Excerpts from Draft Prospectus of a Korean Bank Holding Company

RISK FACTORS

An investment in our securities involves risks. You should carefully consider the risks described below and the other information in this prospectus before making a decision to invest. If the events underlying these risks occur, the trading price of our securities could decline, and you could lose all or part of your investment. Additional risks not currently known to us or that we now believe are immaterial could also harm us or affect your investment. As we are a Korean company, there are additional risks associated with investing in our securities that are not typical for investments in securities of U.S. companies.

Risks relating to our financial holding company structure and strategy

We have a limited operating history as a financial holding company, and our continued success cannot be assured.

We were established as a financial holding company to consolidate the Korean government’s interests in four commercial banks, one merchant bank and a number of other financial institutions. Each of these financial institutions was experiencing significant financial difficulties, including a sharp deterioration in asset quality and capital adequacy ratios and a net capital deficit, as a result of the Korean financial crisis that began in 1997, and had been recapitalized by the Korean government. Since that time, we have reorganized some of those business operations, and we may decide to implement other transfers or reorganizations with respect to our subsidiaries’ business operations in the future. While we believe that we have generally succeeded in improving our overall financial condition and normalizing our operations, we have a limited operating history as a financial holding company, particularly under our current structure and organization, and may experience difficulties in managing a larger and more diverse business. Accordingly, our continued success cannot be assured.

We may not succeed in implementing our current strategy to take advantage of our integrated financial holding company structure.

Our success under a financial holding company structure depends on our ability to take advantage of our large existing base of retail and corporate banking customers and to implement a strategy of developing and cross-selling diverse financial products and services to them. As part of this strategy, we are developing an integrated customer relationship management database shared by all of our subsidiaries and are upgrading and integrating our subsidiaries’ information technology systems, including their accounting and information storage systems. We also plan to continue to diversify our product offerings by, among other things, marketing insurance products and expanding our investment banking and investment trust operations. The continued implementation of these plans may require additional investments of capital, infrastructure,
human resources and management attention. This strategy entails significant risks, including the possibility that:

- we may fail to successfully integrate our diverse systems and operations;
- we may lack required capital resources;
- we may fail to attract, develop and retain personnel with necessary expertise; and
- we may face competition from other financial holding companies and more specialized financial institutions in particular segments.

If our strategy does not succeed, we may incur losses on our investments and our results of operations and financial condition may suffer.

*We may fail to realize the anticipated benefits relating to our reorganization and integration plan.*

Our success under a financial holding company structure depends on our ability to implement our reorganization and integration plan and to realize the anticipated synergies, growth opportunities and cost savings from coordinating and, in certain cases, combining the businesses of our various subsidiaries. Although we currently intend for our commercial banking subsidiaries to continue to operate as separate legal entities within our financial holding company structure and to maintain separate loan origination and other functions, we are in the process of integrating their risk management operations, as well as their diverse information technology systems (including their accounting and information storage systems) and business cultures. As part of our business plan, we also intend to establish a bancassurance joint venture and may enter into other joint venture or acquisition transactions in the future. See “Business—Other Businesses—Bancassurance.”

Although we are in the process of integrating certain aspects of our subsidiaries’ operations in our financial holding company structure, they will generally continue to operate as independent entities with separate management and staff. As a result, our ability to direct their day-to-day operations is and will continue to be limited. Further integration of our subsidiaries’ separate businesses and operations could require a significant amount of time, financial resources and management attention. Moreover, that process could disrupt our operations or information technology systems, reduce employee morale, produce unintended inconsistencies in our standards, controls, procedures or policies, and affect our relationships with customers and our ability to retain key personnel. The continued implementation of our reorganization and integration plan, as well as any future additional integration plans that we may adopt, and the realization of the anticipated benefits of our financial holding company structure may be blocked, delayed or reduced as a result of many factors, some of which may be outside our control. These factors include:

- difficulties in integrating the diverse activities and operations of our subsidiaries, including information technology systems, personnel, policies and procedures;
- difficulties in reorganizing or reducing overlapping personnel, branches, networks and administrative functions;
- restrictions under Korean financial holding company and other regulations on transactions between our company and, or among, our subsidiaries;
• unexpected business disruptions;
• loss of customers; and
• labor unrest.

Accordingly, we may not be able to realize the anticipated benefits of our current or any future reorganization and integration plan, and our business, results of operations and financial condition may suffer as a result.

We may not generate sufficient additional fees to achieve our revenue diversification strategy.

An important element of our overall strategy is increasing our fee income in order to diversify our revenue base, in anticipation of greater competition and declining lending margins. Historically, our primary source of revenues has been interest income from our banking operations. To date, except for credit card, trust management and currency transfer fees (including foreign exchange-related commissions), we have not generated substantial fee income. We intend to develop new sources of fee income as part of our business strategy, including through our investment banking and asset management businesses and our contemplated bancassurance joint venture. Although we, like many other Korean financial institutions, have begun to charge fees to our customers more regularly, customers may prove unwilling to pay additional fees, even in exchange for more attractive value-added services, and their reluctance to do so would adversely affect the implementation of this aspect of our strategy.

We depend on limited forms of funding to fund our operations at the holding company level.

We are a financial holding company with no significant assets other than the shares of our subsidiaries. Our primary sources of funding and liquidity are dividends from our subsidiaries, sales of our interests in our subsidiaries, direct borrowings and issuances of equity or debt securities at the holding company level. In addition, as a financial holding company, we are required to meet certain minimum financial ratios under Korean law, including with respect to liquidity, leverage and capital adequacy. Our ability to meet our obligations to our direct creditors and employees and our other liquidity needs and regulatory requirements at the holding company level depends on timely and adequate distributions from our subsidiaries, the successful completion of those sales and our ability to sell our securities or obtain credit from our lenders.

In the case of distributions, this depends on the financial condition and operating results of our subsidiaries. In the future, our subsidiaries may enter into agreements, such as credit agreements with lenders or indentures relating to high-yield or subordinated debt instruments, that impose restrictions on their ability to make distributions to us, and the terms of future obligations and the operation of Korean law could prevent our subsidiaries from making sufficient distributions to us to allow us to make payments on our outstanding obligations. See “—As a holding company, we depend on receiving dividends from our subsidiaries to pay dividends on our common stock.” Any delay in receipt of or shortfall in payments to us from our subsidiaries could result in our inability to meet our liquidity needs and regulatory requirements and may disrupt our operations at the holding company level.
In addition, trade and other creditors of our subsidiaries will generally have claims that are prior to any claims of our creditors with respect to their assets. Furthermore, unsuccessful completion of any sales of our interests in our subsidiaries or our inability to sell our securities or obtain funds from our lenders on favorable terms, or at all, could also result in our inability to meet our liquidity needs and regulatory requirements and may disrupt our operations at the holding company level.

As a holding company, we depend on receiving dividends from our subsidiaries to pay dividends on our common stock.

