



Deposit Insurance System: Resolution and Recovery

IADI & TMSF

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Outline of Presentation

- I. Overview
- II. Deposit Insurance System of Korea
- III. Resolution System & Strategies
- IV. Recovery Cases & Implication
- V. Lessons

I. Overview



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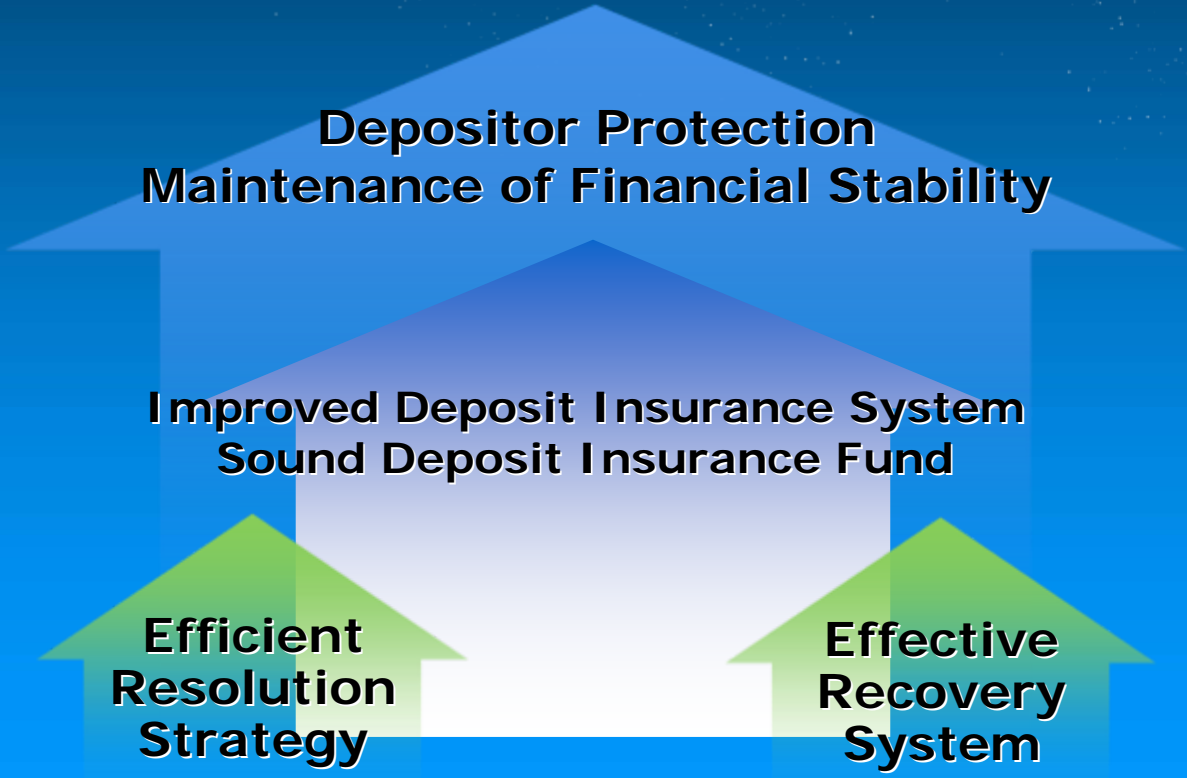
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I.1 Purpose of Presentation

