing a new core business plan and marketing strategy for the merged bank, taking into consideration KB's and KLB's individual

² ADB's effort to make the Housing Urban Affairs Bureau in the Ministry of Construction the IA for this component did not materialize because the bureau was not legally authorized to borrow.

³ Comprising diagnostic studies for loan resolutions, business plans, organizational and managerial adjustments for restructuring, risk management, financial management, corporate governance, and financial disclosure.

strengths, weaknesses, opportunities, and threats; (iii) establishing defined, measurable and quantifiable performance targets for the merged bank and a system of data collection to measure performance; (iv) estimating the merged bank's capital requirements in accordance with the Basle Committee of Banking Supervision's (BCBS) benchmarks and providing guidelines and a road map for achieving it; (v) planning the human resources and information technology requirements of the merged bank; and (vi) designing strategies for recovery of the merged bank's nonperforming loans (to the extent not transferred to KAMCO). Appendix 1 gives the terms of reference (TOR) for KB's consultants. Significant benefits of the TA's inputs to KB's operational and financial performance are borne out by the bank's results since 1999.

7. KB's financial results since 1999 have shown it to be satisfactorily solvent, comfortably liquid, and improving in profitability. KB's risk adjusted capital adequacy ratio (CAR), calculated by the BCBS formula, improved from 10.98% in 1999 to 11.18% in 2000. Considerable loan write-offs caused the CAR to decline marginally to 10.23% in 2001 and to 10.30% in 2002, but it remains satisfactorily solvent. The bank's return on assets (ROA) improved from 0.16% in 1999 to 0.97% in 2000, to 0.98% in 2001, but declined to 0.81% in 2002 after more loan write-offs. The bank's liquidity, measured by its loan to deposit ratio (LDR), was 76.08% in 1999, 77.14% in 2000, 80.86% in 2001, and 92.32% in 2002. KB's intermediation cost ratio (ICR)⁴ was maintained between 33% and 36% from 1998 to 2002. KB's percentage of NPLs declined from 5.9% of its portfolio in 1999 to 3.6% in 2001 and finally to 2.9% in 2002 after more loan write-offs in 2001 and 2002. KB's improved financial parameters closely matched the Korean banking industry's 2001 average.⁵

8. KB's ability to attract considerable foreign direct investment in its equity is impressive, and reflects the confidence of foreign institutional investors in its financial condition. Seventy-two percent of KB's equity is foreign-owned. Goldman Sachs, a US investment bank, owns 5.1% of KB's capital. Another 3.9% is held by ING Insurance. Another 61.2% is owned by other foreign investors. KB also received highly satisfactory credit ratings from Standard & Poor (S&P) (BBB+), Moody's (A3-), and Fitch (A-). Those ratings indicate that the bank's financial condition is stable. KB was the only Korean bank included in the S&P 100 index. *Global Finance* and *Asiamoney* also rated KB as the "best Korean bank."

9. Operationally, the results of KB's takeover of KLB have met the expectations of the envisaged synergy of merger. Since 1999, KB has been a dominant financial intermediary in many facets of Korea's post-reform domestic banking. In March 2003, KB had 2.3 million retail customers who were serviced by its 6,102 automated teller machines (ATMs), 1,056 retail branches, and 176 corporate branches. KB had 25,000 small and medium enterprise (SME) customers and had a market share of 31% of total SME loans. Targeting of Korea's SME was an important KB post-crisis strategy of risk management to move away from concentration of lending to conglomerates, as was the case before 1997. KB had 2.5 million users of its Internet banking services, accounting for a market share of 14%, in March 2003. As suggested by inputs from the TA, KB introduced flexibility into its human resources policy. In March 2003, it had 18,333 full-time and 8,649 part-time employees. Staffing was adequate to its needs without surpluses or shortages of human resources. KB's restructuring provided it with a platform to service its retail customers efficiently by enhancing its reach in selling them a wide array of products and services. This strategy and business plan suggested under the TA benefited the

⁴ Ratio of noninterest expenses to total income.

⁵ At the end of 2001, the CARs of Korean banks averaged about 10%, and their ROAs averaged about 1%, according to the International Monetary Fund (IMF) Source: Staff Report: Article IV Consultations-Republic of Korea. March. 2003.

bank. KB was able to retain most of its staff, who benefited from training under this TA, which indicates the TA's sustainability. This was facilitated by KB's stable low-cost funding through its deposit and equity bases, coupled with a high degree of customer interface through its physical and electronic networks.

10. KB's drawdown totaled \$1,540,244 in loan funds up to 2002. The bank plans to prepay its borrowings by 2004.

b. Woori Bank

11. Woori Bank (WB) was established on 1 January 1999 through a merger of the former Hanil Bank and the Korea Commercial Bank (KCB). It was known as the Hanvit Bank until its name was changed to Woori Bank on 20 May 2002.⁶ The emergence of WB through merger and consolidation of existing financial institutions is consistent with ADB's goal of establishing a stable and efficient financial system. WB is a de facto government-owned bank since KDIC holds 88% of the total equity of Woori Holdings.

12. The TA loan provided consultancies to WB to cover (i) the strategy for initiatives for short-term profit improvement, (ii) the strategy for post-merger integration plans for WB's different constituents and a road map for its implementation, (iii) an action plan for recapitalization of the bank, (iv) the strategy for management and recovery of WB's NPLs not transferred to KAMCO, (v) a new corporate governance plan, (vi) a risk management strategy for WB, and (vii) strategies and action plans for the integration of WB's human resources and information technology policies. Appendix 1 gives the TOR of WB's consultants. WB's improved operational and financial performance since 1999 indicate the efficacy of the TA's inputs.

13. Since 1999, WB has maintained a satisfactory level of solvency, a comfortable level of liquidity, and an improving trend of profitability. WB's CAR improved from 8.69% in 1999 to 10.26% in 2000, to 11.28% in 2001, and to 11.59% in 2002. The bank's ROA improved from -4.36% in 2000 to 1.06% in 2001, then declined marginally to 1% in 2002. This reduction in ROA during 2002 was caused by increased loan loss provisions made by WB in 2002 because of the deterioration in the classification of its loans to the Daewoo and Hynix groups from substandard to doubtful in 2002. That also explains why WB's NPL as a percentage of total portfolio increased from 2.06% in 2001 to 2.21% in 2002. Otherwise, the decline in WB's NPL ratio from 14.04% in 2000 to 2.06% in 2001 is impressive. The SK Global Group of Companies also owed WB \$277 million in loans and \$7 million in guarantees. These were recorded in the bank's books as normal. Deterioration of their classification in 2003, however, would impinge on WB's future portfolio quality. The decline of WB's ICRs from 56.25% in 2000 to 41.17% in 2001 suggests that the bank benefited significantly from the synergies of merger. Its increase to 45.9% in 2002 is attributable to its expansion during the year. WB received a BBB- and A3 from S&P, Baa2 and P3 from Moodys, and BBB and F3 from Fitch, all of which indicate that WB's financial condition is stable. WB's 2001 financial parameters were consistent with the overall trends in the Republic of Korea's banking sector (footnote 5). WB's improved financial performance indicates that the bank is consolidating financially and has benefited from the TA loan's inputs. A particular matter of concern, however, was the large loss of \$65 million in WB's credit card operations in 2002. WB considers such a write-off of losses a one-time occurrence. WB is taking corrective measures to prevent the recurrence of such losses through closer credit scrutiny of new credit card applicants.

⁶ On 31 December 2001, Hanvit Bank absorbed the Korea Peace Bank.

14. WB's post-merger operational efficiency benefited from the TA's inputs for the following salient operational changes: (i) closure of nonproductive branches;⁷ (ii) sale or merger of nonproductive or overlapping operations; (iii) streamlining of the use of fixed assets; (iv) efficient elimination of excess human resources;⁸ (v) introduction of a new strategy for the adoption of universal banking principles using best international practices; (vi) streamlining of its organization structure to improve its accountability and transparency in identifying profit generating and supporting centers, and to improve efficiency; (vii) introduction of a performance-based remuneration system; and (viii) integration of the information technology systems of the two merged banks. WB's reorganization initially met some staff resistance, but was successful, judged by its declining ICR since the merger (para. 13). WB was able to retain the staff who accepted its new strategy, which indicates its sustainability. This trend is further corroborated by improvement in the bank's operating income per employee by 13%: from W245.4 million in 2001 to W277.3 million in 2002.

2. Strengthening of the Korea Asset Management Corporation

15. The Korea Asset Management Corporation (KAMCO) was established in 1962 as a subsidiary of the Korea Development Bank (KDB). KAMCO's ownership structure is: Government ownership, 42.8%; KDB ownership, 28.6%; and ownership by other banks, 28.6%. KAMCO has 1,200 staff. During and after the 1997 financial crisis, KAMCO's charter was amended by new legislation enacted between 1997 and 2002 to facilitate the efficient disposal of nonperforming assets of financial institutions. Most important, legislation was also simultaneously enacted between 1997 and 2002 that granted KAMCO the rights of possession, expeditious foreclosure, and disposal of the NPLs acquired from financial institutions. Such legislation ran parallel to KAMCO's use of public funds for this purpose. KAMCO's main functions in terms of its charter are (i) management and operation of the public NPL fund, (ii) acquisition and resolution of NPLs, (iii) workout of distressed companies, (iv) management and sale of state-owned properties and confiscated properties for tax arrears as mandated by the Government, and (v) consulting services for NPL resolution. Appendix 1 gives the TOR for KAMCO consultants.

16. ADB's TA loan was designed to give KAMCO the consultancy and training services necessary for estimating bailout requirements and methodologies, as well as the introduction of other innovative methodologies, taking into consideration experiences of the Resolution Trust Corporation (RTC) of the United States and the Institute for the Protection of Bank Savings (IPAB) in Mexico.