Since our principal assets at the holding company level are the outstanding capital stock of our subsidiaries, our ability to pay dividends on our common stock largely depends on dividend payments from those subsidiaries. Those dividend payments are subject to the Commercial Code of Korea, the Bank Act and to regulatory limitations, generally based on capital levels and retained earnings, imposed by the various regulatory agencies with authority over those entities. The ability of our banking subsidiaries to pay dividends is subject to regulatory restrictions to the extent that paying dividends would impair each of their nonconsolidated profitability, financial condition or other cash flow needs. For example:

- Under the Commercial Code, dividends may only be paid out of distributable income, an amount which is calculated by subtracting the aggregate amount of a company’s paid-in capital and certain mandatory legal reserves from its net assets, in each case as of the end of the prior fiscal year;
- Under the Bank Act, a bank also must credit at least 10% of its net profit to a legal reserve each time it pays dividends on distributable income until that reserve equals the amount of its total paid-in capital; and
- Under the Bank Act and the requirements of the Financial Supervisory Commission, if a bank fails to meet its required capital adequacy ratio or otherwise subject to the management improvement measures imposed by the Financial Supervisory Commission, then the Financial Supervisory Commission may restrict the declaration and payment of dividends by that bank.

Our subsidiaries may not continue to meet the applicable legal and regulatory requirements for the payment of dividends in the future. If they fail to do so, they may stop paying or reduce the amount of the dividends they pay to us, which would have an adverse effect on our ability to pay dividends on our common stock.

Risks relating to our corporate credit portfolio

We have exposure to the largest Korean commercial conglomerates, known as “chaebols,” and, as a result, recent and any future financial difficulties of chaebols may have an adverse impact on us.

Of our 20 largest corporate exposures (including loans, debt and equity securities, guarantees and acceptances and other exposures) as of June 30, 2003, 11 were to companies that are members of the 30 largest chaebols in Korea. As of that date, the total amount of our exposures to the 30 largest chaebols was W10,869 billion, or 10.0% of our total exposures. If the
credit quality of our exposures to chaebols declines, we could require substantial additional loan loss provisions, which would hurt our results of operations and financial condition.

In particular, we have significant exposure to several former Hyundai Group companies, former Daewoo Group companies, SK Group companies, Ssangyong Group companies and LG Group companies, a number of which have been experiencing financial difficulties. For example:

- As a result of their deteriorating financial condition, several former Hyundai Group companies, including Hynix Semiconductor, Hyundai Engineering & Construction, Hyundai Petrochemical and Hyundai Merchant Marine, have required assistance in recent years from their creditor financial institutions, in the form of additional loans, extensions of maturities of various outstanding payment obligations, debt-equity swap transactions, guarantees of overseas borrowings and injections of additional capital. In addition, in 2003, we downgraded the asset classification of our credit exposures to Hyundai Corporation from precautionary to substandard due to an increase in its capital deficit.

- In 1999, the principal creditor banks of the Daewoo Group companies began formal workout procedures with respect to 12 member companies of that group, including Daewoo Corporation, Daewoo Motors, Daewoo Electronics, Daewoo Heavy Industries, Daewoo Telecom and Ssangyong Motors. Many of these former Daewoo Group companies are currently subject to liquidation proceedings or have been liquidated or sold, are under workouts or reorganization proceedings, have been split up into more than one company or are looking for purchasers.

- In March 2003, the principal creditor banks of SK Networks (formerly SK Global), a member company of the SK Group, commenced corporate restructuring procedures against SK Networks after the company announced that its financial statements understated its total debt by W 1.1 trillion and overstated its profits by W 1.5 trillion. These banks, including our subsidiaries, agreed to a temporary rollover of approximately W 6.6 trillion of SK Networks’ debt until June 18, 2003 and subsequently decided to put SK Networks into corporate restructuring. In October 2003, SK Networks’ foreign and domestic creditors agreed to a restructuring plan which, among other things, allowed the foreign creditors to cash out their debts at a buyout rate of 43% of the face value of the outstanding debt owed to them.

- Several Ssangyong Group companies have recently been experiencing significant financial difficulties and liquidity problems. In particular, in 2003 the principal creditor banks of Ssangyong Corporation and Ssangyong Cement Industrial commenced corporate restructuring procedures against these companies.

- Although no workouts or reorganization proceedings have begun against any significant LG Group companies, LG Card is currently experiencing significant liquidity problems. See “—We have exposure to a number of Korean credit card companies, and recent and future difficulties faced by those companies may have an adverse impact on us.”

The table below summarizes our exposures to these groups, as well as a number of their significant member companies, as of June 30, 2003:

<table>
<thead>
<tr>
<th>Outstanding Exposure (1)</th>
<th>% of Total Exposure</th>
<th>% of Exposure Classified as Substandard or Below</th>
<th>Collateral</th>
<th>Allowance for Loan Losses</th>
<th>Allowance for Loan Losses as a % of Exposure</th>
</tr>
</thead>
<tbody>
<tr>
<td>(in billions of Won)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Former Hyundai Group (Total) (2)</td>
<td>₩1,432</td>
<td>1.31%</td>
<td>17.66%</td>
<td>[●]</td>
<td>₩273</td>
</tr>
<tr>
<td>---------------------------------</td>
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</tr>
<tr>
<td>Hyundai Group (3)..................</td>
<td>487</td>
<td>0.45</td>
<td>26.36%</td>
<td>[●]</td>
<td>136</td>
</tr>
<tr>
<td>Hyundai Engineering and</td>
<td>166</td>
<td>0.15</td>
<td>11.62%</td>
<td>[●]</td>
<td>16</td>
</tr>
<tr>
<td>Construction Group (4)...........</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hyundai Heavy Industry Group (6)</td>
<td>22</td>
<td>0.02</td>
<td>0.00%</td>
<td>[●]</td>
<td>—</td>
</tr>
<tr>
<td>Hynix Semiconductor...............</td>
<td>246</td>
<td>0.23</td>
<td>42.81%</td>
<td>[●]</td>
<td>118</td>
</tr>
<tr>
<td>Former Daewoo Group (Total) (7)</td>
<td>681</td>
<td>0.62</td>
<td>1.68%</td>
<td>[●]</td>
<td>42</td>
</tr>
<tr>
<td>Daewoo International...............</td>
<td>208</td>
<td>0.19</td>
<td>0.00%</td>
<td>[●]</td>
<td>2</td>
</tr>
<tr>
<td>GM Daewoo Auto &amp; Technology......</td>
<td>122</td>
<td>0.11</td>
<td>0.00%</td>
<td>[●]</td>
<td>—</td>
</tr>
<tr>
<td>Daewoo Electronics................</td>
<td>190</td>
<td>0.17</td>
<td>0.00%</td>
<td>[●]</td>
<td>17</td>
</tr>
<tr>
<td>Saangyong Motors..................</td>
<td>37</td>
<td>0.03</td>
<td>30.45%</td>
<td>[●]</td>
<td>10</td>
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<tr>
<td>SK Group (Total) (8)..............</td>
<td>489</td>
<td>0.45</td>
<td>50.58%</td>
<td>[●]</td>
<td>218</td>
</tr>
<tr>
<td>SK Networks........................</td>
<td>266</td>
<td>0.24</td>
<td>93.10%</td>
<td>[●]</td>
<td>217</td>
</tr>
<tr>
<td>Saangyong Group (Total) (9).......</td>
<td>195</td>
<td>0.18</td>
<td>66.58%</td>
<td>[●]</td>
<td>43</td>
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<tr>
<td>Saangyong Corporation.............</td>
<td>104</td>
<td>0.10</td>
<td>52.00%</td>
<td>[●]</td>
<td>43</td>
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<tr>
<td>Saangyong Cement Industrial.......</td>
<td>75</td>
<td>0.07</td>
<td>98.18%</td>
<td>[●]</td>
<td>—</td>
</tr>
<tr>
<td>LG Group (Total) (10).............</td>
<td>1,762</td>
<td>1.61</td>
<td>—</td>
<td>[●]</td>
<td>7</td>
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<tr>
<td>LG Card............................</td>
<td>462</td>
<td>0.42</td>
<td>—</td>
<td>[●]</td>
<td>—</td>
</tr>
</tbody>
</table>

