



# **Forum for Asian Insolvency Reform (FAIR)**

## **MAXIMISING VALUE OF NON- PERFORMING ASSETS**

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**Korean Experiences**

*by*

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### ***1. Source of NPL***

All NPLs are not same. Japan and Taiwan's problems are mainly real estate origin.

Chinese NPLs came from not banking failures but due to the transition from socialist to market economy. Korea, Thailand and Southeast Asian NPLs came from financial crisis. So Korean NPLs had both real estate depression and corporate restructuring features. Korean Public Fund supported banks and banks in turn supported their corporate clients' restructuring.

### ***2. Who is in charge?***

Korea, Indonesia and Malaysia have all established centralized resolution structures, while China and Thailand took decentralized approach; By centralization of ownership of NPLs at KAMCO, more leverage over debtors were attained hence more effective management, and also scarce human resource could be utilized efficiently.

### ***3. Price Mechanism***

AMCs should not serve as a means by which the government bails out private financial institutions by buying their NPLs at above market value. Such a transaction helps recapitalize the institution, which, in effect, conceals the cost of recapitalization from the public and violates the principle of transparency and accountability. KAMCO purchased at market and sold at market. This enabled creation and growth of Korean NPLs market by inducing other banks and investors.

### ***4. NPL Disposition Methods***

Between 1998~1999, KAMCO created market outright sale in bulk targeting foreign investors. From late 1999, KAMCO turned to JV NPL investment vehicle with private investors. In 1999, KAMCO also pioneered NPL backed public ABSs into the capital market.

KAMCO also sold loans individually by auction. In case KAMCO's loans holding was such a large portion of total debt of the borrower that the management control was transferred to the investor, eg Hanbo Steel.

### ***5. Speed of Resolution***

KAMCO had severe trade-off relationship between speedy resolution and maximization of recovery of NPLs.

There have been significant differences in the speed of disposition of assets among AMCs. Spain and the USA was relatively successful in disposing acquired assets rapidly.

Swedish Securum disposed of 98% of its assets in the five years of its existence.

By contrast, the fragile state of the Indonesian economy and the scale of the assets acquired by IBRA are among the factors that have prevented the rapid disposition of

assets in that country<sup>1</sup>. Thailand took the slow & clean way, giving priority to banks' motivation and fair share of loss assumption but the resolution process took long time hence delaying the economic recovery of Thailand.

Acknowledging this trade-off, KAMCO held a seminar on March 1999 at this place to discuss the timing and price of NPL resolution. Most of the attendants at the seminar gave weight to priority rather than price maximization. They emphasized that the turnover of the KAMCO fund should be high so that the recovered fund of KAMCO can be re-cycled into new NPL purchases.

Since the expeditious disposition of NPLs has become the most urgent matter after the financial crisis, KAMCO had to put priority on swift disposition of NPLs rather than maximizing returns.

KAMCO aimed to sell 98% of all NPLs by 2003. This strategy has been influenced by the consideration that many NPLs relate to industrial companies and thus could deteriorate rapidly if "warehoused."

## **6. Investor Base**

When KAMCO first tried to sell NPL in 1988, there existed no market. In the early market, educating market participants and establishing well function was the priority. Only demand was from American distressed investors.

But by the introduction of CRC(Corporate Restructuring Company), domestic investors started to join the market, following foreign investors investment pattern. KAMCO also used CRC for the JV NPL program.

Now, distressed and restructuring investment is quite a regular event for CRCs and venture capitals.

## **7. Reasons behind KAMCO's success**

Market pricing and transparency provided confidence to investors.

KAMCO heavily utilized securitization. KAMCO issued 16 domestic ABSs totalling 4.7 tril KRW and one international ABS amounting to 419 mil USD. Normally real estate acquisition tax is 5.6% and stamp duty for mortgage transfer is 0.2%., But securitization transactions were exempted from real estate acquisition tax and stamp duty.

(But this tax exemption is proposed to be halved from 2004).

Korea's mortgage system is complicated and mortgage is difficult to transfer without borrower's consent. So Korean Securtization Law provided easier process for mortgage transfer.

Korea's capital market was well developed before the crisis. So the innovative financial products as Asset Backed Securities could be quickly transplanted into the country's bond market.

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<sup>1</sup> Stefan Ingves, Director IMF, 1<sup>st</sup> NPL Form Nov 2000

Korean Bankruptcy Court amended Corporate Reorganization process, with speedy decisions, transparent and fair treatment of creditors. This supported KAMCO's securitization and corporate restructuring activities much.

Thank you!