17. Inputs from the loan provided KAMCO advanced techniques for (i) implementing a successful financial and corporate restructuring of the companies whose assets were foreclosed, (ii) completing the efficient recovery of public funds injected for the acquisition of NPLs, and (iii) training KAMCO's staff to play a pioneering role as specialists in these disciplines. In accordance with their TORs, the consultants assessed and made specific recommendations to KAMCO on: (i) the criteria and methodology to apply in the purchase and disposition of nonperforming assets; (ii) the management of the "bail-out-fund;" (iii) KAMCO's organizational structure and financial management, and suitability of its legal framework; (iv) KAMCO's management information system (MIS) needs; and (v) KAMCO's asset disposition proposals and transactions.

⁷ WB's domestic branches were reduced from 687 in 2001 to 635 in December 2002. These branches, together with its 5,534 ATMs, help serve the bank's 12.3 million customers.

⁸ WB's staff strength was reduced from 10,486 employees in 2001 to 10,182 employees by the end of 2002.

18. ADB's TA loan also financed both domestic and out-of-country training of KAMCO staff in NPL resolution. KAMCO's domestic training programs, conducted at the Korea Development Institute (KDI) were in NPL workouts, international financing and asset securitization, mergers and acquisitions, real estate financing, corporate restructuring, and domestic and international legal issues. Diploma examinations were held at the end of the KDI training courses. A total of 854 of KAMCO staff qualified, through 1,022 hours of training, in this intensive training module from March 2000 to February 2001. Another 571 staff qualified in a similar KDI program from April to November 2001. KAMCO staff participation in the domestic training program, both qualitatively and as a percentage of its total staff strength, is impressive and reflects KAMCO's determination to train its staff in basic NPL workouts. KAMCO spent \$595,700 on domestic training at KDI; \$416,990 was financed through ADB's TA loan. Participation in the domestic training module was a necessary requirement for staff participation in out-of-country training.

19. KAMCO's out-of-country training was conducted with PricewaterhouseCoopers in Dallas, Texas, United States, in 2000; and with Baruch College in New York, US, in 2001. Fifty-nine KAMCO staff were trained in Dallas from May to October 2000. The out-of-country training programs were designed to familiarize KAMCO staff in methodologies of the US RTC and IPAB of Mexico. This was particularly relevant to KAMCO staff because many of the Korean banks' NPLs related to foreign operations of their Korean customers. Furthermore, Korean legislation regarding bankruptcy proceedings, foreclosures, and the use of public funds for financial bailouts since 1997 have closely followed the US model. Thus, the understanding of international and US practices to resolve NPLs was important in the introduction of best international practices of financial regulation and supervision. The 2000 course in Dallas covered (i) basic asset valuation, (ii) importance of cash flow, (iii) corporate finance, (iv) corporate restructuring, (v) asset securitization, (vi) asset acquisition and disposal, (vii) operation of bank loan recoveries in the United States from real estate investment trusts (REIT), (viii) bankruptcy proceedings under Chapters 7 and 11 of the Bankruptcy Legislation of the United States, (ix) cross-border insolvency, and (x) insights into bank syndications for the workout process. Twenty-five staff participated in KAMCO's 20-day training programs at Baruch College, New York, in 2001. These courses focused on REIT laws in the United States, and mergers and acquisitions. This course involved case studies of US companies and visits to the New York Stock Exchange (NYSE). The course was particularly relevant for KAMCO as it established REITs with its own (not public) funds under the newly enacted REIT law. KAMCO implemented its training program successfully by entrusting its training courses and dispatching its staff to institutions relevant to its needs. Appendix 1 gives details on KAMCO's domestic and external training programs.

20. Overall, KAMCO benefited considerably from its utilization of ADB's TA loan. The consultancies financed by the loan provided KAMCO with clear guidance and direction in navigating its course to its enhanced mandate. The domestic and external training programs helped KAMCO staff prepare to improve its operating efficiency. KAMCO has retained staff, trained both in Korea and abroad, which vindicates the TA loan's sustainability. The domestic and external training conducted on a one-time basis served as an efficient model for continuous in-house KAMCO training afterward. KAMCO acquired NPLs worth W110 trillion, at a discount, by using public funds. Of the W39.1 trillion spent by KAMCO in financial bailouts since 1997, it had recovered W30.93 trillion (or 79%) by May 2003, according to MOFE in August 2003. This impressive recovery illustrates the TA loan's efficacy.

3. Strengthening of the Korea Deposit Insurance Corporation

21. The Korea Deposit Insurance Corporation (KDIC) was established in 1996 with an initial Government capital contribution of W10 billion, after Korea's admittance to the Organization of Economic Cooperation and Development (OECD). KDIC was designed after studying the models of the US Federal Deposit Insurance Corporation (FDIC) and the Canada Deposit Insurance Corporation (CDIC). The role of KDIC was enhanced significantly during the Korean financial crisis which started in 1997, when KDIC issued special bonds guaranteed by the Government to raise additional resources to rescue troubled financial institutions.⁹ KDIC separated the public funds raised by the issue of such bonds from its normal deposit insurance fund (DIF) accumulated through premiums charged to financial institutions with the help of new legislation. KDIC's mission during the Korean financial crisis was to restore public confidence in the banking system without creating—or giving the impression of creating—a moral hazard.

22. KDIC used funds from ADB's TA loan for consultancy services and external staff training for institutional strengthening to maintain public confidence in the banking system during Korea's financial crisis. KDIC'S institutional strengthening to meet its main objective was well conceived and implemented (para. 21).

23. For consultancy services, KDIC engaged a consortium of Korean and foreign consultants to provide appropriate and innovative financial methodologies to: (i) strengthen KDIC's mid- and long-term development strategies by improving public confidence in KDIC's methods and improving its DIF use, and improving staff capacities for these functions; (ii) strengthen KDIC's risk management capabilities through timely and on-site examination of financial institutions to obtain early warning indications to enable KDIC's prompt and proactive intervention; (iii) strengthen KDIC's autonomous resolution and recovery functions through the adoption of least-cost principles (including appointments of KDIC as liquidator, or official receiver, of bankruptcy trusteeships of troubled financial institutions to enhance efficiency of recovery); (iv) split KDIC'S funds available for bailout between its own funds (DIF) and public funds (para. 21, 24, and 26); (v) develop a management information system for the preparation of a consolidated electronic database of information regarding all insured financial institutions, to share with other regulatory agencies and to be accessed by KDIC staff, as a basis for decision making; (vi) establish a formal training function in KDIC, and providing continuous and systematic participatory training to all levels of KDIC staff; and (vii) improve KDIC's governance structure to help it relate to changing circumstances. For example, the appointment of four outside, independent members of KDIC's Policy Committee was recommended.

24. At the macro level, legal enactments and amendments by Korea's legislature helped KDIC in its endeavors undertaken with ADB's loan inputs. The passage of the Public Fund Oversight Special Act (PFOSA) in December 2000 institutionalized and facilitated the application of the consultants' recommendations for KDIC. Also important, it strengthened the transparency of the regulations on KDIC use of public funds. Thus, PFOSA helped KDIC separate its normal operations (using its DIF) from its special operations, using public funds. Legislation also followed recommendations of the consultants' report by applying the least-cost principle to resolve problems of bankrupt institutions. PFOSA also permitted the appointment of KDIC as the liquidator/trustee of failed financial institutions. The amendment of the Depositor Protection Act (DPA) in December 2000 helped strengthen the prudential autonomy and

⁹ These bonds were guaranteed by the Government, so were regarded as risk-free assets, in which many financial institutions were willing to invest during and after the financial crisis.

independence of KDIC's operation. The enactment of legislation based on the consultants' recommendations is impressive, and reflects commitment of the Government's executive and legislative branches to financial sector reforms.

25. KDIC's out-of-country training was customized to KDIC's specific needs and conducted for 17 persons at Baruch's College, New York, United States from 28 November to 15 December 2000. The training involved both classroom instruction and practical experience with the FDIC, the Federal Reserve Bank of New York (FEDRESERVE), the NYSE, the US Securities Exchange Commission (SEC), and the Office of Comptroller of Currency (OCC) in Washington, DC. The course contents included: (i) introduction to the development strategy and organization of the deposit insurance system in the United States, with particular reference to the 1991 amendments to the FDIC Act coupled with the dilution of the McFaden¹⁰ and the Glass-Steagall Acts;¹¹ (ii) understanding risk management and analyses of financial institutions as well as the practices and methodologies for their institutional supervision and regulation; (iii) introduction to the methodologies for restructuring failed financial institutions, using US case studies; (iv) management and sale of foreclosed assets of insolvent financial institutions; (v) site visits to OCC, FDIC, NYSE, SEC, and FEDRESERVE; (vi) loan syndication, debt securitization, asset securitization, and the accounting and restructuring of defaults on operating and financial leases; (vii) analysis of financial statements; (viii) bank audit; (ix) banking supervision; (x) bank asset-liability management; and (xi) methods for restructuring banks' NPLs. Appendix 1 gives details of KDIC's training programs. This program gave practical examples, using US case studies following RTC operations in the 1980s,¹² for the resolution of insolvent US financial institutions. Korea's DPA closely followed the 1991 amendments to the US FDIC Act. The separation between commercial and investment banking in Korea's past legislation (similar to the Glass Steagall Act) was also abolished. KDIC needed to study the US model of financial supervision where banks were simultaneously supervised by OCC, FDIC, and the Federal Reserve System. Knowledge of the US SEC and NYSE's disclosure requirements of listed banks in the United States was also important for KDIC as early warning indicators for symptoms of possible troubles. Holistic operational knowledge of the US system of financial supervision was particularly relevant to KDIC.