1. Includes loans, debt and equity securities (including collateralized bond obligations), guarantees and acceptances and other exposures.
2. Includes amounts from Hyundai Group, Hyundai Engineering and Construction Group, Hyundai Motors Group and Hyundai Heavy Industry Group.
3. Recognized as the successor to the former Hyundai Group, which includes Hyundai Corporation and Hyundai Merchant Marine. Substantially all of the outstanding exposure of Hyundai Merchant Marine relates to ship financing to a special purpose company guaranteed by Hyundai Heavy Industries.
4. Includes Hyundai Engineering and Construction.
5. Includes Hyundai Motors, Kia Motors, Hyundai Capital and INI Steel.
6. Includes Hyundai Heavy Industries.
7. Includes our twelve largest exposures to former Daewoo Group companies.
8. Includes SK Corporation, SK Networks, SK Telecom, SK Life Insurance, SK IMT, SK Shipping, SKC, SK Construction, SK Chemical and SK Securities.

The allowances we have established against these exposures may not be sufficient to cover all future losses arising from these exposures. In addition, in the case of companies that are in or in the future enter into workout, restructuring, reorganization or liquidation proceedings, our recoveries from those companies may be limited. We may, therefore, experience future losses with respect to these exposures.

We have exposure to a number of Korean credit card companies and recent and future difficulties faced by those companies may have an adverse impact on us.

Our credit exposure to Korean credit card companies increased from ₩[●] billion as of December 31, 2000, to ₩[●] billion as of June 30, 2003, which represented [●]% and [●]% of our total exposures on those dates. As of June 30, 2003, loans and other credits to Korean credit card companies that were classified as substandard or below were ₩[●] billion, representing [●]% of our total exposure, and this amount has continued to increase in the second half of 2003. The Korean credit card industry has experienced increasing delinquency rates with respect to credit card receivables in recent years. Rising delinquency levels and declining demand for their securities have led to financial difficulties for many credit card companies. For example, LG Card, one of Korea’s largest credit card companies, is experiencing significant liquidity problems. In November 2003, we and other creditor banks of LG Card agreed to provide a new
₩2.1 trillion credit facility, secured by credit card receivables, to enable LG Card to resume cash operations. Our portion of this commitment is ₩246 billion, and the credit facility is scheduled to mature in March 2004. Certain of LG Card’s creditor banks also agreed to extend the maturity of ₩[●] billion debt of LG Card coming due in 2003 (including ₩[●] billion owned to us) for one year, after the chairman of LG Group pledged his personal stake in LG Corp., the group holding company, as collateral.

The allowances we have established against our exposures to Korean credit card companies may not be sufficient to cover all future losses arising from these exposures. In addition, in the case of credit card companies that are in or in the future enter into workout, restructuring, reorganization or liquidation proceedings, our recoveries from those companies may be limited. We may, therefore, experience future losses with respect to these exposures.

_A large portion of our credit exposure is concentrated in a relatively small number of large corporate borrowers, which increases the risk of our corporate credit portfolio._

As of June 30, 2003, our 20 largest credit exposures to corporate borrowers totaled ₩17,406 billion, which represented 15.9% of our total loans and other credits. As of June 30, 2003, ₩353 billion, or 2.0%, of our credits to our 20 largest borrowers was classified as substandard or below. We have made efforts to reduce our outstanding credit exposure to large corporate borrowers, including through asset sales, credit line reductions and credit write-offs. Any further deterioration in the financial condition of our large corporate borrowers may require us to take substantial additional provisions and may have a material adverse impact on our results of operations and financial condition.

_We have increasing credit exposure to small- and medium-sized enterprises, and financial difficulties experienced by companies in this segment may result in a deterioration of our asset quality and have an adverse impact on us._

Our credit exposure to small- and medium-sized enterprises increased from ₩23,267 billion as of December 31, 2000, to ₩37,821 billion as of June 30, 2003. As of June 30, 2003, loans and other credits to small- and medium-sized enterprises that were classified as substandard or below were ₩368 billion, representing 1.0% of our total credits to those enterprises. Recently, the industry-wide delinquency rates for loans and other credits to small- and medium-sized enterprises have been sharply rising, and our delinquency rate for those loans may rise further in 2004 compared to 2002 and 2003. Accordingly, we may be required to take measures to decrease our exposures to these customers. For example, in order to stem rising delinquency rates, we recently decided not to lend to small- and medium-sized enterprises in certain industry sectors, such as restaurants and motels.

Financial difficulties experienced by small- and medium-sized enterprises as a result of, among other things, continued weakness in the Korean economy may lead to a deterioration in the asset quality of our loans to this segment and reduced interest and fee income from this segment, which would have an adverse impact on us. In addition, many small- and medium-sized enterprises have close business relationships with chaebols, primarily as suppliers. Any difficulties encountered by those chaebols would likely hurt the financial condition of related small- and medium-sized enterprises, including those to which we have exposure.
We have credit exposure to companies that are currently or may in the future be put in restructuring, and we may suffer losses as a result of additional loan loss provisions required or the adoption of restructuring plans with which we do not agree.

As of June 30, 2003, our credit exposures to companies that were in workout, corporate restructuring, composition or corporate reorganization, including companies in the former Daewoo Group, the former Hyundai Group and the Ssangyong Group amounted to ￦2,240 billion or 2.1% of our total credits, of which ￦716 billion or 32.0% was classified as substandard or below. As of the same date, our allowances for loan losses on these credits amounted to ￦474 billion, or 21.2% of these credits. These allowances may not be sufficient to cover all future losses arising from our exposure to these companies. Furthermore, in the case of our borrowers that are or become subject to corporate restructuring procedures, we may be forced to restructure our credits pursuant to restructuring plans approved by other creditor financial institutions holding 75% or more of the total outstanding debt of the borrower, or to dispose of our credits to other creditors on unfavorable terms.