Overcoming the Asian Financial Crisis



II. Deposit Insurance System of Korea

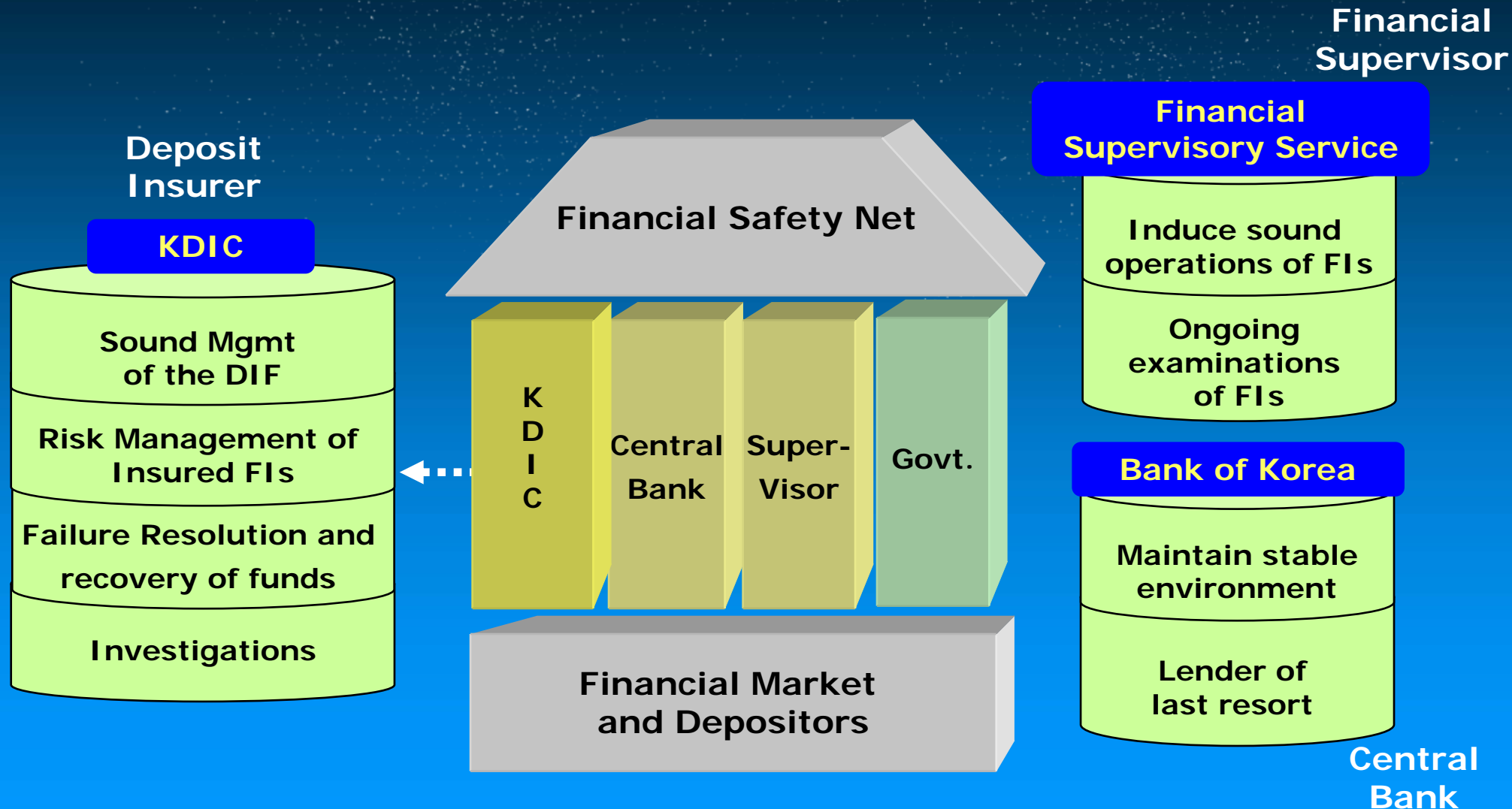
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II.1 The Structure of FSN in Korea





II.2 Coordination among FSN Players

- High level policy-coordination meeting (MOFE, FSC, and BOK etc.)
- FSC has to notify and consult with the MOFE on major PCA in advance
- MOUs on Joint Examination of Financial Institutions
 - KDIC and FSS / BOK and FSS
- MOUs on Sharing Financial Information
 - KDIC, FSS, and BOK



