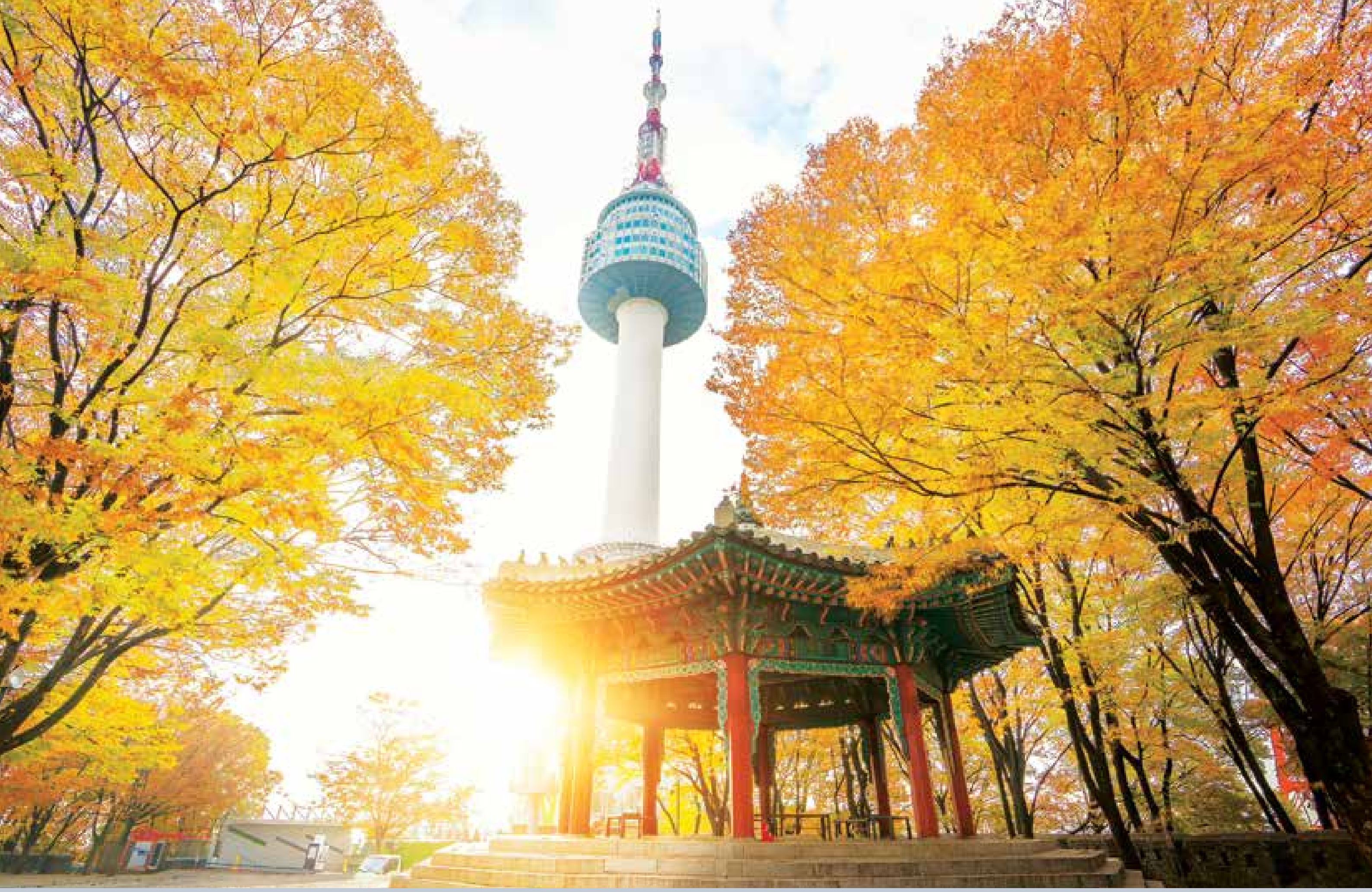
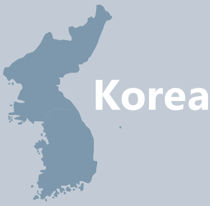


Nationalisation and Restructuring
Woori Financial Group (1998)



Background and context

Woori Bank, formerly known as Hanvit Bank (Hanvit), was a commercial bank established in 1899. During the AFC, the financial condition of Hanvit had been affected by large NPLs, which led to higher reserve requirements. Ultimately, Hanvit was unable to meet regulatory capital requirements. In April 2001, Woori Financial Group (Woori) became the first Korean financial holding company formed out of a merger of five failed banks (Hanvit, Kyongnam Bank, Kwangju Bank, Peace Bank and Hanaro Merchant Bank). These banks were all impacted by the NPLs of large corporates in Korea in the late 1990s, which resulted in capital erosion.