26. KDIC and the Republic of Korea benefited substantially from ADB's TA loan. It enabled KDIC's timely and marked intervention to restore public confidence in the banking system without creating a moral hazard. In doing so, KDIC prevented a more adverse contagion of the crisis. KDIC was able to improve the economy and efficiency of its operations while simultaneously improving the transparency of its governance. Separation of its DIF from its use of public funds enhanced public confidence in KDIC while simultaneously sending the right signals to financial institutions. KDIC's implementation of its early warning system will enable early, timely and proactive interventions in future to stem the onset of financial difficulty by institutions. This will help considerably in saving public expenditures for future financial bailouts. Reorganization of KDIC's internal management and its enhanced staff skills, brought about through consultancy and training financed by the TA loan, have helped in the process. KDIC's retention of staff trained under the TA loan indicates its sustainability. KDIC's external training, conducted on a one-time basis, served as a model for further, continuous in-house training. Of the W102.3 trillion in public funds that KDIC spent in financial bailouts from 1997 to 2003, it had

¹⁰ A law that the US Congress enacted in 1927 giving US states the power to regulate branch banking, including restrictions on branching by national banks. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 lifted most barriers to interstate banking.

¹¹ A federal law enacted by the US Congress in 1933 that forced a separation between commercial and investment banking.

¹² RTC in the United States has since been closed. Its activities are now handled by an FDIC division.

recovered W18.95 trillion (or 18.5%) by May 2003, according to MOFE.¹³ This record bears testimony to the success of the TA loan.

C. Project Cost

27. At appraisal, the total project cost was estimated at \$22.7 million, comprising \$11.7 million in foreign exchange costs and \$11.0 million in local currency costs (Appendix 2). ADB was to finance a portion of total project costs through a loan \$15.0 million, comprising \$11.7 million in foreign exchange costs and \$3.3 million in local currency costs. The Government was to finance the balance of \$7.7 million.

28. The actual cost of the TA was far lower than estimated at appraisal. It was \$13.6 million, comprising \$7.5 million in foreign exchange costs and \$6.1 million in local currency costs. ADB's loan size was reduced to \$7.9 million; the foreign exchange component was \$7.5 million, and the domestic currency component was \$0.4 million.

29. The major change in the TA's scope reduced its cost substantially. The cost underrun is further attributable to (i) the absence of requirement to finance domestic consultancies from the loan, (ii) the reduced cost of domestic training and workshops, and (iii) the cancellation of the originally unallocated amount earmarked in the TA's budget. The TA's four IAs were revenue-earning concerns that had to borrow loan funds at interest, so they used their resources efficiently. The two banks implemented their consultants' suggestions expeditiously in-house, on-the-job, and on a vestibular bases. This saved additional domestic training expenses for the banks. The four IAs also conducted their training workshops economically.

D. Disbursements

30. Although the loan became effective in December 1997, the first disbursements were made only in June 1999.¹⁴ This delay is attributable to considerable revisions in project scope. From 1999 to October 2002, disbursements were made according to the requirements of the revised project scope. Neither the loan's RRP nor the loan agreement included a disbursement schedule.

31. An imprest account was opened with KDB on 31 July 2000¹⁵ in accordance with ADB's *Guidelines on Imprest Fund and Statement of Expenditure Procedures*. Items eligible for financing through the imprest account included consultancy and training expenses. A statement of expenditure was used to reimburse and liquidate eligible expenditures. A total disbursement of \$7.9 million was made under the loan after partial cancellations (Appendix 2). KDB, on behalf of MOF, refunded \$14,545 from KDIC's unliquidated advances on 31 October 2002. Then the loan was closed. The use of the imprest account facilitated project implementation without problems.

¹³ Cumulatively, KDIC and KAMCO spent a W141.4 trillion from 1997 to 2003, and had recovered W49.9 trillion in NPLs (35.3%) by May 2003. By the end of 2003, the two institutions are expected to recover 55% of public funds spent on financial bailouts by the end of 2003. According to the IMF, this recovery record compares favorably with those of other countries.

¹⁴ This \$2.3 million disbursement was through direct payment to the consultants, before opening of the imprest account.

¹⁵ Although the Loan Agreement required the imprest account to be opened with the Bank of Korea, ADB subsequently agreed to its opening with KDB, when ADB approved, retrospectively, a change to use of KDB in the loan's implementation arrangements (para. 34).

E. Project Schedule

32. At appraisal, project implementation was envisaged over a 2-year period beginning in January 1998. Because of revisions in the Project's scope, the TA loan remained unutilized for more than a year, with no envisaged activity undertaken. Subsequently, the TA's implementation period was extended to 31 December 2002 at MOFE's request to accommodate the Project's revised scope (para. 5). Implementation of the revised Project began in June 1999 and ended in May 2002. After accomplishment of the activities envisaged under the Project's revised scope, the TA loan was closed on 31 October 2002.

F. Implementation Arrangements

33. MOFE was the EA, responsible for the overall coordination of the TA loan throughout implementation. After a change in the TA loan's scope, its new IAs were Kookmin Bank, Woori Bank, KAMCO, and KDIC.

34. In the TA loan's original design, the Borrower (the Government of the Republic of Korea) was required to include an allowance in its 1998 budget to provide for borrowing under the TA loan. But the Government was not able to make this line item provision, either in its main or supplementary 1998 budgets. Because of the inability to include the allowance, the Government, without prior ADB approval, entered into a subsidiary loan agreement (SLA) with KDB. Through the SLA, the Government would relend ADB's loan funds to KDB, which would then on-lend to the new IAs. ADB approved this change in implementation arrangements retrospectively through a revised memorandum signed with the Government and a board paper dated 22 December 1998. For this arrangement, KDB paid MOFE five basis points (0.05%) as a management fee for principal and interest installments. KDB charged KDIC and KAMCO a margin of 50 basis points (0.5%), and KB and WB a margin of 40 basis points. KDB bore the credit risk for such on-lending. KDB advised ADB that it charged a lower margin to KB and WB than it charged KDIC and KAMCO because KB and WB were commercial banks. KDB's pricing mechanism appeared symbolic in its demonstration of its newly found independence in ascertaining banking and credit risks and the avoidance of moral hazard in the post-crisis era.

35. Changes in implementation, made after the TA loan's approval, were necessary to achieve the loan's objectives.

G. Conditions and Covenants

36. The TA loan became effective without delay on 23 December 1997, 4 days after Board approval. There were no specific covenants for loan effectiveness. However, the Project's scope had to be revised substantially, which delayed the loan's implementation (para. 4, 5, 30, and 32). The loan's covenants were well drafted, generic in content, and flexible in form. They did not need revision with the change in the project scope. All covenants to the Loan Agreement were complied with satisfactorily (Appendix 3).

H. Consultant Recruitment and Procurement

37. At appraisal, the Project envisaged 312 person-months of consultancy over 2 years. The actual implementation period for the project was 2.6 years. The IAs generally preferred fixed-

sum contracts with consultants, rather than to be billed by person months, because it facilitated determination of costs at the outset of a consultancy.¹⁶

38. All consultants were selected in accordance with ADB's *Guidelines on the Use of Consultants*. ADB's procedures for consultant recruitment caused no problems or disagreements among ADB, MOFE, and the three IAs. For selection of the best talent appropriate to their needs, the three IAs posted bidding notices on the internet, and adopted bidding processes to select applicants' requests for proposals from such notices.

I. Performance of Consultants

39. KB's consultants were fielded within their original schedules, from 15 October 1998 to 31 March 1999. Their output was highly satisfactory and complied wholly with their TORs. Their work was carried out in a participatory manner, maintaining cordial relations with KB staff and seeking feedback on the efficacy of their recommendations in Korea's context. The success of the consultants' output is borne out by KB's operational and financial performance results since 1999.

40. WB's consultants carried out their assignments satisfactorily and within their original time frame, from 23 September to 23 December 1998. Although the consultants' suggestions caused some disagreement within WB, the bank's improved operational and financial performance since 1999 confirms the efficacy of their outputs.

41. KAMCO hired a consultancy firm to provide services from July 1998 to April 1999. The cost was \$803,465, of which ADB's TA loan financed \$802,565.¹⁷ The consultants worked efficaciously, efficiently, and in a participatory manner, to KAMCO's satisfaction. KAMCO endorsed their recommendations, which provide direction for KAMCO's future operations.

42. KDIC engaged services of a consortium of consultants to provide services for 10 months, from 26 June 2000 to 13 April 2001, for \$1,591,223.¹⁸ The consultants' performance was participatory, in consultation with KDIC and relevant to KDIC's needs. KDIC was fully satisfied. The international consultants teamed up with two local consultancy agencies, which greatly enhanced their understanding of KDIC's needs in the Korean context. That facilitated the consultants' design of a schedule of services tailored specifically for KDIC.

J. Performance of the Borrower and Executing Agency

43. The Borrower's performance in commitment to overall financial sector reform was satisfactory. This was evidenced in the passage of important legislation such as DPA and PFOSA. The Borrower cooperated efficiently with ADB in redesigning the Project, and helped identify institutions that could benefit from the TA loan. Participation of these institutions in the loan had a beneficial spinoff on the overall economy. But the Borrower could have avoided duplication by advising IBRD to focus its loan on areas not covered by the previously approved ADB loan. Also, the Borrower could have advised ADB before loan approval of the difficulties of seeking a provision for this project as a budget line item. The Borrower's unilateral change to the implementation arrangement (para. 34) soon after loan approval appears unusual. These two oversights delayed loan implementation. The duplication problem delayed implementation

¹⁶ Because some IAs were using international consultants for the first time, they could not precisely determine their person-month requirements.

¹⁷ KAMCO financed the remaining amount of \$900 in value-added tax.

