Financial System in Korea

December 2008

THE BANK OF KOREA

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Part Ⅰ Overview

The foundations of the modern financial system in Korea were laid during the early 1950s when the central and commercial banking systems were realigned under the new institutional bases provided by the Bank of Korea Act and the Banking Act. Specialized banks were established during the 1960s, in order to increase capital mobilization and to strengthen financial support for underdeveloped or strategically important sectors.

Most non-bank financial institutions were introduced during the 1970s in order to diversify financing sources, to promote the development of the money market, and to attract funds into the organized market.

From the early 1980s, several commercial banks and non-bank financial institutions were added as part of a series of broad measures to spur financial liberalization and internationalization. This coincided with a shift from a government-orientated stance on economic policy towards a market-orientated stance.

Since the financial crisis broke out around the end of 1997, the Korean financial system has been undergoing substantial changes in the course of a comprehensive financial reform program.

The financial institutions in Korea may be divided into seven categories by substance and function: (ⅰ) a central bank, which is the Bank of Korea, (ⅱ) banking institutions including commercial and specialized banks, (ⅲ) non-bank depository institutions including merchant banking corporations, mutual savings banks, credit institutions etc., (ⅳ) insurance institutions, (ⅴ) securities related companies, (ⅵ) other financial institutions, and (ⅶ) financial auxiliary institutions.

Financial Institutions

- **Central Bank**
  - The Bank of Korea
- **Banking institutions**
  - Commercial banks
  - Specialized banks
- **Non-bank depository institutions***
  - Merchant banking corporations
  - Mutual savings banks
  - Credit institutions, etc.
- **Insurance institutions***
  - Life insurance companies
  - Non-life insurance companies
  - Postal insurance, etc.
- **Securities related companies***
  - Securities companies
  - Asset management companies
  - Futures companies
  - Securities finance companies, etc.
- **Other financial institutions***
  - Credit specialized financial companies
  - Venture capital companies, etc.
- **Financial auxiliary institutions***
  - Financial supervisory service
  - Korea Deposit Insurance Corporation
  - Financial Telecommunications & Clearings Institute, etc.

* Non-bank financial institutions

Part Ⅱ The Bank of Korea

General Features

The Bank of Korea was founded on June 12, 1950 under the Bank of Korea Act. The Bank of Korea was originally established with a capital of 1.5 billion won, all of which was subscribed by the Government, but the revision of the Bank of Korea Act in 1962 made the Bank a special juridical person having no capital.

The primary purpose of the Bank, as prescribed by the Act, is the pursuit of price stability. The Bank sets an inflation target in consultation with the Government and draws up and publishes an operational plan for monetary policy.

In line with the shift in the financial supervision system on April 1, 1998 toward the integrated supervision of the banking, securities and insurance industries, the bank supervisory function was separated from the Bank and it now has only indirect and limited supervisory powers.

The Bank performs the typical functions of a central bank: issuing bank notes and coins, formulating and implementing monetary and credit policy, serving as the banker's bank, and the Government's bank. In addition, the Bank of Korea undertakes overall management and surveillance of the payment and settlement systems, and manages the nation's foreign exchange reserves. It also exercises the limited bank supervisory functions stipulated in the Bank of Korea Act.

Policy objectives

The Bank of Korea Act provides that the sole purpose of the Bank is to contribute to the sound development of the national economy by pursuing price stability through the formulation and implementation of efficient monetary and credit policies. Practically, however, the Bank's policy objectives involve following three:

(a) Price stability — the Bank conducts monetary policy to pursue price stability under an inflation targeting regime,

(b) Safety and Efficiency of the Payment System — the Bank has the authority for the comprehensive management and oversight of the payment and settlement system in Korea, and operates BOK-Wire which is the mainstay real-time gross-settlement (RTGS) system,

(c) Financial stability — the Bank constantly monitors and analyzes financial institutions' management status and, if necessary, carries out joint examinations with Financial Supervisory Service (FSS).

Organization

The Bank of Korea's organization consists of the Monetary Policy Committee, the supreme policy-making body; the executive, which carries out the policies formulated by the Monetary Policy Committee; and the Auditor.

The Monetary Policy Committee as the policy decision-making body, has the right to deliberate and resolve on major matters concerning monetary and credit policy and the operations of the Bank of Korea.

The Monetary Policy Committee is composed of seven members representing various groups in the national economy, and includes the Governor and the Senior Deputy Governor of the Bank as ex officio members. The members are appointed by the President for four-year terms except the Senior Deputy Governor whose term is three years. All members serve on a full-time basis and no member may be discharged from office against his or her will. The Governor serves concurrently as the Chairman of the Committee.