In 1999 and 2000, the Korea Deposit Insurance Corporation (KDIC) provided open bank assistance (OBA)[69] by injecting a total of $12.8 billion to recapitalise these failed banks and to stabilise the Korean financial system. Hanvit was a major beneficiary of this exercise and received $7.9 billion. To improve the transparency and efficiency of public fund management, and to expedite recovery of funds from institutions which received support from the government, a Public Fund Oversight Committee (PFOC) was established in February 2001. In evaluating the suitability of this resolution approach, a least-cost assessment concluded that financial assistance would be a costlier option compared with the liquidation of Hanvit. However, a liquidation option could have had adverse implications on the Korean economy. This includes financial market stress, possible freezing of the capital market, insolvencies of domestic companies and an increase in unemployment as a result of large corporate failures. Having considered these factors, the PFOC decided to proceed with OBA.

During the first restructuring exercise on the Korean banking sector in 1998, KDIC had provided KRW3.26 trillion ($2.69 billion) to raise Hanvit's CAR to 10%. This was followed by a capital injection of KRW2.76 trillion ($2.18 billion) in 2000, and the provision of KRW1.88 trillion ($1.44 billion) to settle Hanvit's outstanding payment obligations. To stabilise Hanvit, KDIC had to close the gap between its assets and liabilities, followed by equity investments for continued operations.

[69] The OBA was preceded by capital reductions

Resolution of Woori – Timeline of Key Events

- **Sep 1998** Restructuring started. KDIC injected KRW3.3 trillion into Hanvit.
- **Dec 2000** Second capital injection by KDIC of KRW2.8 trillion.
- **Mar 2001** Hanvit became subsidiary of Woori Financial Group.
- **Sep 2001** KDIC injected another amount of KRW1.9 trillion.
- **Jun 2002** Initial Public Offering (IPO) of Woori on the KSE. KDIC disposed 11.8% of its stake in Woori and recovered $367 million.
- **Sep 2003** Listing of Woori on NYSE.
- **Sep 2004** KDIC recovered $324 million from block sale of 5.7% stake in Woori.
- **Aug 2016** Public announcement on sale of 30% of Woori.
- **Dec 2016** KDIC sold 29.7% of Woori to seven investors.
- **Nov 2021** Sale of 9.3% of Woori by KDIC to five successful bidders announced, marking completion of Woori's privatisation.
- **Feb 2022** KDIC sold 2.2% stock in Woori.

Resolution actions

Open Bank Assistance

In 1999, the first injection of funds totalling $3.5 billion was to recapitalise failed Korean banks. In 2000, the second injection of $9.3 billion into these failed banks took place after a restructuring roadmap was released by the Korea Financial Services Commission. Woori Bank (formerly known as Hanvit) received $7.9 billion out of the total funds of $12.8 billion provided to five failed banks.

Restructuring and privatisation, including IPO and block sale of sales in Woori[70]

The financial group structure was established to strengthen Woori's internal organisation to become a leading financial services institution. A Memorandum of Understanding (MoU) between KDIC and Woori provided for transparent and rigorous oversight. Through clear targets and close monitoring by a representative appointed by KDIC, Woori was able to record an early turn around.

The indicators managed under the MoU were broadly divided into financial and non-financial metrics. Generally, the holding company and bank were required to meet semi-annual and quarterly targets respectively for two years. However, after the GFC, future targets were set for a one-year period and incorporated weighted average performance parameters over the past five years relative to competitors. Non-financial metrics included the streamlining of management, rebuilding of the credit system and the improvement of risk management as well as internal controls.

In 2002, KDIC restructured and listed Woori on the Korea Stock Exchange (KSE) and in 2003 on the New York Stock Exchange (NYSE). The listings served as a self-supervising system through market discipline. The listing on NYSE also countered negative perceptions of Woori. Through an IPO on the KSE in June 2002, KDIC recovered $367 million by disposing 11.8% of its stake in Woori. KDIC received another $324 million in September 2004 through a block disposal of its 5.7% stake at a discounted rate of 3%.