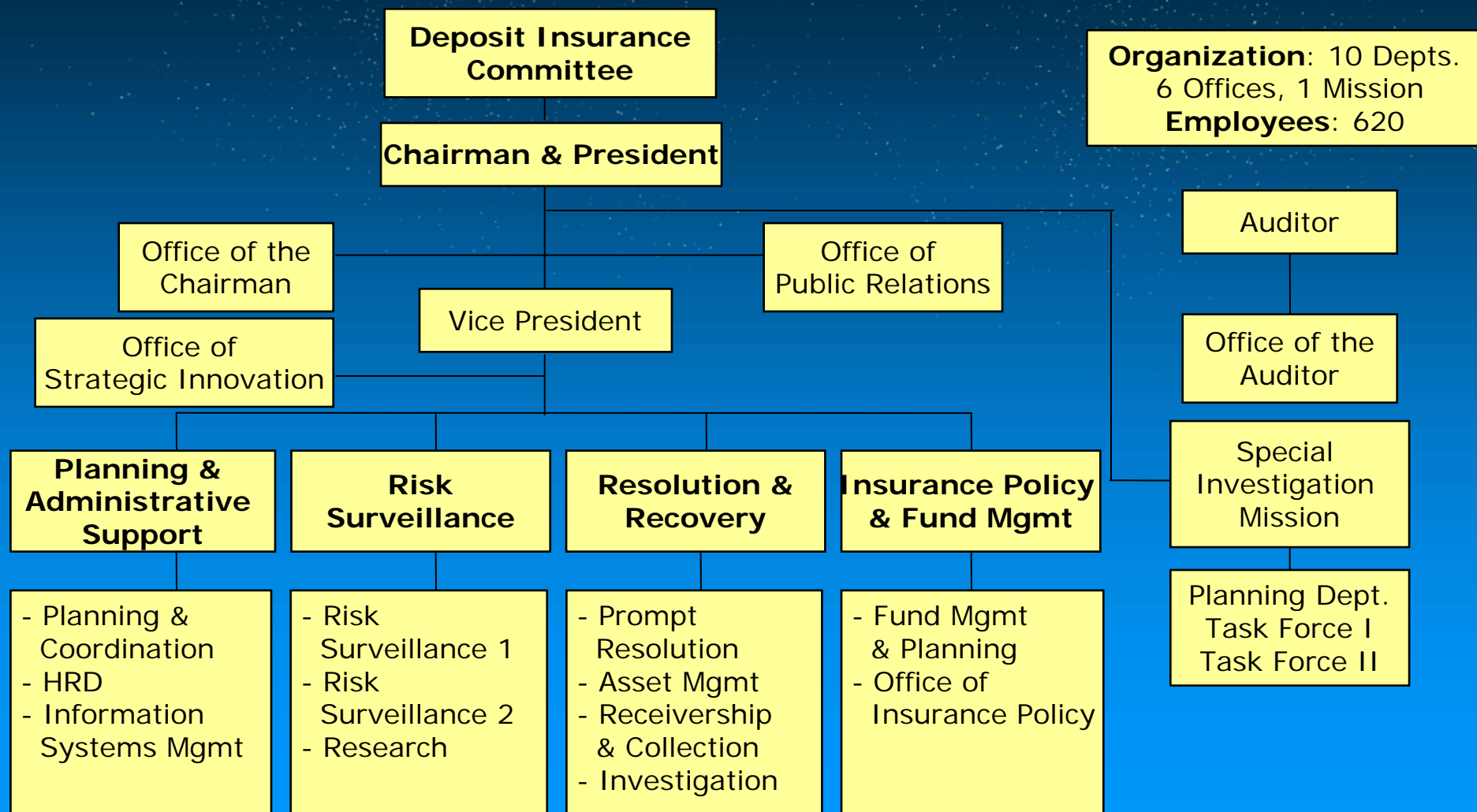
11.3 Mission and Mandates



- ① Establishment of deposit insurance policies / Procurement & management of the Deposit Insurance Fund
- ② Preventing insolvency of financial Institutions by ongoing risk surveillance
- ③ Prompt resolution of insolvent financial institutions in the event of financial institutions' failures
- ④ Recovery of injected funds
- ⑤ Insolvency-related investigations & accountability claims



II.4 Governance & Organization



11.5 Insured FIs & DI Premium

Integrated Deposit Insurance System

(As of Mar. 2007)