The Committee generally convenes on the Thursdays of the second and fourth weeks of each month and holds extraordinary meetings as frequently as needed. Monetary policy is resolved and announced on the Thursday of the second week of every month. The minutes of each Committee meeting are announced in the Bank's web-site on the first Tuesday after six weeks have passed from a meeting.

Resolutions at a Monetary Policy Committee meeting are adopted by simple majority when there are at least five members present. Any member may submit a proposal with the concurrence of at least one other member. The Chairman, however, can submit a proposal on his or her own motion.

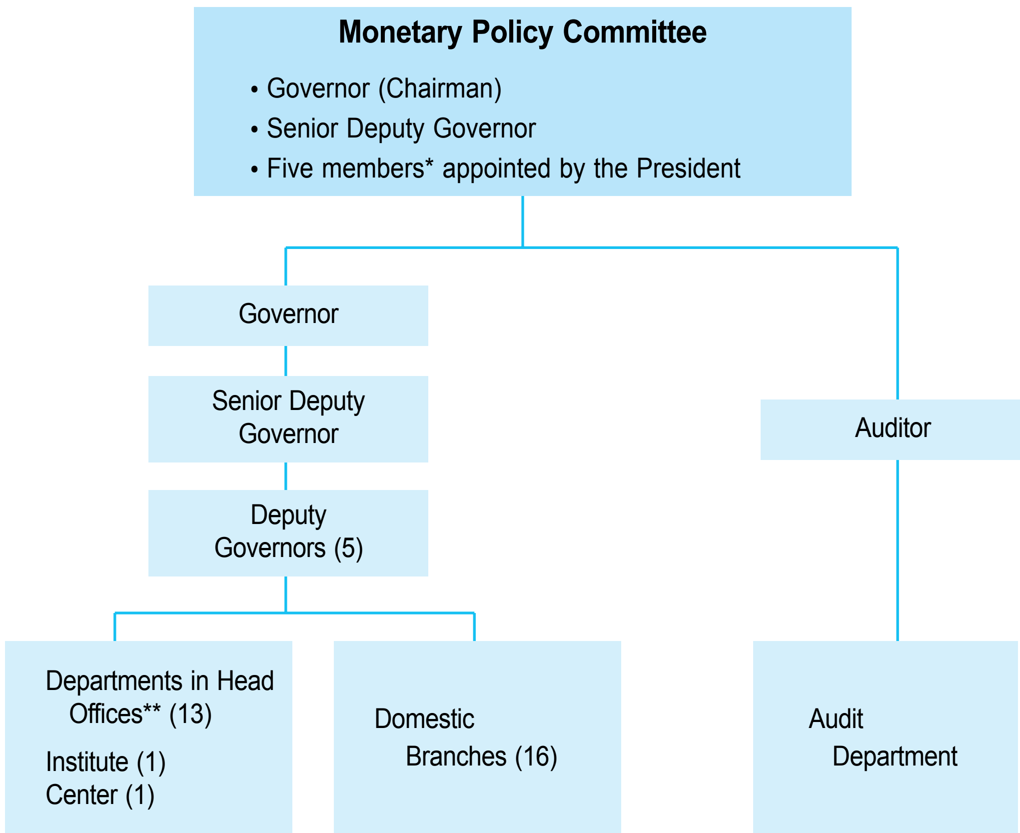
The Bank's executive officers are the Governor, the Senior Deputy Governor, and five Deputy Governors. The Governor, who is appointed by the President following the deliberation of the State Council, administers and directs the operations of the Bank, and conducts monetary policies as formulated by the Monetary Policy Committee. The term of the Governor is four years and he or she may be reappointed only once. The Senior Deputy Governor and Deputy Governors assist the Governor. The Senior Deputy Governor is also appointed by the President on the recommendation of the Governor; the Deputy Governors are appointed by the Governor. The terms for these positions are three years.

As for its executive body, the Bank has 14 departments, one center (Economic Education Center) and one institute (Institute for Monetary & Economic Research) in its head office in Seoul. The Bank also has 16 branches in major cities throughout the country. In addition, the Bank has five overseas representative offices in principal international financial centers. The total number of employees was about 2,200 as of June 2008.

The Auditor is appointed by the President on the recommendation of the Minister of Strategy and Finance for a three-year term. The Auditor inspects the operations of the Bank of Korea and reports the results to the Monetary Policy Committee and the Government.

Organization of the Bank of Korea

(As of the end of June 2008)



* Recommended by

① The Minister of Strategy and Finance
② The Governor of the Bank of Korea
③ The Chairman of the Financial Services Commission
④ The Chairman of the Korea Chamber of Commerce and Industry
⑤ The Chairman of the Korea Federation of Banks

** International Department includes five overseas representative offices.

Functions

1. Issuing Bank Notes and Coins

The Bank of Korea has the exclusive right to issue bank notes and coins in the Republic of Korea. It may, with the approval of the government, issue them in any size, shape and denomination as determined by the Monetary Policy Committee.