KDIC adopted a three-step privatisation plan for Woori. First, through the sale of regional bank units to domestic strategic investors, followed secondly by the direct sale of Woori's various non-bank subsidiaries such as the investment and securities, life insurance and asset management units. Third, through the merger of Woori Bank and Woori Financial Group, and subsequent sale of KDIC's remaining stake in the merged entity.

Another major initiative was to structure and manage the sale of a major stake (29.7%) in Woori to multiple buyers. KDIC chose to pursue this new strategy after several attempts to find a single investor to take on a large stake in Woori. A key challenge was to consider investor needs under a multi-ownership structure, which included the easing of KDIC's control over Woori. For instance, once investors named outside directors to Woori's board and upon approval by the PFOC, the MoU between KDIC and Woori would cease. However, KDIC would continue to provide support to Woori for a period of time, as it transitioned into full autonomy by the management of Woori. The model of multi-ownership shareholding with a controlling stake was also expected to enhance firm value and promote governance as well as healthy competition in the banking industry.

[70] KDIC's stake in Woori Bank was converted to shares in Woori Financial Group in early 2020

> ***The revised MoU with Woori (in 2015) is expected to help assure market participants of the government's commitment to privatize Woori and improve its corporate value to facilitate the sale***
>
> Korea Financial Services Commission

On 1 December 2016, KDIC agreed to sell its 29.7% stake to seven investors with collective ownership of Woori (IMM Private Equity: 6%; Hanwha Life, Tongyang Life Insurance Co. (owned by China's Anbang Insurance), Eugene Asset Management Co., Korea Investment & Securities Co., Kiwoom Securities Co: Each 4%; and Mirae Asset Global Investments Co.: 3.7%). This deal marked significant progress in KDIC's commendable efforts over many years to privatise Woori.

The proceeds of KRW2.4 trillion ($2.05 billion) from the sale substantially increased the recovery of public funds injected into Woori. It was reported in June 2019 that KDIC had recouped 87.3% of its initial investment through proceeds from the sale of shares, sale of subsidiaries and dividends. In November 2021, the sale of 9.3% of shares in Woori by KDIC to five bidders was announced. This marked completion of Woori's privatisation after 23 years, as KDIC ceased to be its largest shareholder. The proceeds from this sale would result in a collective recovery of about KRW12.3 trillion ($10.4 billion) or 96.6% of the total funds injected to bailout Woori.

In February 2022, KDIC sold a 2.2% stake in Woori for about KRW239 billion ($199 million), and holds a remaining stake of 3.6%.

Key takeaways

The case of Woori highlights challenges faced in resolving the failure of a systemic institution. These challenges cover the dimensions of assessing systemic risks, the legal basis for resolution and type of financial assistance provided, and subsequently to return the ownership of a large, nationalised financial group to the private sector. Frameworks established during good times to provide safeguards against moral hazard and to manage bank failures may be superseded by extenuating circumstances in a financial crisis. In this case, the systemic nature of the AFC and the contagion effects on the Korean financial sector, economy, corporate insolvencies and unemployment, drove the decision by policymakers to provide the OBA and override the results of the least-cost assessment for Woori.

> ***With successful result of the auction (in November 2021) ... the government's goal of privatisation of Woori has been accomplished some 23 years after the injection of public funds for bailout in 1998.***
>
> Korea Financial Services Commission

In situations with a high level of systemic risk, the nationalisation of FIs could offer immediate stability to the financial system. Nevertheless, post-nationalisation, the restructuring of a large, distressed bank and the return of ownership to the private sector can be a long drawn and costly affair. The divestment of KDIC's shares and privatisation of Woori has taken more than two decades.

Another takeaway is that OBA or financial assistance raises the issue of moral hazard and increases the risk exposure of deposit insurers to higher levels of uncertainty about policy outcomes.

In addition, the need for an effective strategy and the implementation of robust processes to effectively turn around a large, distressed banking institution should not be underestimated. KDIC's successful approach required close and laborious oversight. To ensure progress, KDIC designed and set specific goals and measures to be achieved over an extended timeline and agreed these in an MoU with Woori. One restructuring objective was for Woori to acquire competitive market leadership through scale via the creation of a megabank with an asset size of $93 billion. Finally, imposing market discipline on Woori through listings on the KSE and NYSE proved to be a sound tactic as part of the restructuring scheme. This helped to sustain improvements in Woori's performance as well as raise its domestic and international standing.