Type	Banks	Merchant Banks	Mutual Savings Bank	Insurance Companies			Securities Companies	Total
				Sub Total	Life	Non-Life		
Insured FIs (Unit)	53	2	111	43	22	21	53	262
Insured Deposit (billion dollars)	491.8	0.7	44.0	150.9	123.8	27.1	14.3	701.7
Deposit Insurance Premium (million dollars)	499	2	112	406	336	70	30	1,049
Premium Rate (%)	0.1	0.3	0.3	0.3	0.3	0.3	0.2	-



III. Resolution System & Strategies

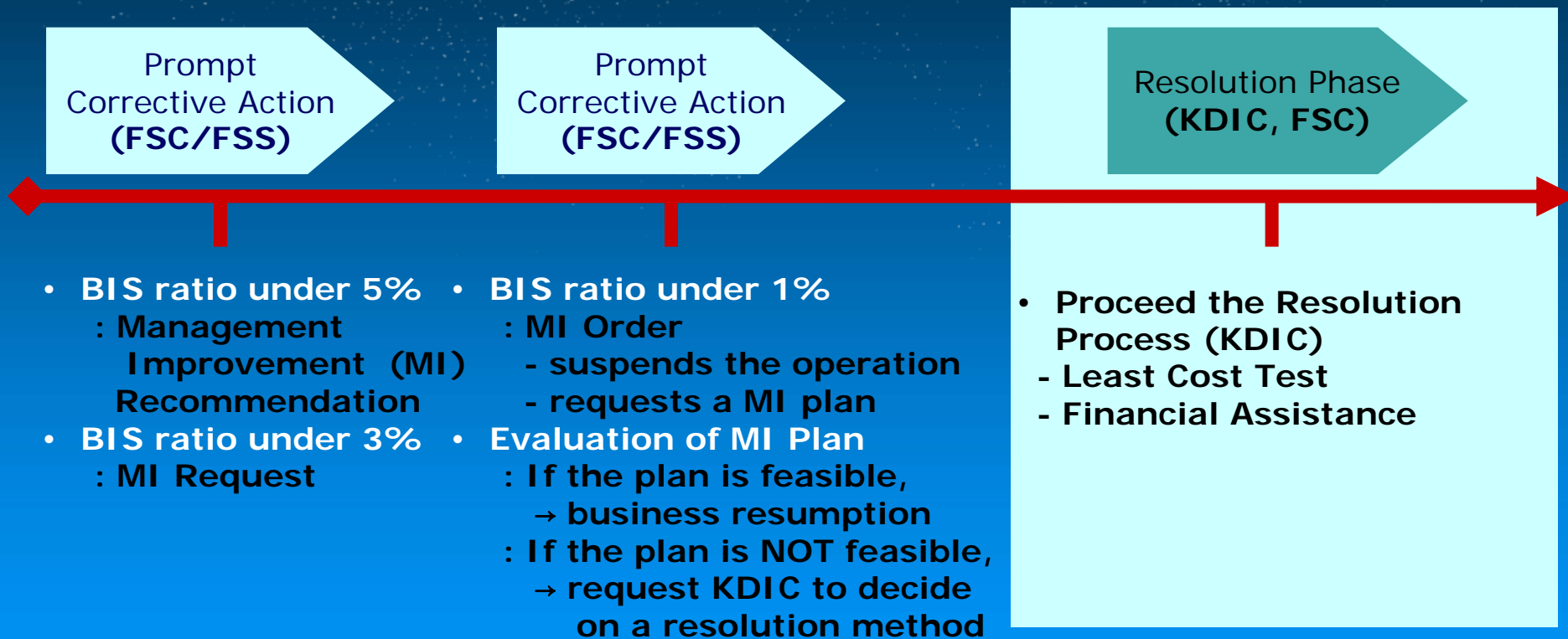
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III.1 Resolution Framework



* This procedural diagram is prepared based on regulation criteria of MSB.