Risks relating to our consumer credit portfolio

We may not be able to sustain or improve the asset quality of our consumer loan and credit card portfolios.

In recent years, consumer debt has increased rapidly in Korea. Our portfolio of consumer loans and the aggregate outstanding balance of our credit card accounts have grown from ￦9,780 billion and ￦3,593 billion, respectively, as of December 31, 2000 to ￦27,920 billion and ￦5,907 billion, respectively, as of June 30, 2003. As of June 30, 2003, our consumer loans and credit card receivables represented 32.9% and 7.0% of our total lending, respectively. Until the second half of 2003, the growth of our consumer lending and credit card businesses, which offer higher margins than other lending activities, contributed significantly to the increase in our interest income and our profitability.

The rapid growth in our consumer loan and credit card portfolios has been accompanied by increasing delinquencies. Our non-performing consumer loans (defined as those that are over 90 days past due) increased from ￦107 billion, or 1.1% of our consumer loan portfolio, as of December 31, 2000 to ￦223 billion, or 0.8% of our consumer loan portfolio, as of June 30, 2003. In our credit card segment, outstanding balances overdue by 30 days or more increased from ￦220 billion, or 6.1% of our credit card receivables, as of December 31, 2000 to ￦594 billion, or 10.1% of our credit card receivables, as of June 30, 2003 and has continued to increase during the second half of 2003. In line with industry practice, we have restructured a portion of delinquent credit card account balances as loans and have also replaced a portion of our delinquent credit card account balances with cash advances that are rolled over from month to month. As of June 30, 2003, these restructured loans and revolving cash advances amounted to ￦382 billion and ￦[●] billion, respectively, or in aggregate [●]% of our credit card balances. Because these restructured loans and revolving cash advances are not initially treated as being delinquent, our delinquency ratios may not fully reflect all delinquent amounts relating to our outstanding consumer loans and credit card balances. Delinquencies may increase further in the future as a result of, among other things, adverse economic developments in Korea or the inability of Korean consumers to manage increased household debt, as reflected, for example, in
the practice among some credit card holders of obtaining multiple credit cards and using cash advances from one card to make payments due on others.

Further deterioration of the credit quality of our consumer loan and credit card portfolios would require us to increase our loan loss provisions and charge-offs and will adversely affect our financial condition and results of operations. Our loan loss provisions in respect of our consumer loan and credit card portfolios, as a percentage of total average consumer loan and credit card balances, increased from 1.9% in 2000 to 3.2% in 2002. In the first six months of 2003, that percentage was 1.9%. However, our charge-offs of non-performing consumer loans and delinquent credit card receivables, as a percentage of total average consumer loan and credit card balances, decreased from 2.4% in 2000 to 1.7% in 2002. In the first six months of 2003, that percentage was 0.9%. We expect that our provisions and charge-offs in respect of our consumer loan and credit card balances will increase substantially in the second half of 2003.

In addition, our increased exposure to consumer debt means that we are more exposed to changes in economic conditions affecting Korean consumers. Accordingly, economic difficulties in Korea that hurt those consumers could result in further deterioration in the credit quality of our consumer loan and credit card portfolios. For example, a rise in unemployment or an increase in interest rates in Korea, which have been at historically low levels in recent years, could adversely affect the ability of consumers to make payments and increase the likelihood of potential defaults.

*Government regulation of the credit card business has increased significantly in recent years, which may hurt our credit card operations.*

Due to the rapid growth of the credit card market and rising consumer debt levels in Korea in recent years, the Korean government has heightened its regulatory oversight of the credit card industry. In May 2002, the Korean Ministry of Finance and Economy and Financial Supervisory Commission announced that they would encourage credit card issuers to lower their fee rate on cash advances. As a result, cash advance fee rates fell to historically low levels during 2002, although they have increased in 2003.

In addition, from mid-2002 through early 2003, the Ministry of Finance and Economy and the Financial Supervisory Commission adopted a variety of amendments to existing laws and regulations governing the credit card industry. Among other things, these amendments increased minimum required provisioning levels applicable to credit card receivables, required the reduction in lending volumes for certain types of lending, increased reserve requirements and minimum capital ratios and allowed the imposition of new sanctions against credit card companies that failed to meet applicable requirements. For more details relating to these regulations, see “Supervision and Regulation—Principal Regulations Applicable to Credit Card Companies.”

The government has also increased its enforcement activities with respect to the credit card industry in recent years. In March 2002, the Financial Supervisory Commission imposed sanctions, ranging from warnings and administrative fines to partial business suspensions, on substantially all Korean credit card issuers in respect of unlawful or unfair practices discovered in the course of its industry-wide inspection. In April 2002, the Korean Fair Trade Commission
imposed administrative fines on four credit card companies for collusive and anti-competitive practices in fixing credit card interest and fee levels in 1998 and 1999. Our credit card subsidiary has not been subject to any such sanctions. In July and August 2003, the Financial Supervisory Commission conducted an inspection of several credit card issuers, including our credit card subsidiary, and ordered them to cease the practice of replacing delinquent credit card balances with revolving cash advances.

In light of the deteriorating liquidity position of a number of credit card companies in Korea, in March, September and October 2003 the Korean government announced measures intended to support the credit card industry. These include the relaxation or delay in the implementation of some of the new regulatory restrictions applicable to credit card issuers, such as restrictions on cash advance fee rates and on the level of cash advance and card loan receivables as a percentage of total receivables. We believe, however, that these relief measures are likely to be temporary, and that the overall effect of the Korean government’s recent regulatory initiatives has been, and will continue to be, to constrain the growth and profitability of our credit card operations. In October 2003, the Financial Supervisory Commission revised the calculation formula for capital adequacy ratios and delinquency ratios applicable to credit card companies, and has indicated its intention to impose sanctions against credit card companies with capital adequacy ratios below 8% or delinquency ratios above 10%. In this connection, the Financial Supervisory Commission announced that it may change its standards for reporting credit card delinquency ratios to require the inclusion of restructured loans and revolving cash advances in the calculation of such ratios. If these changes are adopted, the delinquency ratio reported by credit card companies, including our credit card subsidiary, will increase significantly, which may heighten public concern regarding their financial health and thereby exacerbate their liquidity problems. The Korean government may also adopt further regulatory changes in the future that affect the credit card industry, which in turn may adversely affect our credit card operations.

Our credit card operations have required and may continue to require financial support, which could hurt our financial condition and performance.