¹⁸ Of this, \$108,777 was subsequently cancelled.

substantively, and the budget line problem, procedurally. But ADB, recognizing the Borrower's predicament, signed a new memorandum of understanding with the Government of the Republic of Korea for changes in the TA loan's scope and implementation arrangements (para. 3 and 34). MOFE's performance as the loan's EA was satisfactory. MOFE's expeditious identification of those areas in the financial sector to be covered by the revised scope of this loan helped ADB redesign its scope. MOFE's cooperation with ADB in the efficient implementation of the redesigned Project was impressive.

K. Performance of ADB

44. ADB's performance in the Project's design, and later redesign, and implementation was partly satisfactory. The structural changes to the loan's design to keep it relevant amid circumstantial changes (para. 3) inevitably delayed its implementation. ADB's interventions during project implementation were reactive rather than proactive. Consequently, the loan's implementation progress was categorized as "partly satisfactory" for the periods January 1998 to May 1999 and April 2001 to January 2002. ADB fielded four special project administration missions¹⁹ during this period to seek the Government's concurrence to change the loan's scope, and to implement these changes. The successful outcome of these missions resulted in a revised TA scope more focused to the country's needs, and with considerable cost savings. The TA loan's implementation progress had a satisfactory rating from June 1999 to March 2001.²⁰ But the loan's implementation progress dropped to partially satisfactory from April 2001 to January 2002. This was attributed to (i) the extension in the loan's closing date, so the Project could cover new areas, from 31 December 2000 to 31 December 2002; and (ii) delays and subsequent cancellation of training programs under the TA to be held in New York in October 2001 because of the 11 September 2001 incident. For administrative purposes, implementation of the loan was originally the responsibility of ADB's Extended Mission in Korea. It was then transferred to headquarters, first to IEOD and then to IEFI, to be inherited by ECGF. Frequent changes in personnel in ADB's administering of the loan also caused some delays in its implementation. The TA loan's development objectives, however, were consistently satisfactory (Appendix 4). The content of the loan's revised scope and the training programs financed by it were relevant to the country's financial sector reforms, as it helped strengthen financial institutions. Once its scope was changed, ADB's supervision of the loan was effective and its decisions were made on a timely basis. This was recognized in the Borrower's PCR.

III. EVALUATION OF PERFORMANCE

A. Relevance

45. The Project's goal and objectives were relevant at the time of its preparation. The Project's design needed considerable alteration to keep it relevant during implementation by recognizing changes in macroeconomic and legislative circumstances in Korea. More careful planning at the design stage could have avoided the need for project redesign so soon after approval. The Project's design to accomplish its goal and objectives was, therefore, only partly relevant (Appendix 4).

¹⁹ These missions were fielded 23–28 May 1998, 31 August–4 September 1998, 9–13 October 1998, and 3–7 December 1998.

²⁰ During this period, three missions were fielded: 18–29 October 1999, 2–4 December 1999, and 8–10 November 2000.

B. Efficacy in Achievement of Purpose

46. The Project achieved the immediate development objectives of a better and prudentially regulated financial sector envisaged in its revised design. It also laid the foundation for continued reform of the financial sector. The TORs for the consultants and the training were particularly pertinent for this purpose. The Project achieved the immediate objectives envisaged in its revised design and was, therefore, efficacious (Appendix 4).

C. Efficiency in Achievement of Outputs and Purpose

47. The Project's implementation period was delayed because of significant post-approval changes to its design. Consequently, the TA loan's closing date had to be extended by 1.75 years. Nevertheless, implementation of the Project, with the revised scope, was completed within its revised schedule. The performance of the Borrower, EA, and IAs (including their contributions to counterpart funding) was satisfactory in the circumstances. Recruitment and selection of consultants were in accordance with ADB procedures. ADB's internal processing and administration of the Project was, however, reactive rather than proactive. The Project's design and implementation were less than efficient (Appendix 4).

D. Preliminary Assessment of Sustainability

48. The TA's outputs facilitated (i) considerable improvement in the operational and financial performance of KB and WB and (ii) strengthened capacities of KAMCO and KDIC for the recovery of public funds spent on financial bailouts. KAMCO and KDIC had cumulatively recovered 35.3% of public funds spent by May 2003, and are expected to recover 55% of funds spent by the end of 2003. This impressive recovery record earned the IMF's commendation (footnotes 5 and 13). Importantly, the TA helped build institutional capacity in financial institutions for sustainable operations in the post-reform era. KDIC and KAMCO still retain the staff trained in Korea and abroad under this TA loan. KB and WB also retained most of their staff trained under this TA. All four financial institutions have continued regular in-house training programs. The benefits of this TA loan are sustainable (Appendix 4).

E. Institutional Development, and Other Impacts

49. The TA loan facilitated restructuring of two banks as a paradigm demonstration of ADB's goal of strengthening the financial sector. The TA's inputs, particularly for KDIC and KAMCO, were useful for legislation enacted for strengthening the prudential supervision powers of financial regulation without creating a moral hazard. The passage of PFOSA endorsed the TA's inputs on the need for transparency and the application of the least-cost principle for the resolution of banking financial institutions. The DPA, amended in 2000, endorsed the TA's recommendations for strengthening KDIC's prudential autonomy and independence. The Project's institutional developments and other impacts are moderate (Appendix 4).

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

50. Overall, the Project is rated as successful.²¹ Its design had to be changed substantially to maintain its relevance to the changed macroeconomic circumstances, which delayed its implementation and reduced its efficiency. Nevertheless, ADB's interventions in changing the project design and implementation arrangements, although reactive, helped keep the Project efficacious and its outputs sustainable. Fortunately, suitable institutions were selected as IAs in the project's reformulation. These institutions used the TA's inputs efficiently, which benefited not only the institutions themselves, but also the overall economy. This offset the Project's delayed implementation. Importantly, the Project helped to build institutional capacity in financial institutions for efficient operations in the post-reform era. This achievement is crucial as the Korean economy embraces further financial sector reforms based on market discipline, complemented by sound macroeconomic policies. The importance will be greater as Korea prepares for full capital account convertibility by 2011, as committed to the IMF (footnote 5).

B. Lessons Learned

51. Four important lessons were learned from this TA loan.

1. Improvement in Macroeconomic Conditions Necessary for Success of the TA Loan

52. The impacts of the TA loan were beneficial to the Korean economy because of serious structural reforms that the Government undertook. These reforms included (i) enactment of legislation such as DPA and PFOSA (para. 24) and the REIT Law of Korea (para. 19) and (ii) the Government's encouragement of the merger of banks (para. 6). The legislation served to create a sound financial regulatory and supervision system to build public confidence without moral hazard. KDIC's and KAMCO's high recovery of public funds and the improvements in financial performance of the two banks bear testimony to the necessity of successful and far-reaching domestic reforms for the effective use of donor-funded technical assistance programs. The IMF has rightly commended Korea's successful reform efforts (footnote 13).

2. Policy Dialogue and Coordination with Other Development Partners

53. This loan was processed rapidly, and simultaneously with ADB's FSP loan, in November–December 1997. Consequently, the consultancy requirements of the Korean financial system that were being financed by loans from other development partners did not appear to have been kept in perspective when designing its components. Circumstances indicate that policy dialogue with the Government and with other development partners on ADB's focus was inadequate. That is why the same components were covered by the IBRD's FCRP. To avoid duplication, ADB and the Government had to agree to new components, which undoubtedly assisted the country's reforms and reduced its cost considerably, but also delayed implementation. More careful and thoughtful design by ADB could have avoided this time overrun and reduced costs from the beginning.

²¹ Using OED's methodology, it obtained a rating score of 1.6 (Appendix 4, which also provides the basis for the overall and individual ratings).

3. Cost of Funding Training and Consultancy Services

54. The Government of the Republic of Korea considered ADB's OCR lending too costly to finance training and consultancy, which is why it prepaid \$3.3 million (including a penalty)²² of the \$7.8 million used for this purpose as its balance of payments improved. This explains reluctance of some other of ADB's developing member countries to borrow from ADB's LBL facility to finance consultancies and training.

4. ADB's Unfamiliarity with Korea in 1997

55. The Republic of Korea stopped borrowing from ADB in 1988, so ADB was not familiar with Korea's development priorities and Government procedures in 1997. If policy dialogue had been maintained with Korea between 1988 and 1997, ADB could have been better aware of Korea's development needs and its dealings with other development partners. Such knowledge could have helped ADB design a better project without duplicating the efforts of others.

C. Recommendations

56. The Republic of Korea has ceased to be an ADB borrower. No further assistance, nor changes of the covenants of this Loan Agreement, were deemed necessary. But ADB should continue to field policy consultation missions, similar to IMF's Article IV Missions, to monitor Korea's continued recovery and reform efforts. This could help ADB ascertain the continued progress of Korea's economy, and provide ADB with the knowledge to apply the model of the Korean success story to other developing member countries.

²² This was the amount of installments due from 2009 to 2012, and the maximum amount of the loan that could be prepaid.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. Kookmin Bank

1. Introduction

1. Kookmin Bank (KB) is a privately owned bank with substantial foreign direct investments. It absorbed the Korea Long-Term Credit Bank (KLB) on 1 January 1999. KB applied for a consulting fee from the TA loan to seek the most effective ways to integrate the bank's business and to establish a long-term strategy plan to maximize a synergy created from the merger.

2. Timing

2. Consulting services were conducted by Anderson Consulting Co. from 15 October 1998 to 31 March 1999, within the original schedule.