III.2 Resolution Methods

OBA

Deposit insurer provides financial assistance to a failing insured bank through equity participation, contribution or purchase of assets and acquires its shares in return

P&A

A healthy insured institution purchases some or all of the assets and assumes the deposit liabilities of a failed institution

Bridge Bank

A temporary financial institution established and operated by deposit insurer on interim basis to acquire the assets and assumes the liabilities of a failed institution until the final resolution is accomplished

Deposit Payoff

A resolution method that is used when liquidation of failed financial institution is determined to be the least costly resolution or when no assuming institution can be found



III.3 Principle of Resolution

Least Cost Test

After comparing the costs of all possible resolution alternatives, KDIC shall choose the method that minimizes loss to the deposit insurance funds

Systemic Risk as an exception

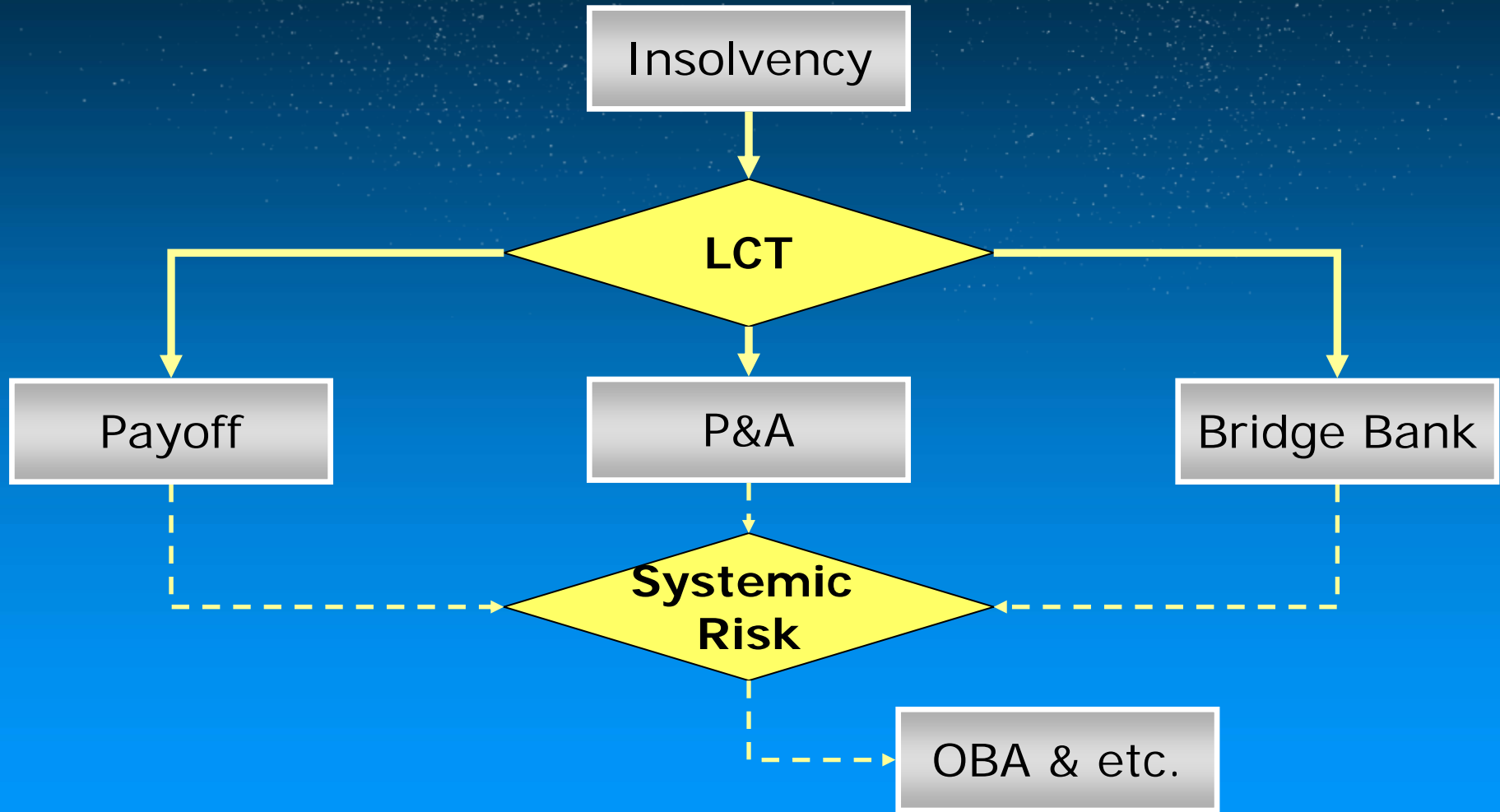
When deemed that bankruptcy of FI may significantly threaten the stability of the financial system, KDIC may use other methods even though they do not meet the least cost principle with 2/3 of affirmative votes by the Deposit Insurance Committee