Credit card companies, including our credit card subsidiary, are among the largest Korean corporate debt issuers. Recently, however, demand for Korean corporate bonds has declined, in part as a result of recent accounting scandals involving SK Networks and weak conditions in the Korean economy. In addition, demand for debt securities issued by credit card companies has declined as a result of concerns regarding their financial health triggered by increasing credit card delinquency levels, as well as the liquidity problems currently affecting LG Card and other Korean credit card companies. According to press reports, as of [●], 2003, approximately W[●] trillion of Korean credit card companies’ bonds, asset-backed securities, commercial paper and other borrowings, including W[●] trillion issued by our credit card subsidiary, is scheduled to mature in 2004. In part to address such liquidity concerns, the Korean government has encouraged the parent companies of credit card subsidiaries to make additional capital contributions or otherwise take steps to improve the capital adequacy ratios of their credit card subsidiaries. Our credit card operation may continue to generate losses and require financial support from our other operations, which may adversely affect our overall financial condition and performance.
Government regulation of consumer lending, particularly mortgage and home equity lending, has recently become more stringent, which may hurt our consumer banking operations.

In light of concerns regarding the potential risks of excessive consumer lending, particularly mortgage and home equity lending, the Korean government has recently adopted more stringent regulations with respect to consumer lending by Korean banks. The Financial Supervisory Commission increased the minimum loan loss reserve requirements applicable to consumer loans with effect from May 2002. In addition, in an effort to curtail the growth in property speculation caused by increased levels of mortgage and home equity lending, the Financial Supervisory Commission and Financial Supervisory Service adopted measures during the second half of 2002 that decreased our ability to provide certain higher-risk mortgage and home equity loans.

Furthermore, in November 2002, the Financial Supervisory Commission and Financial Supervisory Service announced new, more stringent guidelines applicable to mortgage and home equity lending by Korean banks. More recently, in October 2003, the government advised Korean banks to limit their loans to a maximum of 40% of the value of the underlying real estate collateral, in the case of mortgage and home equity lending in areas where the average real estate price had increased substantially. See “Supervision and Regulation—Principal Regulations Applicable to Banks—Recent Regulations Relating to Household Loans.” These regulations, as well as any similar regulations that the Korean government may adopt in the future, may have the effect of constraining the growth and profitability of our consumer banking operations, especially in the area of mortgage and home equity lending.

Risk relating to competition

Competition in the Korean financial industry is intense, and we may lose market share and experience declining margins as a result.

Competition in the Korean financial market has been and is likely to remain intense. Some of the financial institutions that we compete with are significantly larger in terms of asset size and customer base and have greater financial resources or more specialized capabilities than our subsidiaries. In addition, in the area of our core banking operations, most Korean banks have indicated their intention to target retail customers and small- and medium-sized enterprises as they scale back their exposure to large corporate borrowers. Similarly, in the area of credit cards, Korean banks and credit card companies have been engaging in aggressive marketing activities and making significant investments. The competition and market saturation resulting from this common focus may make it more difficult for us to secure retail and small- and medium-sized customers with the credit quality and on credit terms necessary to achieve our business objectives.

In addition, we believe regulatory reforms and the general modernization of business practices in Korea will lead to increased competition among financial institutions in Korea. We also believe that foreign financial institutions, many of which have greater experience and resources than we do, will seek to compete with us in providing financial products and services either by themselves or in partnership with existing Korean financial institutions. Furthermore, a number of significant mergers and acquisitions in the industry have taken place in Korea over the
last few years. We expect that consolidation in the financial industry will continue. Some of the financial institutions resulting from this consolidation may, by virtue of their increased size and business scope, provide significantly greater competition for us. Our results of operations and financial condition may suffer as a result of increasing competition in the Korean financial industry.

Other risks relating to our business

We sold substantial amounts of assets with repurchase obligations held by us to the Korea Asset Management Corporation and provided substantial amounts of assets as collateral in connection with our secured borrowings, and could be required to make payments and realize losses in the future relating to those assets.

We have sold significant amounts of non-performing assets to the Korea Asset Management Corporation, which we refer to as KAMCO, in recent years. Some of those assets were sold with repurchase obligations by us, which means that if specified events occur, KAMCO may require us to repurchase such assets at the original sale price, plus accrued interest. See “Assets and Liabilities—Asset Quality of Loans—Sales of Non-Performing Loans—Korea Asset Management Corporation.” As of June 30, 2003, the aggregate amount of assets we sold to KAMCO that remained subject to such repurchase obligations based on the sales price of those assets to KAMCO was W429 billion. As of that date, we had established allowances of W156 billion in respect of possible losses on those assets. If we are required to repurchase those assets and are unable to make sufficient recoveries on them, we may realize further losses on those assets to the extent such recovery shortfalls exceed our allowances.

We have also provided a significant amount of our assets as collateral for our secured borrowings in recent years. These secured borrowings often take the form of asset securitization transactions, where we nominally sell our assets to a securitization vehicle that issues securities backed by those assets, although the assets remain on our balance sheet. These secured borrowings are intended to be fully repaid through recoveries on collateral. Some of these nominal asset sales were with recourse, which means that if delinquencies arise with respect to such assets, we will be required to either repay a proportionate amount of the related secured borrowing (by reversing the nominal sale and repurchasing such assets) or compensate the securitization vehicle for any net shortfalls in its recoveries on such assets. As of June 30, 2003, the aggregate amount of assets we had provided as collateral for our secured borrowings was W4,930 billion. As of that date, we had established allowances of W589 billion in respect of possible losses on those assets. If we are required to make payments on such assets, or to repay our secured borrowings on those assets and are unable to make sufficient recoveries on them, we may realize further losses on those assets to the extent those payments or recovery shortfalls exceed our allowances.

An increase in interest rates would decrease the value of our debt securities portfolio and raise our funding costs while reducing loan demand, which could adversely affect us.

Interest rates in Korea have fluctuated significantly in recent years. In 2000 and 2001, interest rates declined to historically low levels as the government sought to stimulate economic growth through active rate-lowering measures. Interest rates stabilized at these low levels in
2002 and 2003. Approximately half of the debt securities our banking subsidiaries hold pay interest at a fixed rate. All else being equal, an increase in interest rates would lead to a decline in the value of traded debt securities. A sustained increase in interest rates will also raise our funding costs, while reducing loan demand, especially among consumers. Rising interest rates may therefore require us to re-balance our assets and liabilities in order to minimize the risk of potential mismatches and maintain our profitability. See “Risk Management.” In addition, rising interest rate levels may adversely affect the Korean economy and the financial condition and repayment ability of our corporate and consumer borrowers, including holders of our credit cards, which in turn may lead to a deterioration in our credit portfolio.

*Our funding is highly dependent on short-term deposits, which dependence may adversely affect our operations.*

Our banking subsidiaries meet a significant amount of our funding requirements through short-term funding sources, which consist primarily of customer deposits. As of June 30, 2003, approximately 89.9% of these deposits had maturities of one year or less or were payable on demand. In the past, a substantial proportion of these customer deposits have been rolled over upon maturity. We cannot guarantee, however, that depositors will continue to roll over their deposits in the future. In particular, we believe that the recent increase in these short-term deposits is attributable in large part to the lack of alternative investment opportunities for individuals and households in Korea, especially in light of the current low interest rate environment and weak stock market conditions. Accordingly, a substantial number of these short-term deposit customers may withdraw their funds or fail to roll over their deposits if higher-yield investment opportunities emerge. In that event, our liquidity position could be adversely affected. Our banking subsidiaries may also be required to seek more expensive sources of short-term and long-term funding to finance our operations.