The Bank is not required to maintain any prescribed minimum ratio of gold or foreign exchange against its bank notes and coins issue, nor is any maximum limit imposed on the issue. The issue of bank notes and coins relies ultimately on decisions made by the Bank of Korea in line with its monetary policy.

Currently, the Bank issues bank notes in three denominations : ₩1,000, ₩5,000, ₩10,000; and coins in six: ₩1, ₩5, ₩10, ₩50, ₩100, ₩500. Additionally, it plans to issue higher-value notes in 2009.

2. Formulating and Implementing Monetary and Credit Policy

The Bank conducts monetary policy with an emphasis on price stability, but with economic growth, financial and asset market conditions also being taken into consideration. The Bank introduced an inflation targeting regime after the 1997 foreign currency crisis, and changed the monetary aggregate-oriented operational framework to an interest rate-oriented framework in which the Bank of Korea Base Rate (reference rate applied in transactions between the BOK and finantial institutions) forms its policy rate and operational target.

The Bank's monetary and credit policy is implemented principally through three orthodox instruments, open market operations, lending and deposit facilities and reserve requirements, which affect the availability and cost of banking institutions' reserves, and thereby influence overall monetary and credit conditions.

In addition to these instruments, the Bank has the authority to set maximum interest rates on deposits and loans of banking institutions and to control the volume of bank credit directly in periods of pronounced monetary expansion.

Functions of the Bank of Korea (I)

■ Issuing Bank Notes and Coins

o Bank notes in three denominations : ₩1,000, ₩5,000, ₩10,000

o Coins in six denominations : ₩1, ₩5, ₩10, ₩50, ₩100, ₩500

■ Formulating and Implementing Monetary and Credit Policy

o Pursuit of the objective of price stability

· Sets an inflation target in consultation with the government
· Formulates and promulgates an operational plan for monetary and credit policies

o Indirect instruments

· Open market operations
· Lending and deposit facilities
· Reserve requirements

o Other instruments

· Maximum interest rates of banks
· Imposing ceilings on bank credits in periods of pronounced monetary expansion.

3. Acting as the Banker's Bank

The Bank of Korea makes loans to and receives deposits from banks, thus serving as the banker to the banking sector.

It maintains checking accounts for banking institutions. Reserve deposits kept in these checking accounts are used to clear checks and settle inter-bank balances, including those arising from the use of BOK-Wire, the Bank's real-time gross-settlement system.

The Bank conducts credit operations with banks by rediscounting commercial bills or by extending loans against eligible collateral with maturities of up to one year.

As the lender of last resort, the Bank may extend exceptional loans to banking institutions, in periods of serious emergency when monetary and banking stability is directly threatened.

4. Serving as the Government's Bank

As the fiscal agent of the Government of the Republic of Korea, the Bank of Korea carries out various kinds of business for the Government in accordance with the Bank of Korea Act and other relevant laws.

The Bank handles the receipt of national revenues and the disbursement of national expenditures as the depository of the Government.

The Bank may extend loans to the Government, and may directly subscribe to Government bond issues. It may also grant loans to government agencies which carry out projects or functions of a public character, and handle business related to the issue, sale, or redemption of securities representing obligations of the Government.

5. Operating and Managing Payment Systems

The Bank was given the authority for the overall management and oversight of the payment and settlement system in Korea by the revised Bank of Korea Act of 2003. Even before the revision of the Bank of Korea Act, the Bank had already been involved in various functions aimed at ensuring the safety and efficiency of the payment system.

It provides settlement facilities to financial intermediaries by use of their current accounts with the Bank for final settlement purposes. Net settlement arising from bill clearing, giro, the interbank funds transfer system, and the interbank CD/ATM network is made through these current accounts with the Bank.

To ensure safe and efficient settlement for large-value interbank fund transfers, the Bank operates a real-time gross-settlement system, termed BOK-Wire, which was launched in mid-December 1994.

Functions of the Bank of Korea (Ⅱ)

■ Acting as the Banker's Bank

o Extending loans and rediscounts to banks

o Receiving deposits from banks

o Conducting temporary credit operations in periods of serious emergency as the lender of last resort

■ Serving as the Government's Bank

o Receipt and disbursement of Treasury funds

o Loans to government

o Issue, sale, or redemption of securities representing government obligations

■ Operating and Managing Payment Systems

o Responsible for the overall management and oversight of the payment and settlement system

o Operating a real-time gross-settlement system (BOK-Wire)

6. Managing Official Foreign Exchange Reserves

The Bank holds and manages Korea's official foreign exchange reserves. Its principal objectives in their management are to safeguard the value of the reserves and to meet the nation's demand for foreign exchange.