Discipline

Any loss in the DIF incurred by the insured financial institution shall be shared equitably among the liable parties



III.4 Application of LCT: Conceptual Flow Chart





IV. Recovery Cases & Implication

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IV.1 Overview of Recovery Strategy

Resolution Method	Types of Financial Intervention	Forms of Recovery	Apply to
OBA	Equity Participation Contribution	Equity Sale	Large Banks Systemic Risk
P&A	Contribution	Dividend	Small Banks
Bridge Bank	Equity Participation Contribution	Equity Sale Dividend	Small Banks
Deposit Payoff	Deposit Payoff	Dividend	Small Banks



IV.2 Recovery Management Framework



KDIC as Bankruptcy Trustee

The court appoints the KDIC or its employees as the bankruptcy trustee

Why? KDIC employees have more experiences and incentives than the lawyers appointed as bankruptcy trustees

Integrated Mgmt of Bankruptcy Trustee

A Bankruptcy trustee takes control over several bankruptcy estates.

⇒ This system could save expenses to operate bankruptcy estates and eventually contributed to minimizing the loss to deposit insurance fund.

Outcome

Reduce the time spent for the bankruptcy proceedings despite the delay caused by the system structure



IV.3 Case 1: OBA-Bank A (Large Bank, part 2)

In 1998

In 1999

In 2002

In 2003

Delinquent Loan to Conglomerates
→ (-) Net Wealth

Insolvent Stage

Public Fund Injection (\$2.7 bil.)
→ KDIC, sole shareholder

Rehabilitation Stage

Profitability & Asset Quality ↑
→ Strong Capital & Earnings

Normalization Stage

Sale to a leading bank
→ a consideration (51% cash, 49% stock)

Privatization Stage

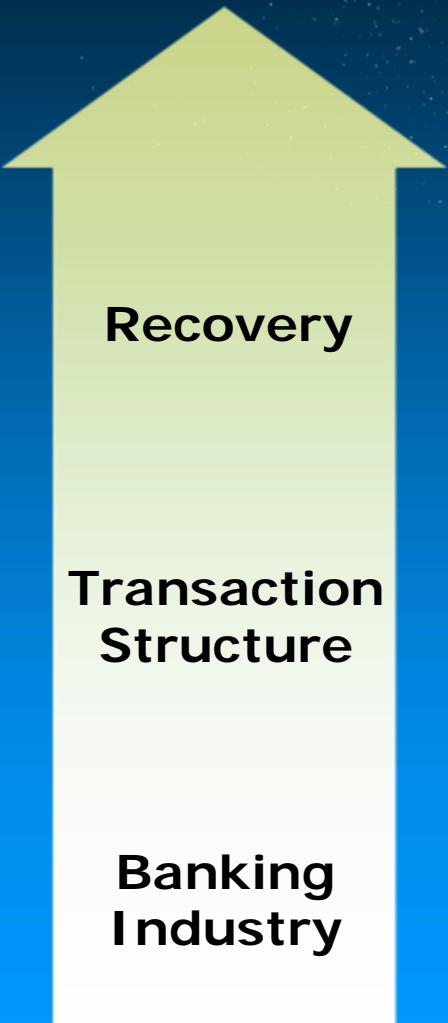
- Bank A was the largest bank in Korea which went insolvent due to the excessive loans made to the specific conglomerate (Chaebol)
- The KDIC promptly initiated the resolution process to prevent market disruption





IV.3 Case 1: OBA-Bank A (Large Bank, part 2)