*A decline in the value of the collateral securing our loans and our inability to realize full collateral value may adversely affect our credit portfolio.*

A substantial portion of our loans is secured by real estate, the values of which have fluctuated significantly in recent years. Although it is our general policy to lend up to 60% of the appraised value of collateral and to periodically re-appraise our collateral, downturns in the real estate markets in Korea from time to time have resulted in declines in the value of the collateral securing some loans to levels below their outstanding principal balance. If collateral values decline in the future, they may not be sufficient to cover uncollectible amounts in respect of our secured loans. Any declines in the value of the real estate or other collateral securing our loans, or our inability to obtain additional collateral in the event of such declines, could result in a deterioration in our asset quality and may require us to take additional loan loss provisions.

In Korea, foreclosure on collateral generally requires a written petition to a court. An application, when made, may be subject to delays and administrative requirements that may decrease the value of such collateral. We cannot guarantee that we will be able to realize the full value on our collateral as a result of, among other factors, delays in foreclosure proceedings and defects in the perfection of our security interest in collateral. Our failure to recover the expected value of collateral could expose us to potential losses.
Labor union unrest may disrupt our operations and hinder our ability to continue to reorganize and integrate our operations.

Most financial institutions in Korea, including our subsidiaries, have experienced periods of labor unrest. As part of our reorganization and integration plan, we have transferred or merged some of the businesses operations of our subsidiaries into one or more entities and implemented other forms of corporate and operational restructuring. We may decide to implement other organizational or operational changes, as well as acquisitions or dispositions, in the future. Such efforts have in the past been met with significant opposition from labor unions in Korea. For example, in July 2000, the Korea Financial Industry Union, which represented the employees of 30 financial institutions, urged its members to participate in a strike to express their opposition to the increase in bank mergers and the promulgation of the Financial Holding Company Act. This strike was motivated by a fear that these mergers and the Financial Holding Company Act would lead to large-scale layoffs of financial institution employees. Actual or threatened labor disputes may disrupt the reorganization and integration process and our business operations, which in turn may hurt our financial condition and results of operations.

The secondary market for corporate bonds in Korea is not fully developed, and, as a result, we may not be able to realize the full “marked-to-market” value of debt securities we hold when we sell any of those securities.

As of June 30, 2003, our banking subsidiaries held debt securities issued by Korean companies and financial institutions (other than those issued by government-owned or -controlled enterprises or financial institutions, which include the KDIC, the Korea Electric Power Corporation, the Bank of Korea, the Korea Development Bank and the Industrial Bank of Korea) with a total book value of W5,957 billion in our trading and investment securities portfolio. The market value of these securities could decline significantly due to various factors, including future increases in interest rates, which may be significant in light of the current low interest environment, or a deterioration in the financial and economic condition of any particular issuer or of Korea in general. Any of these factors individually or a combination of these factors would require us to write down the fair value of these debt securities, resulting in impairment losses. Because the secondary market for corporate bonds in Korea is not fully developed, the market value of many of these securities as reflected on our balance sheet is determined by references to suggested prices posted by Korean rating agencies or the Korea Securities Dealers Association. These valuations, however, may differ significantly from the actual value that banking subsidiaries could realize in the event we elect to sell these securities. As a result, our banking subsidiaries may not be able to realize the full “marked-to-market” value at the time of any such sale of these securities and thus may incur additional losses.

We and our commercial banking and credit card subsidiaries may be required to raise additional capital to maintain our capital adequacy ratios or for other reasons, which we or they may not be able to do on favorable terms or at all.

Pursuant to the capital adequacy requirements of the Financial Supervisory Commission, we are required to maintain a minimum requisite capital ratio, which is the ratio of net total equity capital as a percentage of requisite capital, of 100% on a consolidated Korean GAAP basis. See “Supervision and Regulation—Principal Regulations Applicable to Financial Holding
Companies—Capital Adequacy.” In addition, each of our commercial banking subsidiaries, as well as our credit card subsidiary, is required to maintain a minimum combined Tier I and Tier II capital adequacy ratio of 8.0%, on a consolidated Korean GAAP basis. In both cases, Tier II capital is included in calculating the combined Tier I and Tier II capital adequacy ratio up to 100% of Tier I capital. As of September 30, 2003, our capital ratio and the capital adequacy ratios of our subsidiaries exceeded the minimum levels required by both the Financial Supervisory Commission and these memoranda. However, our capital base and capital adequacy ratio or those of our subsidiaries may deteriorate in the future if our or their results of operations or financial condition deteriorates for any reason, or if we or they are not able to deploy their funding into suitably low-risk assets.

If our capital adequacy ratio or those of our subsidiaries deteriorate, we or they may be required to obtain additional Tier I or Tier II capital in order to remain in compliance with the applicable capital adequacy requirements. As the financial holding company for our subsidiaries, we may be required to raise additional capital to contribute to our subsidiaries. We or our subsidiaries may not be able to obtain additional capital on favorable terms, or at all. The ability of our company and our subsidiaries to obtain additional capital at any time may be constrained to the extent that banks or other financial institutions in Korea or from other Asian countries are seeking to raise capital at the same time. Depending on whether we or our subsidiaries are obtaining any necessary additional capital, and the terms and amount of any additional capital obtained, holders of our securities may experience a dilution of their interest, or we may experience a dilution of our interest in our subsidiaries.

Under the new Basel Capital Accord, which is scheduled to take effect after December 2006, credit exposures to small- and medium-sized enterprises with no external ratings will be allocated a risk weighting of 150%. This would increase our banking subsidiaries’ capital requirements for small- and medium-sized enterprise lending unless they are able to obtain approval for their internal rating models from the Financial Supervisory Service. Although we expect our banking subsidiaries to continue their efforts to improve the accuracy of their internal rating models, they may not be able to obtain the Financial Supervisory Service’s approval with respect to such models. If such approval is not obtained, our banking subsidiaries may have to increase their capital to support their small- and medium-sized enterprise lending.

*We generally do not publish interim financial information on a U.S. GAAP basis.*

Neither we nor our subsidiaries regularly publish interim financial information on a U.S. GAAP basis. U.S. GAAP differs in significant respects from Korean GAAP, particularly with respect to the establishment of loan loss allowances and provisions. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Selected Financial Information under Korean GAAP” and “—Reconciliation with Korean GAAP.” As a result, our allowance and provision levels, as well as assets and liabilities, reflected in our interim financial statements under Korean GAAP may differ substantially from those required to be reflected under U.S. GAAP.
Risks relating to government regulation

The Korean government promotes lending and financial support by the Korean financial industry to certain types of borrowers as a matter of policy, which financial institutions, including us, may decide to follow.