The Bank conducts certain foreign currency operations in the foreign exchange market. Their main aim is generally to counter disorderly market conditions. The exchange rate of the Korean won against U.S. dollar is determined by market forces, namely foreign exchange demand and supply in the domestic market. Exceptionally, however, if there is a large discrepancy between demand and supply that disrupts the regular operation of the foreign exchange market, the Bank can participate in it as a buyer or seller.

In addition, the Bank acts as an agent for the Government in managing the Foreign Exchange Equalization Fund, which was founded in 1967 with the object of stabilizing the foreign exchange market. The Bank represents the Government in all dealings and transactions with international financial institutions of which the Republic of Korea is a member.

7. Exercising Certain Bank Supervisory Functions

The Bank of Korea exercises certain bank supervisory functions as stipulated in the Bank of Korea Act. The Bank may request materials from banks, and from institutions engaged in financial business which enter into agreements to hold checking account with it, when the Bank deems this desirable for implementing monetary policy effectively and checking destabilizing factors within the financial system preemptively.

The Bank may also request the Financial Supervisory Service to examine banking institutions within a determined specific range. It may also require the

Financial Supervisory Service to have members of staff of the Bank of Korea participate on a joint basis in the examination of banking institutions.

The Bank may request the Financial Supervisory Service to submit to it the findings of examinations and on the basis of these findings to order corrective action to the banking institutions concerned.

In addition, the Bank may, at its own initiative, check and confirm the operation and status of the assets of banks and those for-profit enterprises to which the Bank extends emergency loans.

8. Compiling Statistics and Conducting Economic Research

The Bank of Korea collects and compiles statistics, and conducts economic research.

The Bank compiles statistics which are essential to developing the appropriate economic policies. They include money and banking statistics, GDP statistics, the producer price index, the balance of payments, the flow of funds account, input-output tables, etc.

The Bank carries out research on national and world-wide economic activities in order to formulate monetary policy effectively, enabling it to advise the Government on various economic policy options.

It also publishes various periodicals, such as the Annual Report and the Monthly Bulletin, to provide accurate and up-to-date information to the public on the economy.

9. Carrying out Economic Education

The Bank of Korea undertakes diverse activities to boost public awareness about the economics and Korean economy.

The Bank conducts economic education activities for youth, led by ‘Economic Lecture for Youth’ programs. It also holds economic lectures on request for universities, the military and police services, and non-government organizations. The Bank also runs a weekly ‘BOK Friday Lecture’ program for the general public. In addition, the Bank holds an annual ‘Monetary Policy Challenge’ for college students to promote greater understanding of the Bank’s role in formulating and implementing monetary policy.

At the same time, the Bank publishes various educational materials. The Bank started to put out leaflets and cartoons covering basic economic concepts from 1988. In March 2005, the Bank published four versions (for primary, middle, and high school students, and for the general public) of ‘BOK’s Easy Economic Story,’ a standard set of economic education materials.

Moreover, the Bank has operated a special website (www.bokeducation. or.kr) providing online economic education since September 2006. The website is composed of three sub-sites for children, youths and adults. It contains articles on the economy and finance, e-learning programs, flash animations, games and quizzes, audiovisual materials, etc. In addition, the Bank runs ‘Bank of Korea Museum’, which displays various Korean and foreign currencies, to provide visitors with a hands-on economic education experience.

Functions of the Bank of Korea (Ⅲ)

■ Managing Official Foreign Exchange Reserves

o Conducting certain foreign currency operations to counter disorderly market conditions

■ Exercising Certain Bank Supervisory Functions

o Request for on-site examination of banking institutions by Financial Supervisory Service (FSS) or joint examination with FSS

■ Compiling Statistics and Conducting Economic Research

o Compilation of statistics such as money and banking statistics, GDP statistics, the producer price index, the balance of payments, etc.

o Research on national and world-wide economic activities

■ Carrying Out Economic Education

o Conducting various economic lectures

o Operating a economic education website (www.bokeducation.or.kr)

o Running 'Bank of Korea Museum'

Part Ⅲ Banking Institutions

Commercial Banks

1. General Features

As of the end of June 2008, commercial banks consisted of seven nationwide commercial banks, six local banks, and 39 foreign bank branches. Commercial banks have adopted the branch banking system with a nationwide or province-wide network. The total number of domestic branches of commercial banks amounted to about 4,900 as of the end of June 2008.

Since business demarcation is still quite strict, commercial banks can engage in very limited securities business, and had not been allowed to engage in insurance business until August 2003. However, since then, bancassurance has been introduced to permit commercial banks to sell insurance products.

The ownership of a commercial bank's stocks by a single holder has been restricted since 1982, except in the case of a joint bank, a local bank, or where they are held by the government. This limit was set at 8 percent in 1982 and was tightened to a 4 percent ceiling in 1994. In 2002, the single shareholder ceiling was raised to 10 percent.