3. Terms of Reference

3. Anderson Consulting's role in this engagement was to work closely with the KB and KLB merger team to undertake analysis and consultancy services that covered the following areas:

- a. Developing a new risk management strategy for the merged bank;
- b. Establishing a new core business plan and marketing strategy for the merged bank, taking into consideration KB's and KLB's individual strengths, weaknesses, opportunities, and threats;
 - i. Specification of the merged bank core businesses and development of a long-term business plan
 - (i) A definition of the alternative plan for the merged bank core businesses,
 - (ii) A definition of the standard for the estimation of the alternative plan, and
 - (iii) Development of a long-term business plan.
 - ii. Marketing strategy of the merged bank
 - (i) Comparison of the marketing strategies of two banks, KB and KLB,
 - (ii) Development of a strategy for management of the existing customers, and
 - (iii) Analysis of the demands by its branch network.
 - iii. Identification of key opportunities and a high-level implementation plan for improvement of operations performance to be achieved through the merger.
- c. Establishing and defining measurable and quantifiable performance targets for the merged bank, and a basis for data collection through:

- i. Vision and key performance targets for the merged bank
 - (i) Development of a high-leveled vision for the merged bank,
 - (ii) A definition of framework for key performance targets and the collection of data on key performance in other cases, and
 - (iii) A draft of estimation on synergy effect for 3 years.
 - ii. An international business strategy for the merged bank
 - (i) Comprehension of key performance targets for international business, and
 - (ii) Definition of an international business strategy.
- d. Estimating the merged bank's capital requirements in accordance with the Basle Committee of Banking Supervision (BCBS), and providing guidelines and a road map for meeting those requirements
- i. An efficient capital management plan
 - (i) Estimation of the two banks' capital management, and
 - (ii) Provision of information considering the present capital condition, BCBS ratios, and benchmark requirements.
- e. Planning the HR and IT requirements of the merged bank
- i. Merged bank organization and HR strategy
 - (i) Comprehension of the present HR system (merits ratings, promotions, etc.), and
 - (ii) A performance target for a new human resources management system.
 - ii. Changed management and communication strategy for merger integration
 - (i) Analysis of the cultural gap between the two banks, and
 - (ii) Establishment of a strategy to reduce the cultural gap, and develop better communication.
 - iii. An IT integration plan and strategy for the merged bank
 - (i) Estimation of the present system and technical architecture,
 - (ii) Establishment of performance targets for the merged banks' IT system, and
 - (iii) Development of a framework for an IT integration plan.
- f. Designing strategies for recovery and management of the merged bank's nonperforming loans (NPLs), to the extent not transferred to the Korea Asset Management Corporation (KAMCO).

4. Deliveries

4. Anderson Consulting, in its final report, presented a new and detailed strategy for the reshuffled organization. Its activities included:

- a. Measurement of implementation and planning
 - i. Improved capability to measure implementation
 - (i) Market Opportunity Rate System. Distribution of the prime cost and the capital, which included estimation of the two banks' capital requirements in accordance with BCBS and systems for measuring capital requirements of the two banks and of the merged bank on a real time basis.
 - (ii) Balance Score Card. Developed process like Shadow Reporting.
 - ii. An early analysis of implementation on a department-wide system of the strategy for recovery and management of those NPLs not transferred to KAMCO.
- b. Improvement of a loan business
 - i. Introduced a new system on a loan business, such as formula-based lending, and
 - ii. Standardized and improved the procedure for lending to small and medium enterprises.
- c. Retail banking business
 - i. Developed a cross sales program on mortgage loans, and
 - ii. Developed a profit-improving program on private banking business.
- d. Corporate banking business
 - i. Introduced the subdivided strategy for targeting high-profitable customers, and
 - ii. Initiated methods for acceleration of the risk management system.
- e. International banking business: Developed a new strategy for overseas branches
- f. Human resource management
 - i. Developed a new human resource management system, and
 - ii. Remedied the training and compensation system.
- g. IT integration
 - i. Developed an upgraded process system, and
 - ii. Connected the IT enhancement project with key performance targets.

5. Conclusion

5. The output of KB's consultants was highly satisfactory. The output complied entirely with the terms of reference (TOR), and was delivered within the original time frame. The consultants' work was carried out in a participatory manner. The consultants maintained cordial relations with KB staff and sought their feedback on the efficacy of their recommendations in Korea's context. The testimony to the success of the efficacy of the consultants' output is borne out of KB's operational and financial performance results since 1999.

6. KB's financial and operational performance since 1999 is evidence of the efficacy of the TA. Financially, KB has been satisfactorily solvent, comfortably liquid, and improving in profitability (para. 7 of main text). Operationally, the results of KB's takeover of KLB fully met the expectations of the envisaged synergy of merger. With inputs from the TA, KB increased its retail customer base and diversified its lending for Korea's small and medium enterprises. Such diversification helped reduce KB's cost of funds. While reducing KB's exposure to larger conglomerates, this also benefited the country's upcoming sector in terms of output and employment. The increased use of electronic banking enabled KB to rationalize its HR management successfully. Such rationalization, coupled with the bank's reduced cost, enabled it to maintain a sustainable growth trajectory (para. 9 of main text). Overall, the TA outputs were highly beneficial to KB. The improvements in KB's operational and financial performance were recognized internationally and drew in foreign direct equity investment from reputable foreign institutional investors (para. 8 of main text).

B. Woori Bank

1. Introduction

7. Woori Bank (WB) is a de facto government-owned bank, because the Korea Deposit Insurance Corporation (KDIC) holds 88% of the total equity of Woori Holdings. It was established on 1 January 1999 through a merger of the former Hanil Bank and the Korea Commercial Bank (KCB), and was formerly known as the Hanvit Bank. The emergence of WB through merger and consolidation of existing financial institutions is consistent with ADB's goal of creating a stable and efficient financial system.

2. Timing

8. The consulting services by PricewaterhouseCoopers were conducted within the original schedule, from 23 September to 23 December 1998.

3. Terms of Reference

9. The TA loan provided consultancy to WB for:

- a. A strategy for initiatives for short-term profit improvement;
 - i. Staff reductions,
 - ii. Branch consolidation,
 - iii. Consolidation of subsidiaries, and
 - iii. Handling of nonbusiness related real estate.
- b. A strategy for postmerger integration plans for WB's constituents, and a road map for its implementation;

- i. A top-level organization structure,
 - ii. Project management of the integration,
 - iii. A communications plan, and
 - iv. A plan for IT integration.
- c. An action plan for recapitalization of the bank;
- d. A strategy for management and recovery of WB's NPLs, not transferred to KAMCO;
- i. Recapitalization and management of bad assets
 - (i) Managed the NPLs left behind (not sold to KAMCO),
 - (ii) Treated NPLs in subsidiaries, and
 - (iii) Created in-house cell for NPLs.
- e. A new corporate governance plan;
- f. A risk management strategy for WB; and
- g. Strategies and action plans to integrate WB's HR and IT policies.

4. Deliveries

10. The consultant provided the newly appointed business unit heads, the merger committee teams, and the post-merger management team with a framework, or "road map," to complete integration plans. The salient features of the TA's deliveries were:

- a. Short-term profit improvement initiatives:
 - i. Eliminated excess manpower through objective and transparent process,
 - ii. Closed overlapping/unproductive branches based on return on assets (ROA), profit, profit per staff, and enhanced market potential and market competitiveness,
 - iii. Merged overlapping subsidiaries and liquidated those with poor asset quality, and
 - iv. Recommended sale of overlapping assets (such as the head office building and parking facilities), unoccupied real estate, and other nonprofit generating assets.
- b. Post merger integration plan
 - i. Redesigned organization for the merger, including the Merger Steering Committee, and Merger Executive Office, and
 - ii. Proposed integration steps for post-merger organization, HR, corporate culture, operation, and IT.
- c. Recapitalization of the bank and management of NPLs
 - i. Devised capital plan to meet 10% BCBS capital adequacy ratio (CAR) (5% tier 1, 5% tier 2),
 - ii. Initiated recapitalization by the Government and foreign investors,
 - iii. Established facilities for liquidating NPLs,

- iv. Initiated loan workout program, and
 - v. Devised plans for NPL sales.
- d. Financial projections for the following parameters:
- i. Drafted a 5-year financial projection to 2004, including economic index, capitalization, and NPL sales;
 - ii. Devised a management index;
 - iii. Improved profitability and productivity: ROA, return on equity (ROE), CAR, intermediation cost ratio, operating income per employee; and
 - iv. Financial quality: BCBS CAR, NPL ratio, risk exposure.
- e. Strategy
- i. Initiated three-phase strategies:
 - (i) Phase 1: Merger and Acquisition (1999): Commencement of Universal Banking
 - (ii) Phase 2: Best Practice (2000–2002): Strengthening of Universal Banking Best Practices
 - (iii) Phase 3: High Growth for the Group (2003–2004)
- f. Corporate governance
- i. Composed board members and board committees with non-standing directors;
 - ii. Composed board of directors with a minimum of 50% outside members,
 - iii. Separated the board of directors (a policy making body) and executive directors (an executive body); and
 - iv. Established a management structure that focuses on shareholders' value.
- g. Risk management
- i. Proposed new direction and objectives of risk management;
 - ii. Enhanced systems of risk management, including credit, market, liquidity, and investment risks; and
 - iii. Enhanced organization to prepare it for the role of risk management: Board Risk Management Committee, Risk Management Committee, Risk Management Business Unit.
- h. Organizational structure
- i. Introduced business units to build management that is accountable for their decisions;
 - ii. Classified businesses: profit generating business, control and supervision, support and service;
 - iii. Established independent accounting units for every profit center;
 - iv. Provided the head of the Human Resources (HR) Department with the authority resources for reorganization; and
 - v. Increased efficiency by reducing decision-making steps according to hierarchy.

i. Performance culture

- i. Introduced salary plan per level, starting with high level and implementing down through the management;
- ii. Classified jobs for HR management: specialists and generalists;
- iii. Selected and managed core job posts;
- iv. Developed new reward system based on evaluation of performance, productivity, and quality; and
- v. Proposed improvements in hiring practice and HR management.

j. Information technology (IT) and management information system (MIS)

- i. Proposed integrated IT system for the merged bank;
- ii. Compared IT systems of Korea Commercial Bank (KCB) and Hanil Bank, and proposed an integration method; and
- iii. Integration of IT center, network, operating system, accounting system, information system, IT staff.

k. Integration master plan.