Recovery > Injection



Recovery

More recovery than public fund injection
4.4 billion USD > 2.7 billion USD

Transaction Structure

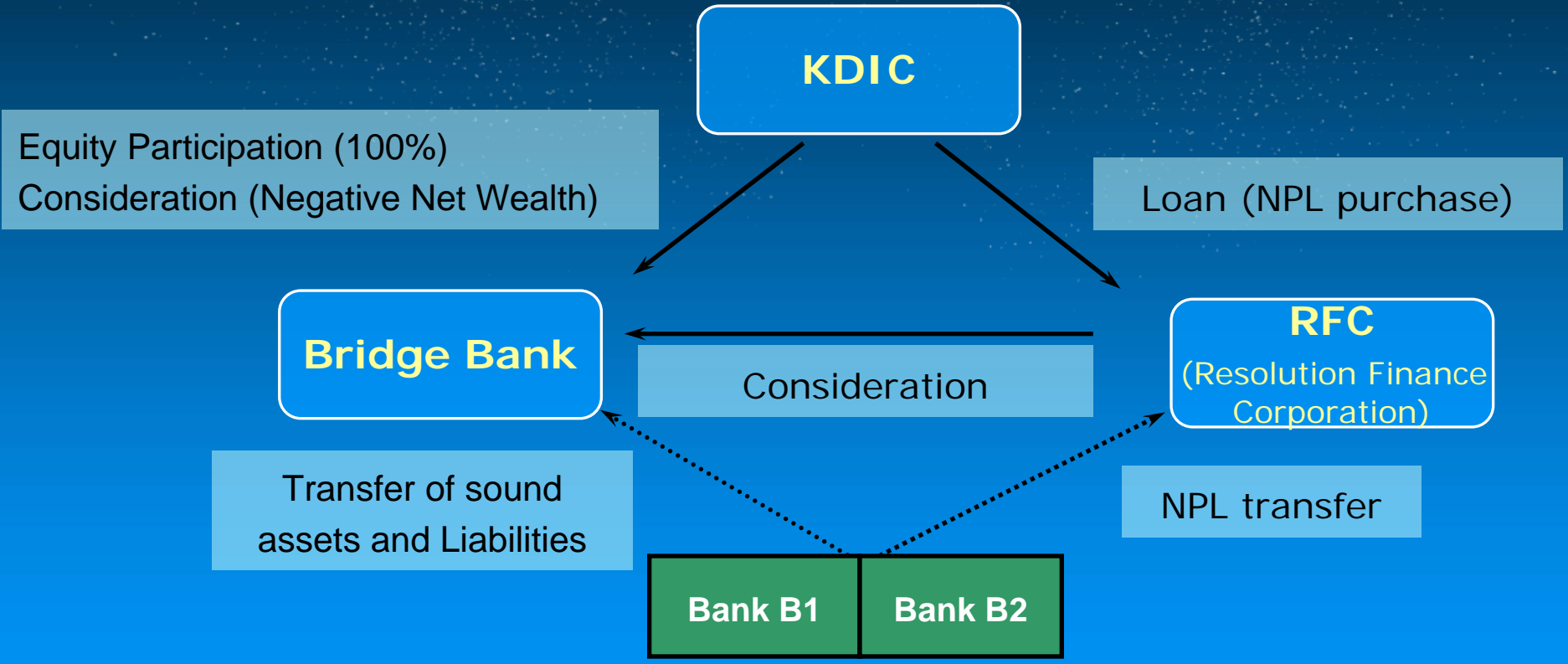
49% stocks = 25% common stocks + 24% convertible stocks

Banking Industry

Merger of Bank A with a leading bank → Increase in efficiency of merged bank → Increase in Competitiveness of the banking industry