Foreign bank branches carry on their business under almost identical conditions to Korean banks nowadays as preferential treatment has been reduced and discriminatory business regulations lightened.

Commercial Banks

(As of the end of June 2007)

Nationwide Commercial Banks (7)*	○ Branch banking system throughout the country ○ Handling of long-term financing in addition to short-term financing
Local Banks (6)**	○ Branch banking system within a province ○ Business oriented to regional small and medium enterprises
Foreign Bank Branches (36)	○ Wholesale banking ○ Retail banking recently strengthened

* Woori Bank, SC First Bank, Hana Bank, Korea Exchange Bank, Shinhan Bank, Citi Bank Korea, Kookmin Bank

** Daegu Bank, Pusan Bank, Kwangju Bank, Jeju Bank, Jeonbuk Bank, Kyongnam Bank

2. Sources and Uses of Funds

Nationwide commercial banks held total assets amounting to about 983.0 trillion won as of the end of June 2008, representing a 90.7 percent share in the total assets of commercial banks.

Their principal sources of funds are deposits in domestic currency. At the end of June 2008, deposits and bonds payable in domestic currency accounted for 45.8 percent and 12.1 percent of total sources, respectively. As for uses of funds, nationwide commercial banks operated the largest proportion of their funds, 58.2 percent, as loans and discounts in won. The share of securities investment in total assets was 14.2 percent.

The financial structure of local banks is largely similar to that of the nationwide commercial banks, but their reliance on domestic currency deposits and securities investment is higher. At the end of June 2008, deposits in domestic currency accounted for 49.2 percent of total sources. And the share of securities investment in their total assets was 19.1 percent.

Foreign bank branches' most important source of funds is, typically, call money which, as of the end of June 2008, represented 17.4 percent of their total sources followed by inter-office account (15.9%) while deposits in domestic currency constituted only 3.4 percent. As to uses of funds, securities investment accounted for the largest proportion, at 26.7 percent. Loans to Korean banks in foreign currencies accounted for 5.3 percent and loans in domestic currency represented 2.5 percent.

Sources and Uses of Funds

(As of the end of June 2008)

Unit: trillion won, %

		Commercial Bank					
				Nationwide Bank		Local Bank	
		Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Assets		1083.6	100.0	983.0	100.0	100.6	100.0
Major Sources	Deposits	632.1	58.3	569.4	57.9	62.7	62.3
	Deposits in Won	499.5	46.1	450.0	45.8	49.5	49.2
	CDs	107.3	9.9	94.6	9.6	12.7	12.6
	Borrowings	256.5	24.9	233.7	23.8	22.8	22.6
	Borrowings in Foreign Currency	54.6	5.0	49.6	5.1	5.0	4.9
	Bonds Payable in Won	127.8	11.8	119.2	12.1	8.5	8.5
Major Uses	Securities	159.0	14.7	139.8	14.2	19.2	19.1
	Loans	768.4	70.9	701.1	71.3	67.3	66.9
	Loans & Discounts in Won	632.0	58.3	571.8	58.2	60.2	59.9
	Loans in Foreign Currency	45.2	4.2	42.8	4.4	2.4	2.4

Note: Foreign bank branches are not included

Specialized Banks

As of the end of June 2008, there were five specialized banks:

- The Korea Development Bank for the financing of key industries for the development of industries and national economy,
- The Export-Import Bank of Korea for financial support for export and import transactions, overseas investment projects, and the development of natural resources abroad,
- The Industrial Bank of Korea for the financing of small and medium-sized firms,
- The credit and banking sector of the National Agricultural Cooperative Federation for agricultural, forestry, and livestock loans,
- The credit and banking sector of the National Federation of Fisheries Cooperatives for fishery loans.

Specialized banks share the following main characteristics. First, they were established to provide funds to particular sectors whose supply of funds through commercial banks was insufficient due to limited availability or low profitability. With subsequent changes in the financial environment, however, they have expanded their business into commercial banking areas, although their share of funds allocation to their relevant sectors is still relatively high. Now most specialized banks have, by and large, the same pattern of business as commercial banks.

Second, they rely heavily on deposits from the public for their sources of funds in addition to the issue of debentures and borrowing from the government. Therefore, they compete with commercial banks in acquiring deposits.

Specialized Banks

- o The Korea Development Bank
- o The Export-import Bank of Korea
- o The Industrial Bank of Korea
- o The National Agricultural Cooperative Federation*
- o The National Federation of Fisheries Cooperatives*

* Credit and Banking Sector

Main Characteristics

o Funds allocation to particular sectors specifically defined by the relevant legislation

o Heavy reliance on deposits as a source of funds

Part Ⅳ Non-Bank Financial Institutions

Non-bank financial institutions can be broadly classified into five categories according to their business activities: that is non-bank depository institutions, insurance institutions, securities related companies, other financial institutions, and financial auxiliary institutions.