- i. Proposed plan for the day one of the integration, and
- ii. Proposed contingency plan for various situations during the integration process.

5. Conclusion

11. WB's consultants carried out their assignments satisfactorily and within their original time frame from 23 September to 23 December 1998. WB benefited significantly, both operationally and financially, from the TA. Financially, WB's levels of solvency and liquidity, and trends in its profitability and efficiency, improved with the TA's outputs (para. 13 of main text).

12. WB's post-merger operational efficiency benefited from the TA's inputs for the following salient operational changes: (i) closure of nonproductive branches; (ii) sale or merger of nonproductive or overlapping operations; (iii) streamlining of the use of fixed assets; (iv) elimination of excess HR efficiently; (v) introduction of a new strategy for the adoption of universal banking principles, using best international practices; (vi) streamlining the organization structure to improve accountability, transparency, and efficiency in identifying profit-generating and supporting centers; (vii) introducing a performance-based remuneration system; and (viii) integration of the IT systems of the two merged banks. Although WB's organizational plans met some staff resistance, the bank's successful operating and financial results are evidence of the success of the TA's goals in these endeavors.

C. Korea Asset Management Corporation**1. Introduction**

13. KAMCO was established in 1962 as a subsidiary of the Korea Development Bank (KDB). As a sole government-run agency specializing in disposition of and management of NPLs, KAMCO played an important role in revitalizing the distressed Korean economy during the financial crisis in late 1998. Confronted with the need to systemize and expand its organization to perform unprecedented tasks, KAMCO realized that training of specialists was essential. Thus, KAMCO requested a technical assistance (TA) loan from the Asian Development Bank (ADB) to provide the necessary consultancies and training services for

estimating the bailout requirements of banks affected with NPLs and to introduce innovative practices, taking into consideration experiences of the Resolution Trust Corporation (RTC) of the United States and the Institute for the Protection of Bank Savings (IPAB) in Mexico. Korea Development Institute (KDI) under its Advanced Finance Internship Program developed customized courses for KAMCO. This program included courses in corporate restructuring, real estate finance, and taxation.

2. Timing

14. KAMCO entered into a consulting service agreement with KPMG-Barents Limited Liability Company (KPMG) to provide services between July 1998 and April 1999 and training service agreement with PricewaterhouseCoopers (PWC), KDI and KPMG between April 2000 and March 2001.

3. Terms of Reference

15. In accordance with the TOR, KPMG studied and reviewed KAMCO's operating policies and procedures. Senior officials in all major areas were interviewed. Data on KAMCO's asset inventory were studied. Such reviews and assessments included:

- a. Purchase and disposition of nonperforming assets
 - i. Establishing a strategy for taking over and managing nonperforming assets, and
 - ii. Providing advice on bank resolution techniques and "bad banks."
- b. Management of the "bailout" fund, including its organizational structure, financial management, and the suitability of the existing legal framework
 - i. Reviewing the need to rationalize the corporate structure of companies whose assets KAMCO foreclosed;
 - ii. Reviewing relevant laws, including the KAMCO Act, and recommending legal changes to strengthened KAMCO's capabilities;
 - iii. Identifying major KAMCO goals and objectives—particularly those that conflict with one another;
 - iv. Reviewing KAMCO's organizational structure and capacity, including skills and training needs of its personnel;
 - v. Reviewing the availability, costs, and management of funding;
 - vi. Assessing techniques used for managing NPLs, including evaluation of a company's financial and operational capacity and future potential;
 - vii. Reviewing laws that affect the asset management and disposition process; and
 - viii. Reviewing the adequacy of funding, how funds are managed, and the likely impact of funding on asset acquisition and management.
- c. MIS needs: Assisting in the identification of MIS needs, solicitation of expertise, and the development of criteria for evaluation of bids.
- d. Disposition proposal and transaction support
 - i. Establishing techniques for improving asset disposition;
 - ii. Advising on asset disposition proposals, procedures, and transactions;

- iii. Providing professional services associated with asset disposition;
- iv. Assessing the scope and complexity of assets already in inventory, as well as the potential scope of new assets;
- v. Reviewing and making recommendations regarding KAMCO's strategic plans, strategies, and procedures for asset management and disposition;
- vi. Reviewing asset pricing policies, and their consistency with goals and strategies;
- vii. Helping solicit experienced asset management contractors;
- viii. Assisting in the design, marketing, and successful implementation of KAMCO's first sales effort, including review of bids considering asset-backed securitization, equity participation and structured transactions; and
- ix. Developing and presenting training seminars on asset management disposition.

16. KAMCO staff were trained domestically and abroad in corporate finance, workouts for financial and other industries and international business skills. Staff gained skills in NPL resolution, international finance, asset securitization, mergers and acquisitions, real estate financing, corporate restructuring, and domestic and international legal issues.

4. Deliveries

17. In accordance with their TORs, the consultants assessed and made specific recommendations to KAMCO on:

- a. Criteria and methodology for the purchase and disposition of nonperforming assets;
- b. Management of the "bailout fund;"
- c. Organizational structure, financial management, and suitability of the existing legal framework;
- d. MIS needs; and
- e. Proposals and transactions for asset disposition.

18. KAMCO's domestic training programs were conducted at KDI. Eight hundred and fifty-four KAMCO staff took 1,022 hours of training in the NPL workout/training module from March 2000 to February 2001. Another 571 staff qualified in a similar program at KDI from April to November 2001. Participation in the domestic training module was a prerequisite for out-of-country training, which was conducted by PricewaterhouseCoopers in Dallas, Texas, United States, in 2000, and by Baruch College in New York in 2001. Fifty-nine KAMCO staff were trained in Dallas from May to October 2000, and 25 staff were trained at Baruch College in 2001.

19. Diploma examinations were held at the end of the KDI training courses. The domestic training of KAMCO staff is impressive, in both quality and in the percentage of total staff trained. The out of the country training programs were designed to acquaint KAMCO staff with methodologies applied by the Resolution Trust Corporation (RTC) of the United States and the Institute of Protection of Bank Savings (IPAB) of Mexico. This was particularly relevant to KAMCO staff because many of the Korean banks' NPLs related to foreign operations of their Korean customers. Therefore, the understanding of international practices to resolve NPLs was important in the introduction of better international practices of financial regulations and supervision. The 2000 course in Dallas covered (i) basic asset valuation, (ii) the importance of cash flow, (iii) corporate finance, (iv) corporate restructuring, (v) asset securitization, (vi) asset acquisition and disposal, (vii) operation of bank loan recoveries in the United States from real

estate investment trusts (REITS), (viii) bankruptcy proceedings in the United States under Chapters 7 and 11 of the US Bankruptcy Legislation, (ix) cross-border insolvency, and (x) insights into bank syndications for the workout process. The 20-day course focused on REITS laws in the United States and mergers and acquisitions. The course included case studies of US companies and visits to the New York Stock Exchange (NYSE). This course was particularly relevant for KAMCO in its establishment of REITS in Korea with its private funds through the newly enacted REITS Law in Korea. KAMCO implemented its training program successfully by entrusting its training courses and dispatching its staff to institutions relevant to its needs.

20. Inputs from the TA loan provided KAMCO staff advanced techniques for (i) successful financial and corporate restructuring, and (ii) efficient recovery of public funds injected for the acquisition of NPLs.

5. Conclusion

21. The consultants KPMG/Barents worked efficaciously, efficiently, and in a participatory manner, to KAMCO's satisfaction. KAMCO endorsed their recommendations, which are providing direction for KAMCO's future operations.

22. Overall, KAMCO benefited considerably from its utilization of ADB's TA loan. The consultancy financed by the loan provided KAMCO with clear guidance and direction in its enhanced mandate. The domestic and external training programs helped prepare KAMCO staff for operating efficiency in these circumstances. Of the W39.1 trillion in public funds that KAMCO spent in acquiring NPLs from 1997 to 2003, KAMCO had recovered W30.9 trillion by May 2003. KAMCO's high rate of recovery indicates the TA's efficacy.

D. Korea Deposit Insurance Corporation

1. Introduction

23. KDIC was established in 1996 with an initial capital contribution by the Government of W10 billion after Korea's admittance to the Organization of Economic Co-operation and Development (OECD). KDIC was designed after studying models of the Federal Deposit Insurance Corporation (FDIC) of the United States and the Canada Deposit Insurance Corporation (CDIC). Its role was enhanced significantly during the Korean financial crisis beginning 1997, during which KDIC issued special bonds guaranteed by the Government for raising additional resources to rescue troubled financial institutions. KDIC separated the public funds raised by the issue of such bonds from its normal deposit insurance fund (DIF) accumulated through premiums charged to financial institutions. KDIC's mission during the Korean financial crisis was to restore public confidence in the banking system without creating, or giving the impression of creating, a moral hazard. KDIC used funds from ADB's TA loan for consultancy services and external staff training for institutional strengthening to contain the fallout of Korea's financial crisis.

2. Timing

24. KDIC engaged the services of a consortium composed of Deloitte Touche Tohmatsu (DTT), KDI, and the Korea Institute of Finance (KIF). Services were for 10 months, from 26 June 2000 to 13 April 2001.