Through its policy guidelines and recommendations, the Korean government has promoted and, as a matter of policy, may continue to attempt to promote lending by the Korean financial industry to particular types of borrowers. For example, the Korean government has in the past announced policy guidelines requesting financial institutions to participate in remedial programs for troubled corporate borrowers, as well as policies identifying sectors of the economy it wishes to promote and making low interest funding available to financial institutions that lend to these sectors. The government has in this manner encouraged low-income mortgage lending and lending to small- and medium-sized enterprises and technology companies. We expect that all loans or credits made pursuant to these government policies will be reviewed in accordance with our credit approval procedures. However, these or any future government policies may influence us to lend to certain sectors or in a manner in which we otherwise would not in the absence of that policy.

In the past, the Korean government has also issued policy recommendations encouraging financial institutions in Korea to provide financial support to particular sectors as a matter of policy. For example, in light of the financial market instability in Korea resulting from the liquidity problems faced by credit card companies during the first quarter of 2003, the Korean government announced temporary measures in April 2003 intended to provide liquidity support to credit card companies. These measures included, among other things:

- requesting credit card companies to effect capital increases in the aggregate amount of W4.6 trillion, as part of their self-rescue efforts;
- requesting banks and other financial institutions to agree to extend the maturity of all debt securities of credit card companies that they hold through June 2003;
- requesting investment trust management companies to agree to extend the maturity of 50% of the aggregate amount of the debt securities of credit card companies held by the investment trusts they manage that are scheduled to mature by June 2003; and
- with respect to the remaining 50% of such credit card company debt securities, requesting banks and other financial institutions to contribute an aggregate amount of W5.6 trillion to mutual funds to enable them to purchase such debt securities from investment trusts.

Of the W5.6 trillion aggregate contribution made by Korean financial institutions to purchase credit card company debt securities held by investment trusts, the portion allocated to us was approximately W540 billion. In accordance with a schedule agreed upon by us and other Korean financial institutions, we were reimbursed for the full amount of our contribution by the end of July 2003.

The Korean government may in the future request financial institutions in Korea, including us, to make investments in or provide other forms of financial support to particular sectors of the Korean economy as a matter of policy, which financial institutions, including us,
may decide to accept. We may incur costs or losses as a result of providing such financial support.

The Financial Supervisory Commission may impose burdensome measures on us if it deems us or one of our subsidiaries to be financially unsound.

If the Financial Supervisory Commission deems our financial condition or the financial condition of our subsidiaries to be unsound, or if we or our subsidiaries fail to meet applicable regulatory standards, such as minimum capital adequacy and liquidity ratios, the Financial Supervisory Commission may order, among other things:

- capital increases or reductions;
- stock cancellations or consolidations;
- transfers of business;
- sales of assets;
- closures of branch offices;
- mergers with other financial institutions; and
- suspensions of a part or all of our business operations.

If any of these measures are imposed on us by the Financial Supervisory Commission, they could hurt our business, results of operations and financial condition. In addition, if the Financial Supervisory Commission orders us to partially or completely reduce our capital, you may lose part or all of your investment.

Ongoing significant reforms and changes to the regulatory framework for the Korean financial industry could adversely affect our results of operations.

The legal and regulatory framework for the Korean financial industry is undergoing significant reforms and changes. For example, in the past the Korean government regulated, among other things, lending rates and deposit rates for banks. Regulations also dictated the extent of competition by restricting new entrants and the growth of existing financial institutions, including the opening of new branches. Ongoing regulatory reforms have removed all controls on lending rates and deposit rates (other than the maximum interest rate for demand deposits, which the Bank of Korea has announced it intends to remove) and have relaxed barriers to entry, including by foreign financial institutions, leading to increased competition. At the same time, the Korean government has revised its regulations in recent years to impose stricter regulatory standards and oversight on Korean financial institutions, as part of its efforts to modernize the industry and to address specific social and economic issues. Most recently, the Korean government has revised the regulations relating to credit cards and household lending as part of its effort to control the potential risks of excessive consumer lending. Continuing regulatory changes in the financial industry will require us to modify our business operations and may adversely affect our results of operations.
Risks relating to Korea

Unfavorable financial and economic developments in Korea since late 1997 had, and future adverse economic developments in Korea would likely have, an adverse effect on us.

We are incorporated in Korea, and substantially all of our operations are located in Korea. As a result, we are subject to political, economic, legal and regulatory risks specific to Korea. Beginning in late 1997, Korea experienced a significant financial and economic downturn that resulted in, among other things, an increase in the number and size of companies filing for corporate reorganization and protection from their creditors. As a result of these corporate failures, financial institutions in Korea, including our subsidiaries, experienced a sharp increase in non-performing loans and a deterioration in their capital adequacy ratios.

Although the Korean economy began to experience a recovery in 1999, the pace of the recovery has since slowed and has been volatile. The economic indicators in 2001, 2002 and 2003 have shown mixed signs of recovery and uncertainty, and future recovery or growth of the economy is subject to many factors beyond our control. Events related to terrorist attacks in the United States that took place on September 11, 2001, recent developments in the Middle East, including the war in Iraq, higher oil prices, the general weakness of the global economy and the outbreak of severe acute respiratory syndrome, or SARS, in Asia and other parts of the world have increased the uncertainty of world economic prospects in general and continue to have an adverse effect on the Korean economy. Any future deterioration of the Korean economy would adversely affect our financial condition and results of operations.

Developments that could hurt Korea’s economy in the future include:

- financial problems relating to chaebols, or their suppliers, and their potential adverse impact on Korea’s financial sector, including as a result of recent investigations relating to unlawful political contributions by chaebols;
- failure of restructuring of large troubled companies;
- volatility in foreign currency reserve levels, commodity prices (including oil prices), exchange rates (including depreciation of the U.S. dollar or Japanese yen), interest rates and stock markets;
- increased reliance on exports to service foreign currency debts, which could cause friction with Korea’s trading partners;
- adverse developments in the economies of countries such as the United States, China and Japan to which Korea exports, or in emerging market economies in Asia or elsewhere that could result in a loss of confidence in the Korean economy;
- social and labor unrest or declining consumer confidence or spending resulting from lay-offs, increasing unemployment and lower levels of income;
- a decrease in tax revenues and a substantial increase in the Korean government’s expenditures for unemployment compensation and other social programs that, together, lead to an increased government budget deficit;
- political uncertainty or increasing strife among or within political parties in Korea; and
- a deterioration in economic or diplomatic relations between Korea and its trading partners or allies, including such deterioration resulting from trade disputes or disagreements in foreign policy.
Tensions with North Korea could have an adverse effect on us and the price of our securities.