Non-bank depository institutions consist of merchant banking corporations, mutual savings banks, credit institutions, and the postal savings system. Merchant banking corporations can engage in almost all financial businesses except insurance business. Mutual savings banks specialize in taking deposits and lending for populace and small enterprises. Credit institutions such as credit unions, mutual credit facilities, and community credit cooperatives operate for mutual aid between members by taking deposits and lending. The postal savings system, which operates through post offices nationwide, is a public financial institution.

Insurance institutions consist of life insurance companies, non-life insurance companies, postal life insurance, and pensions.

The Act on the Business of Operating Indirect Investment and Assets entered into force from January 5, 2004; under its provisions both securities investment trust companies and asset management companies, which had been regulated respectively by the Securities Investment Trust Companies Act and the Securities Investment Company Act, were converted into asset management companies. The main business of such asset management companies is investing capital raised from investors in stocks and bonds and distributing the earnings on such investments. Securities companies engage in the stock and bond markets either as dealers or brokers. There are futures companies, securities finance company (the Korea Securities Finance Corporation), investment advisory companies which also operate as securities related companies.

In addition to the financial institutions just mentioned, there are other financial institutions such as credit specialized financial companies, venture capital companies, and trust companies. Also there are financial auxiliary institutions including, financial supervisory service, deposit insurance institution (the Korea Deposit Insurance Corporation), financial telecommunications & clearings institute, credit guarantee institutions, credit rating companies, etc.

These non-bank financial institutions, unlike banks, have no special limits on ownership, and some are affiliated companies of other financial institutions such as banks and securities companies.

Non-Bank Financial Institutions*

(As of the end of June 2008)

Non-bank depository institutions	o Merchant banking corporations	(2)
	o Mutual savings banks	(107)
	o Credit institutions	(3,948)
	o Postal Savings	(1)
Insurance institutions	o Life insurance companies	(22)**
	o Non-life insurance companies	(30)**
	o Postal Life Insurance	(1)
Securities related companies	o Securities companies	(54)**
	o Asset management companies	(55)
	o Futures companies	(14)**
	o Securities finance companies	(1)
	o Investment advisory companies	(83)
Other financial institutions	o Credit specialized financial companies ***	(55)
	o Venture capital companies	(121)
	o Trust companies****	(24)**
Financial auxiliary institutions	o Financial Supervisory Service	(1)
	o Korea Deposit Insurance Corporation	(1)
	o Korea Financial Telecommunications & Clearings Institute	(1)
	o Credit guarantee institutions	(2)
	o Credit rating companies	(4)
	o Korea Asset Management Corporation	(1)
	o Korea Housing Finance Corporation	(1)
	o Korea Securities & Futures Exchange	(1)
	o Money broker companies	(9)

* Figures in parentheses are numbers of institutions.
** Foreign companies' branches are included.
*** Credit specialized financial companies consist of credit card companies, leasing companies, installment financing companies, and new technology venture capital companies.
**** The figures of trust companies are based on the banks' trust accounts.

Financial Markets

Money Market

The money market in Korea embraces the call market and a wide rangeofotherfinancialmarketsincludingthoseforMonetary Stabilization Bonds (MSB), negotiable certificates of deposit (CD), repurchase agreements (RP), commercial paper (CP), and cover bills (CB).

Since 1985, there has been a sharp increase in the outstanding balance of money market instruments. This has been chiefly prompted by product innovation and the expansion in the number of financial institutions handling such instruments.

However, the scale of the money markets contracted except for the MSB and call markets in the course of financial and corporate restructuring. Most notably, the CP market shrank dramatically in the three years after the crisis. As the financial market stabilized as a result of financial and corporate restructuring, the markets for CD and CP rebounded from 2001 as did the RP market from 2000.

Capital Markets

The growth of the capital markets in Korea has been substantial. Encouraged by government efforts and an improved investment climate with rapid economic growth and the opening of the stock market, the role of the capital markets in mobilizing funds continued to strengthen. The monthly traded value of stocks in the exchange swelled from 4.5 trillion won as of December 1990 to 93.3 trillion won as of June 2008 and that of bonds also burgeoned from 3.2 trillion won to 243.9 trillion won. The market value of listed stocks in KOSPI (The Korea Composite Stock Price Index) increased from 79.1 trillion won as of the end of 1990 to 850.9 trillion won as of the end of June 2008.

In the meantime, foreign direct investment in stocks was allowed in 1981 for the first time within a ceiling set on the total stocks of each individual issue.

Thereafter, the government expanded the investment ceilings several times, completely lifting them in May 1998, except for investment in public corporations. The stock holdings of foreigners as a percentage of stock market capitalization in KOSPI soared remarkably from 13.7 percent at the end of 1997 to 30.7 percent as of the end of June 2008.