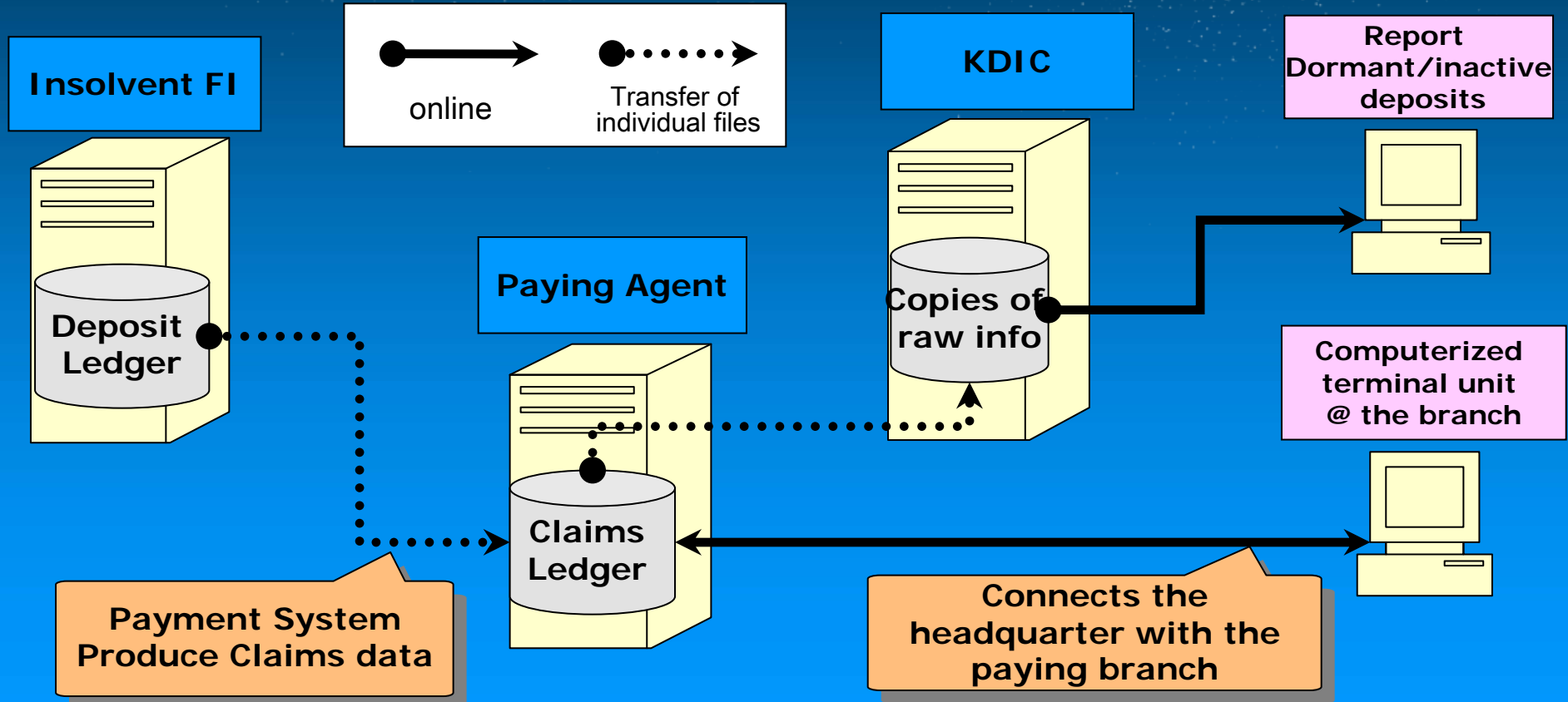
IV.4 Case 2: Bridge Bank-Bank B1,B2 (MSB)



- The KDIC decided to transfer the assets and liabilities of Bank B1 and Bank B2 to a bridge bank due to the fact that both banks are located in the same region and went insolvent almost at the same time, which might bring adverse effect on the regional economy.

IV.5 Case 3: Deposit Payoff Flow Chart

KDIC makes claim payments through the branches of a nationwide bank for the convenience of depositors





V. Lessons

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V.1 Lessons from our experiences

- ❏ **KDIC has adopted a flexible resolution strategy in response to market situation and bank's conditions**
(e.g. OBA scheme for large banks and bridge bank scheme for simultaneous small bank failures)
- ❏ **KDIC has devised a sophisticated transaction structure to accomplish policy objectives**
(e.g. KDIC could enjoy additional recovery from the bank merger by receiving acquiring bank stocks as shown in Case A)
- ❏ **KDIC has pursued continuous improvement in expeditious and performance-oriented recovery system**
(e.g. KDIC or its employees are appointed as the bankruptcy trustee, which expedites bankruptcy procedure)

V.2 Lessons from our experience

A deposit insurance system should take the initiative in overcoming the challenges posed by uncertainty, vulnerability and weakness of the financial system.

Thank you!