3. Terms of Reference

25. The consultancy services consisted of applied and operational technical assistance covering the following key areas:
- a. Development of a corporate strategy and business and management plans for the medium to long term;
 - b. Strengthening of implementation processes and capacities in KDIC's core business areas such as risk analysis and management, resolution and collection processes, and an improved MIS for support; and
 - c. Design, development, and assistance in implementation of a comprehensive training program for KDIC staff.
26. The technical assistance TORs covered:
- a. Corporate strategy, business, and management plans
 - i. Undertaking a diagnostic review of KDIC's current core business operations and its organizational and operational arrangements for management and implementation;
 - ii. Establishing the strategic and mid- to long-term corporate operational strategy, taking into account the enlarged magnitude of the tasks and the challenges that KDIC faced in the context of the financial and corporate restructuring process in the Republic of Korea; and
 - iii. Developing a corporate business plan and a corporate strategic management plan, including changes in internal organizational arrangements necessary for KDIC to achieve its corporate goals.
 - b. Strengthening of implementation processes
 - i. Strengthening systems and processes for the resolution of insolvent financial institutions, and for effective collection of bonds;
 - ii. Strengthening capacity for risk analysis and management. This included a review of KDIC's organizational arrangements and capacity for analyzing and managing risks and, drawing on the best international practices, recommending changes to KDIC's systems and processes for risk analysis and management, design and assistance in establishing a risk analysis and management system, and training of KDIC staff in implementing the system; and
 - iii. Establishing a MIS. This included a review of KDIC's MIS arrangements for the purpose of introducing state-of-the-art improvements to the system, and design of an information system that would make KDIC's operational activities in deposit insurance and banking supervision more efficient by integrating internal and external information channels.

- c. Staff training and development, which covered:
 - i. language and computer training,
 - ii. specialized and technical areas such as risk analysis and management,
 - iii. advanced inspection techniques,
 - iv. management workouts of failed financial institutions, and
 - v. management systems and techniques for deposit insurance funds.

4. Deliveries

27. The consortium of Korean and foreign consultants provided appropriate and innovative financial methodologies to: (i) strengthen KDIC's mid- and long-term development strategies by (a) improving public confidence in KDIC's methods and improving its prudential use of the DIF and (b) improving KDIC's staff capacities for these functions; (ii) strengthen KDIC's risk management capabilities through timely and on-site examination of financial institutions to obtain early warning indications to enable KDIC's prompt and proactive intervention; (iii) strengthen KDIC's autonomous resolution and recovery function through the adoption of least-cost principles, including the appointment of KDIC as the liquidator, or official receiver, of bankruptcy trusteeship of troubled financial institutions to enhance the efficiency of the recovery process; (iv) split KDIC'S funds available for bailout between its own DIF funds and public funds; (v) develop an appropriate MIS for the preparation of a consolidated electronic database of information regarding all insured financial institutions, which could be shared with other regulatory agencies and accessed by KDIC staff as a basis for decision making); (vi) establish a formalized training function within the organization and providing continuous and systematic participatory training to all levels of KDIC staff in disciplines relevant to KDIC's operations; and (vii) improve KDIC's governance structure to align the organization's capacity to relate to its changing circumstances (for example, by recommending the appointment of four outside and independent members of KDIC's Policy Committee).

28. The consultants designed and developed a detailed training plan for KDIC, which involved a combination of short- and medium-term programs, including short-term attachments abroad at specialized institutions. The training activities were implemented both in-house (at KDIC) and externally (both domestically and abroad). The consultants provided the services of one training coordinator and specialist trainers to ensure effective coordination and implementation. The consultants ensured that the design, development, and delivery of the training program was done in collaboration with Korea-based centers of training in related fields such as the Korea Banking Institute and the Korea Management Association, and with overseas centers of excellence including the US Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of New York (FEDRESERVE). One training program in 2000 was conducted at Baruch College of the City University of New York, United States, from 28 November to 15 December 2000. The program was composed of a combination of lectures and on-site practical training.

29. KDIC's out- of-country training was conducted at Baruch's College, New York, and customized to KDIC's specific needs, for 17 individuals from 28 November to 15 December 2000. This training program was conducted both in the classroom and through practical experience with the FDIC, the FEDRESERVE, the New York Stock Exchange (NYSE), the US Securities Exchange Commission (SEC), and the Office of Comptroller of Currency (OCC) in Washington, DC. The contents of this course included: (i) an introduction to the development strategy and organization of the deposit insurance system in the US with particular reference to the 1991 amendments to the FDIC Act coupled with the dilution of the McFaden and the Glass-Steagall Acts; (ii) understanding risk management and analyses of financial institutions as also the practices and methodologies for their current institutional supervision and regulation;

(iii) an introduction to the methodologies for restructuring failed financial institutions using US case studies; (iv) management and sale of the foreclosed assets of insolvent financial institutions; (v) loan syndication, debt securitization, asset securitization and the accounting and restructuring of defaults on operating and financial leases; (vi) financial statements' analyses; (vii) bank audit; (viii) banking supervision; (ix) bank asset-liability management; and (x) methodologies for restructuring banks' NPLs. This program used practical examples and US case studies to demonstrate to KDIC staff, such as the Resolution Trust Corporation's (RTC) operations for the resolution of insolvent US financial institutions in the 1980s. Korea's Deposit Protection Act (DPA) closely followed the 1991 amendments to the US FDIC Act. The separation of commercial and investment banking that previously existed in Korea (similar to the Glass Steagall Act) was also abolished. KDIC studied the US model of financial supervision where banks are simultaneously supervised by OCC, FDIC, and the Federal Reserve System. Knowledge of the US SEC and NYSE's disclosure requirements of listed US banks was also important for KDIC. Holistic operational knowledge of the US system of supervision was particularly relevant.

5. Conclusion

30. KDIC and the Republic of Korea benefited substantially from ADB's TA loan. It enabled KDIC's timely intervention to restore public confidence in the banking system without creating a moral hazard. In doing so, KDIC prevented a more adverse contagion of the crisis. KDIC improved the economy and efficiency of its operations while simultaneously improving the transparency of its governance. Its separation of its DIF from its use of public funds enhanced public confidence in KDIC while simultaneously sending the right signals to financial institutions. KDIC's implementation of its early warning system will enable KDIC's early, timely, and proactive interventions to stem future onsets of financial difficulty of institutions. This will help considerably in saving public expenditures for future financial bailouts. KDIC's reorganization of its internal management and its enhanced staff skills through consultancy and training financed by the TA loan has helped in the process.

31. Of W102.30 trillion in public funds spent by KDIC in financial bailouts from 1997 to 2003, KDIC had recovered W18.95 trillion by May 2003. This record bears testimony to the success of the TA loan.

LOAN COSTS, UTILIZATION AND DISBURSEMENT

**Table 2.1: Summary of Appraised and Actual Costs
(\$'000)**

	Appraised			Actual		
	Foreign Exchange	Local Currency	Total	Foreign Exchange	Local Currency	Total
A. ADB Financed						
1. International Consultants	6,000	0	6,000	6,202	0	6,202
2. Domestic Consultants	0	2,500	2,500	0	0	0
3. Domestic Workshops	0	800	800	0	416	416
4. External Training	1,200	0	1,200	1,252	0	1,252
5. Unallocated	4,500	0	4,500			
Subtotal	11,700	3,300	15,000	7,454	416	7,870
B. Government Financed				IA Financed		
1. Domestic Consultants		1,070	1,070		1,000	1,000
2. Office Support		1,000	1,000		1,200	1,200
3. Equipment		1,500	1,500		3,000	3,000
4. Counterpart Staff		3,000	3,000		500	500
5. Transport		200	200		0	0
6. Contingencies		930	930		5,700	5,700
Subtotal		7,700	7,700		5,700	5,700
Total	11,700	11,000	22,700	7,454	6,116	13,570

ADB = Asian Development Bank, IA = Implementing Agencies (Kookmin Bank, , Korea Asset Management Corporation, Korea Deposit Insurance Corporation, Woori Bank).

Sources: ADB Report and Recommendation of the President to the Board of Directors, Ministry of Finance and Economy, Kookmin Bank, Korea Asset Management Corporation, Korea Deposit Insurance Corporation, and Woori Bank.

Table 2.2 : Loan Allocation and Utilization
(As of 31 October 2002)

Item	Original Allocation	Reallocation^a	Amount Cancelled	Actual Disbursements
International Consulting Services	6,000,000	6,240,805	38,774	6,202,031
Domestic Consulting Services	2,500,000			
External Training	1,200,000	2,479,504	1,227,927	1,251,577
Domestic Training/Workshop	800,000	890,500	474,358	416,142
Unallocated	4,500,000			
Total	15,000,000	9,610,809.00	1,741,059.00	7,869,750

^a Of the original amount of \$15 million, \$9.61 was reallocated for utilization.
Source: ADB Loan Financial Information System.

**Table 2.3: Loan Disbursement Schedule
(\$)**

Original Loan Amount		15,000,000	
Less: Partial Cancellation-Feb. 25, 2000		<u>5,389,191</u>	
Amount Reallocated and Requested by MOFE		9,610,809	
Amount Disbursed to MOFE		<u>7,869,750</u>	
		<u>1,741,059</u>	
Less: Cancellation and Refund			
Amount Cancelled by 15 Feb 2002		1,726,515	
Amount Refunded by 31 Oct 2002		<u>14,545</u>	
Total		<u>1,741,059</u>	
Principal Payment Due from MOFE			7,869,750
Less: Payment made from			
15 Mar 2001 to 17 Mar 2003		1,093,900	
Partial prepayment made on Mar.17, 2003			
KDIC	1,378,806		
KAMCO	<u>1,865,444</u>	3,244,250	<u>4,338,150</u>
Balance Outstanding as of 17 April 2003			<u>3,531,600</u>
Accounted for as follows:			
KDIC	83,278		
KAMCO	112,958		
Kookmin Bank	1,348,987		
Woori Bank	<u>1,986,376</u>		<u>3,531,600</u>

KDIC = Korea Deposit Insurance Corporation, KAMCO = Korea Asset Management Corporation.
Source: ADB and MOFE records.