Opening of the bond market was sequenced later than the stock market mainly in consideration of differences between domestic and foreign interest rates and the low domestic demand for bonds. In December 1997 immediately after the currency crisis, all restrictions on foreign investment in listed bonds were abolished. Foreign investment in bonds, however, has remained lackluster with foreign holdings representing only 6.0 percent of all listed bonds as of the end of June 2008.

Money and Capital Markets

1. Money Market Trends (Balance as of the end of period)

(billion won)

	1990	1998	2000	2003	2004	2005	2006	2007	2008.6
Call*	3,650.5	15,955.8	12,916.0	24,773.8	27,481.5	34,608.2	28,626.2	27,882.5	26,632.0
MSB**	15,240.5	45,673.3	66,377.7	105,496.7	142,773.0	155,235.0	158,390.0	150,340.0	142,440.0
CD	6,803.5	15,742.6	14,217.8	36,827.6	43,544.9	63,877.1	79,774.0	112,769.1	130,591.9
RP	3,357.1	17,543.4	26,308.7	38,703.1	34,574.9	42,932.7	58,417.7	68,250.7	72,668.9
CP	22,686.6	19,872.1	9,113.5	16,214.3	15,898.2	20,043.0	27,624.0	45,297.2	50,573.9
CB	276.8	4,092.9	11,201.4	4,305.1	3,906.0	4,031.4	3,675.0	4,444.7	4,383.0

* Daily average transactions during the last month in the period

** Monetary Stabilization Bonds issued by the Bank of Korea

Source : Money and Banking Statistics, the Bank of Korea

2. Capital Market Trends (As of the end of period)

	1990	2000	2003	2004	2005	2006	2007	2008.6
Stocks Number of listed companies (KOSPI)*	669	704	684	683	702	731	740	760
Composite stock price index	696.1	504.6	810.7	895.9	1,379.4	1,434.5	1897.1	1674.9
Traded value** (bil. won)	4,454.5	52,261.1	45,625.70	46,316.3	65,521.5	70,707.5	95,268.6	850,859.5
Market value (bil. won)	79,109.7	188,041.5	355,362.6	412,588.1	655,074.6	704,587.5	951,900.4	850,859.5
Bonds Traded value*** (bil. won)	3,213.1 (284.2)	215,560.9 (713.0)	220,528.1 (19,431.7)	293,524.8 (29,377.6)	312,857.7 (19,275.5)	345,474.2 (15,580.9)	167,501.0 (20,084.8)	243,860.7 (33,800.0)

* The Korea Composite Stock Price Index (4. Jan. 1980 = 100)

** Monthly average during the period

*** Monthly average during the period and figures in parentheses represent values traded on the stock exchange

Source : Korea Exchange, Korea Securities Dealers Association

Part Ⅵ Recent Changes in the Financial System

Korea undertook a strong drive for financial liberalization and market opening from the early nineties. Unfortunately, however, in 1997 a string of large corporate insolvencies and the consequent rapid build-up of financial institutions' bad loans undermined their soundness and threatened the systemic health of the financial system. Coupled with the negative effects of the Southeast Asian currency crisis, this caused a large net outflow of foreign portfolio capital, plunging Korea into a financial and currency crisis.

Thereafter, financial sector restructuring focused on improving the financial infrastructure in order to facilitate the early turnaround of troubled financial institutions and to benefit from the positive effects of financial liberalization and opening policies. Important measures implemented since then include a shake-out among financial institutions, the clearing-off of bad loans, the tightening of prudential regulation, the heightened transparency of financial information, and the reorganization of the corporate governance of financial institutions.

Resolution of Unsound Financial Institutions

The top priority in financial sector restructuring was given to the earliest possible resolution of unsound financial institutions. In 1998, five banks whose capital adequacy ratios were below the 8% BIS guideline were forced to exit the market. Nine banks merged to form four successor banks in 1999, and two merged to form one successor bank in 2000. In the meanwhile, eight banks were nationalized through recapitalization by the government.

Recently, in 2007, there were only a few instances of mergers between financial institutions or exits from the market as the financial restructuring since the Asian financial crisis moved into its final stage. Looking at merger activities among financial institutions, Shinhan Financial Group incorporated LG Card as its subsidiary in March. In addition, Hana Financial Group acquired 100 percent of stocks of Hana Life Insurance owned by Hana Bank in conformity with the stipulation of the “Financial Holding Company Act” that a banking subsidiary of a financial holding company cannot exercise control over an insurance or a securities company.

In the case of non-bank financial institutions, 29 merchant banking corporations, 15 securities companies, 15 asset management companies, and 22 insurance companies were closed down in the period between 1998 and June 2007.

Injection of Public Funds

The government raised 102.1 trillion won in public funds by issuing Deposit Insurance Fund Bonds and Non-performing Loans Management Fund Bonds for financial restructuring and recycled funds to the value of 42.3 trillion won through new issues of such bonds up until June 2008. Also it pumped in an additional 24.1 trillion won by June 2008 raised from various other sources including Public Capital Management Fund and loans from the World Bank. As a result, the total amount of financial support devoted to financial restructuring stood at 168.5 trillion won at the end of June 2008. Out of the total amount, 63.5 trillion won was used for recapitalization, 38.6 trillion won for the purchase of non-performing loans, and 30.3 trillion won for the payment of deposit insurance claims.

Throughout the year 2007, the government encouraged financial institutions to carry out restructuring at their own initiative. In the process, Korea Deposit Insurance Corporation provided support amounting to 132 billion won from public funds to financial institutions for compensation for losses, the purchase of non-performing loans, and the vicarious payment of deposits on behalf of troubled institutions.

Public Funds Injected

(November 1997 ~ June 2008)

(trillion won)

Source	Support type	Total
Korea Deposit Insurance Corporation	Recapitalization	50.8
	Compensation for losses	18.6
	Purchase of assets	11.0
	Repayment of deposits	30.3
	Subtotal	110.7
Korea Asset Management Corporation	Purchase of NPLs	38.6
Fiscal resources	Recapitalization	11.8
	Purchase of subordinated debentures	6.4
	Subtotal	18.2
Bank of Korea	Recapitalization	0.9
	Total	168.5

Heightening Prudential Regulation

In order to tighten the prudential regulation of financial institutions, a prompt corrective action framework was introduced so that regulatory authorities could order financial institutions that failed to meet certain criteria to replace their management, reduce capital, merge, or dispose of certain businesses. And the asset quality classification standards of banks, merchant banking corporations, securities companies, asset management companies and insurance companies were strengthened in order to take into consideration the future repayment capacity of borrowers. To reduce the risk resulting from large credit exposures to a single entity, the ceilings on credit to a single individual or juridical person, as well as to a single large business group, were lowered. Also criteria for internal controls and a compliance system were introduced for banks, merchant banking corporations, securities companies, asset management companies, insurance companies, etc.

Improving Corporate Governance of Financial Institutions

An outside director system and an audit committee system were introduced to improve corporate governance in 1999. At least three outside directors must be appointed to make up over half of total board membership and an audit committee must be set up with outside directors forming at least two-thirds of its membership. These two systems were put in place for all commercial banks and merchant banking corporations, and for some securities companies, insurance companies, asset management companies, and other financial institutions whose assets are above a specific level.

To attract foreign investment, the restriction on the nomination of foreigners as directors of banks was lifted and ceilings on the foreign ownership of domestic banks were eased in 1998.

In 2002, to encourage the emergence of sound financial capital and promote accountability in the management of financial institutions, the single shareholder ceiling restriction on the holding of stocks issued by a bank or a bank holding company was raised from 4 percent to 10 percent.

Heightening Transparency of Financial Institutions

At the same time, efforts have been made to strengthen market discipline and to enhance the transparency of financial information. Standards for accounting and public disclosure were heightened to enable shareholders, creditors, and others to gauge financial institutions' management performance accurately from their financial statements. For example, a mark-to-market system for marketable securities was introduced and financial institutions' financial statements should now be drawn up according to accepted corporate accounting standards.

In 2007, in order to prevent unfair transaction behavior between financial institutions and major shareholders, the government made it obligatory for merchant banking corporations, mutual savings banks, securities companies and credit specialized financial companies to pass a resolution at a board of directors' meeting concerning transactions with their major shareholders and give public notice of the transactions.

Other Recent Steps

During 2007, the government revised a number of finance-related laws and regulations, with emphasis on improving the efficiency and soundness of the financial institutions.

As an initial step, pursing the balanced development of the financial industry through the galvanization of the capital market, the government enacted the "Financial Investment Services and Capital Market Act"(promulgated on August 3, 2007, to come into force on February 4, 2009). Through this, it defined financial investment products comprehensively as financial products that have the potential to give rise to loss of principal and included financial contracts, such as exchange-traded and over-the-counter derivatives, within the scope of financial investment products. Applicants who wish to engage in financial investment services should receive approval or enroll for those fields of services which they wish to enter either individually or collectively.

In addition, to upgrade banks' risk management systems and to help banks achieve appropriate capital adequacy in keeping with the enforcement of the New BIS Agreement(Basel Ⅱ), the government differentiated risk weightings when estimating credit risk according to a borrower's credit rating and added operating risk to the targeted objects of equity capital management, along with the previous credit risk and market risk("Regulation on Supervision of Banking Business", promulgated on June 28, 2007, implemented on January 1, 2008).

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