STATUS OF COMPLIANCE WITH LOAN COVENANTS

Covenants	Reference in Loan Agreement	Status of Compliance
1. The Borrower shall make available, as promptly as needed, the funds, facilities, services, and other resources that are required, in addition to proceeds of the loan, for the carrying out of the technical assistance (TA).	Article IV Section 4.02	Complied with
2. In carrying out the TA, the Borrower shall cause competent and qualified consultants, acceptable to the Borrower and ADB, to be employed to an extent and upon the terms and conditions satisfactory to the Borrower and the Asian Development Bank (ADB).	Article IV Section 4.03	Complied with
3. The Borrower shall ensure that the activities of its departments and agencies in carrying out of the TA are conducted and coordinated in accordance with sound administrative policies and procedures.	Article IV Section 4.04	Complied with
4. The Borrower shall make arrangements, satisfactory to ADB, for insurance of the goods to be financed under the TA against such risks and in such amounts as are consistent with sound practice. To here	Article IV Section 4.05 (a)	Not applicable because no goods were financed from TA loan funds
5. (a) The Borrower shall maintain, or cause to be maintained, records and accounts adequate to identify the goods and services financed from proceeds of the loan, to disclose their use in the TA, to record progress of the TA (including costs), and to reflect, in accordance with sound accounting principles, the operations and financial condition of the Borrower's agencies that carry out any part of the TA.	Article IV Section 4.06 (a)	Complied with
(b) The Borrower shall (i) maintain, or cause to be maintained, separate accounts for the TA; (ii) have such accounts audited annually, in accordance with appropriate auditing standards that are consistently applied, by independent auditors whose qualifications, experience, and terms of reference are acceptable to ADB; (iii) furnish to ADB, as soon as available	Article IV Section 4.06 (b)	Complied with

Covenants	Reference in Loan Documents	Status of Compliance
<p>but no later than 6 months after the end of each fiscal year, certified copies of such audited accounts and auditors' reports (including the auditors' opinion on the use of loan proceeds and compliance with the covenants of this TA Loan Agreement), all in English; and (iv) furnish to ADB other information concerning such accounts and audits that ADB shall from time to time reasonably request.</p>		
<p>(c) The Borrower shall allow ADB, upon ADB's request, to discuss the Borrower's accounts for the TA and its financial affairs related to the TA, from time to time with the Borrower's auditors. Such discussions shall be conducted only in the presence of an authorized officer of the Borrower unless the Borrower agrees otherwise.</p>	Article IV Section 4.06 (c)	Complied with
<p>6. (a) The Borrower shall furnish, or cause to be furnished, to ADB all reports and information that ADB reasonably requests concerning (i) the loan, and the expenditure of its proceeds and maintenance of its services; (ii) the goods and services financed from the loan proceeds; (iii) the TA; (iv) the administration, operations, and financial condition of the agencies of the Borrower that are responsible for carrying out the TA, or any part of it; (v) financial and economic conditions in the territory of the Borrower, and the international balance-of-payments position of the Borrower; and (vi) any other matters relating to the purposes of the loan.</p>	Article IV Section 4.07 (a)	Complied with
<p>(b) The Borrower shall furnish, or cause to be furnished, to ADB semiannual reports on the carrying out of the TA. Such reports shall be submitted in the form and detail, and within a time period that ADB reasonably requests. Such reports shall indicate, among other things, progress made and problems encountered during the period under review, steps taken or proposed to be taken to remedy these problems, and the proposed program of</p>	Article IV Section 4.07 (a)	Complied with

Covenants	Reference in Loan Documents	Status of Compliance
<p>activities and expected progress during the following 6 months.</p>		
<p>(c) The Borrower shall prepare and furnish to ADB a report, in such form and in such detail as ADB shall reasonably request, on the execution and initial operation of the TA, including its cost, the Borrower's performance of its obligations under this TA Loan Agreement, and accomplishment of the loan purposes.</p>	<p>Article IV Section 4.07 (a)</p>	<p>Complied with</p>
<p>7. The Borrower and ADB mutually intend that no other external debt owed a creditor other than ADB shall have any priority over the loan by way of a lien on the Borrower's assets. For that reason, the Borrower agrees that (i) unless ADB agrees otherwise, any lien created on any of the Borrower's assets as security for any external debt will <i>ipso facto</i> equally and ratably secure the payment of the principal of, and the service charge and any other charge on, the loan; and (ii) the Borrower, in creating or permitting the creation of any such lien, will, make express provision to that effect.</p>	<p>Article IV Section 4.09 (a)</p>	<p>Complied with</p>
<p>8. As the Project Executing Agency, the Ministry of Finance and Economy (MOFE) shall be responsible for overall coordination and implementation of the TA.</p>	<p>Schedule 6 (1)</p>	<p>Complied with</p>
<p>9. At the end of the first year of the TA, the Borrower shall conduct a midterm review of all aspects of the TA. Based on its outcome, any necessary adjustments in the design and implementation arrangements of the TA shall be made by agreement between the Borrower and ADB.</p>	<p>Schedule 6 para. 3</p>	<p>Complied with</p>
<p>10. (a) Unless ADB agrees otherwise, the Borrower shall establish, immediately after the effective date, an imprest account at ADB of Korea to expedite disbursements of the loan proceeds for local currency expenditures under the TA.</p>	<p>Schedule 3 para. 7</p>	<p>Complied with</p>

Covenants	Reference in Loan Documents	Status of Compliance
<p>10. The imprest account shall be established, managed, replenished, and liquidated in accordance with ADB's Loan Disbursement Handbook dated June 1996, as amended from time to time, and with detailed arrangements agreed upon by the Borrower and ADB. The initial amount deposited in the imprest account shall be based on estimated expenditures for the first 6 months of TA implementation, but shall not exceed the equivalent of \$1 million.</p> <p>(b) ADB's statement of expenditures (SOE) procedure shall be followed for reimbursing eligible expenditures and for liquidating advances provided in the imprest account. Unless ADB agrees otherwise, no individual payment to be reimbursed or liquidated under the SOE procedure shall exceed the equivalent of \$200,000.</p> <p>(c) The Borrower shall ensure that (i) the imprest account and the expenditures liquidated under the SOE procedures are audited; and (ii) the opinions of the auditors are included separately in the auditors' reports required pursuant to Section 4.06 (b) of this TA Loan Agreement.</p>		<p>Complied with</p> <p>Complied with</p>

ASSESSMENT OF PROJECT OVERALL PERFORMANCE

Criterion	Weight (%)	Details of Performance	Rating Description	Rating Value	Weighted Rating
A. Project Outcome Assessment					
1. Relevance	20%	The objectives and goals of the Project were relevant at the time of its preparation and approval. The Project's design needed to be altered considerably to keep it relevant during implementation by recognizing changes in attendant macroeconomic and legislative circumstances in the country. More careful planning at the design stage could have avoided the need for redesign of the Project so soon after approval.	Partly Relevant	1	0.20
2. Efficacy	25%	The Project achieved the immediate development objectives of a better and prudentially regulated financial sector envisaged in its revised design. It also laid the foundation for continued financial sector reform. The terms of reference for the consultants and the training were particularly relevant for this purpose. However, the Project's outputs achieved, although impressive in themselves, were different from the tangibles assumed at approval. This is because two of the originally assumed implementing agencies ceased to exist in that capacity.	Efficacious	2	0.50
3. Efficiency	20%	The loan closing date was extended by 1.75 years (from 30 December 2000 to 31 October 2002), caused by delays in the implementation, due to the Project's redesign. Nonetheless, the implementation of the revised Project got underway and was completed within its revised schedule. ADB's internal processing of design changes appeared more reactive rather than proactive. The Ministry of Finance and Economy's role as the executing agency despite many changes in its personnel, was satisfactory within the given circumstances. Counterpart funding was made available by the three implementing agencies. Consultant recruitment and selection was in accordance with ADB guidelines and was conducted without delays. Overall, this rating may be "less than efficient."	Less than Efficient	2	.040

4. Sustainability	20%	<p>The TA Loan strengthened the managerial and financial capabilities of Kookmin Bank (KB) and Woori Bank (WB), which was reflected in their improved operational and financial performance since 1999. The TA's inputs (in particular the training in the US) strengthened the capacities of Korea Asset Management Corporation (KAMCO) and Korea Deposit Insurance Corporation (KDIC) in recovery of public funds. KAMCO and KDIC's recovery of 32% of public funds spent until November 2002 is highly impressive and has been commended by the International Monetary Fund. Importantly, the TA helped to build institutional capacity for sustainable operations in the postreform era. KDIC and KAMCO retained all staff trained in and out of the country under this TA. KB and WB retained the majority of staff trained under this TA. The effects of the TA's inputs remain sustainable.</p>	Likely	2	0.40
5. Institutional Developments and Other Impacts	15%	<p>The TA loan also facilitated restructuring of the two banks as a paradigm demonstration of ADB's goal of financial sector strengthening. The TA's inputs, particularly for KDIC and KAMCO, were useful for legislation enacted for strengthening the prudential supervision powers of financial regulation without creating a moral hazard. The strengthening of commercial and regulatory financial institutions assisted in the institutional development of the financial sector (whose strengthening was discussed in the "Efficacy" section of this matrix). The passage of the Public Fund Oversight Special Act endorsed the TA's inputs on the need for transparency and the application of the least-cost principle for the resolution of banking financial institutions. The Depositor Protection Act enacted in 2000 endorsed the TA's recommendations for strengthening the prudential autonomy and independence of KDIC. The TA's development impacts are moderate.</p>	Moderate	2	0.30

**OVERALL WEIGHTED
AVERAGE**

1.6