Relations between Korea and North Korea have been tense over most of Korea’s history. The level of tension between the two Koreas has fluctuated and may increase or change abruptly as a result of current and future events, including ongoing contacts at the highest levels of the governments of Korea and North Korea and increasing hostility between North Korea and the United States. In December 2002, North Korea removed the seals and surveillance equipment from its Yongbyon nuclear power plant and evicted inspectors from the United Nations International Atomic Energy Agency, and has reportedly resumed activity at its Yongbyon power plant. In January 2003, North Korea announced its intention to withdraw from the Nuclear Non-Proliferation Treaty, demanding that the United States sign a non-aggression pact as a condition to North Korea dismantling its nuclear program. In August 2003, representatives of Korea, the United States, North Korea, China, Japan and Russia held multilateral talks in an effort to resolve issues relating to North Korea’s nuclear weapons program. While the talks concluded without resolution, participants in the August meeting indicated that further negotiations may take place in the future. Any further increase in tensions, resulting for example from a break-down in contacts or an outbreak in military hostilities, could hurt our business, results of operations and financial condition and could lead to a decline in the price of our securities.

Labor unrest in Korea may adversely affect our operations.

The economic downturn in Korea in 1997 and 1998 and the increase in the number of corporate reorganizations and bankruptcies thereafter caused layoffs and increasing unemployment in Korea, and a similar economic downturn in the future could lead to further layoffs. These factors could lead to social unrest and substantially increase government expenditures for unemployment compensation and other costs for social programs. During 1998 and 1999, there were large-scale protests and labor strikes in Korea. According to statistics from the Bank of Korea, the unemployment rate generally decreased from 4.1% in 2000 to 3.1% in 2002, but increased to 3.2% in the first nine months of 2003. A continued increase in unemployment and continuing or future labor unrest could adversely affect our operations, as well as the operations of many of our customers and their ability to repay their loans, and could adversely affect the financial conditions of Korean companies in general, depressing the price of securities on the Korea Stock Exchange and the value of the Won relative to other currencies. These developments would likely have an adverse effect on our financial condition and results of operations.
The Korean financial industry includes the following categories of financial institutions:

- The Bank of Korea;
- banking institutions;
- non-banking financial institutions; and
- other financial entities, including, but not limited to, securities institutions, credit guarantee institutions and venture capital companies.

Korean law requires that financial institutions confirm that their customers use their real names when transacting business in order to increase financial transaction transparency and to enhance the integrity and efficiency of Korea’s financial markets. However, in order to ease the liquidity crisis, in 1998, the Korean government loosened these rules to allow investors without identification to sell or deposit foreign currencies through domestic financial institutions and to purchase certain debt securities, including Korean government bonds. The Korean government also strengthened the rules relating to confidentiality for private financial transactions.

The Banking Industry

The banking sector in Korea can be divided into two broad categories: commercial banks and specialized banks. Commercial banks serve both the general public and corporate sectors. As of June 30, 2003, commercial banks consisted of eight nationwide commercial banks (including Woori Bank), all of which have branch networks throughout Korea, six regional banks (including Kyongnam Bank and Kwangju Bank) and 61 domestic branches of foreign banks operating in Korea. Regional banks provide services similar to nationwide banks, but operate in a geographically restricted region. Domestic branches of foreign banks have operated in Korea since 1967, but provide a relatively small proportion of Korea’s banking services. As of December 31, 2002, nationwide and regional banks had an aggregate of 4,967 domestic branches and offices, 54 overseas branches, four overseas representative offices and 20 overseas subsidiaries.

As in most countries, commercial banks in Korea engage in a wide range of business. Their core activities include taking deposits, extending loans and discounts, remittances and collections. They also provide guarantees and acceptances and conduct own-account securities investment. They must obtain specific authorization from the Financial Supervisory Commission for each area of non-bank business in which they engage, such as the trust and credit card businesses. Bank funding in Korea has traditionally been deposit based since long-term domestic borrowings are limited, the short-term money market is relatively illiquid and foreign borrowings are regulated by the government.

Specialized banks meet the needs of specific sectors of the economy in accordance with Korean government policy. These banks are organized under, or chartered by, special laws. There are five specialized banks:

- the Korea Development Bank;
- the Export-Import Bank of Korea;
- Industrial Bank of Korea;
• National Agricultural Cooperatives Federation; and
• National Federation of Fisheries Cooperatives.

The economic difficulties in 1997 and 1998 caused Korean banks’ non-performing assets to increase and their capital adequacy ratios to decline. From 1998 through 2002, the Financial Supervisory Commission amended banking regulations several times to adopt more stringent definitions for non-performing loans that more closely followed international standards. These new definitions increased the level of non-performing loans held by banks and other financial institutions. The following table sets forth the total loans and non-performing assets of the banking sector (excluding specialized banks) at year-end from 1999 through 2002 and as of June 30, 2003.

<table>
<thead>
<tr>
<th>Date</th>
<th>Total Loans</th>
<th>Non-Performing Assets</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 1999</td>
<td>₩328.3</td>
<td>₩27.4</td>
<td>₩8.3</td>
</tr>
<tr>
<td>December 31, 2000</td>
<td>₩361.6</td>
<td>₩23.9</td>
<td>₩6.6</td>
</tr>
<tr>
<td>December 31, 2001</td>
<td>₩379.1</td>
<td>₩11.0</td>
<td>₩2.9</td>
</tr>
<tr>
<td>December 31, 2002</td>
<td>₩464.6</td>
<td>₩9.0</td>
<td>₩1.9</td>
</tr>
<tr>
<td>June 30, 2003</td>
<td>₩489.8</td>
<td>₩11.3</td>
<td>₩2.3</td>
</tr>
</tbody>
</table>


Most of the growth in total loans from 1999 through 2003 has been attributable to increases in outstanding consumer loans and credit card balances. In March 2003, the Financial Supervisory Commission announced that a group of Korean banks, consisting of eight nationwide commercial banks, six regional commercial banks and five specialized banks, posted an aggregate net profit under Korean GAAP of ₩5.6 trillion in 2002, compared to an aggregate net profit of ₩5.3 trillion in 2001.

**Non-Banking Financial Industry**

Non-banking financial institutions include:

- investment institutions, including merchant banks, investment trust companies and the Korea Securities Finance Corporation;
- savings institutions, including trust accounts of banks, mutual savings and finance companies, credit unions, mutual credit facilities, community credit cooperatives and postal savings;
- insurance companies; and
- credit card companies.

**Investment Institutions.** As of June 30, 2003, three merchant banks (including Woori Investment Bank) were operating in Korea. Since 1998, 28 merchant banks have been closed or merged into commercial banks or securities firms. As of June 30, 2003, assets of the three operating merchant banks totaled ₩2,498 billion. As of June 30, 2003, 32 investment trust
management companies, which manage trusts, operate in Korea. As of March 31, 2003, the total assets under management of all investment trust companies in Korea totaled ₩153 trillion.

**Savings Institutions.** Korean law permits Korean banks to provide trust account management services. Banks segregate trust assets and cannot use those assets to satisfy claims of depositors or other creditors. Accordingly, trust accounts appear separately from banking accounts in the banks’ financial statements. As of June 30, 2003, assets of trust accounts of all banks providing trust account management services totaled ₩1,032,051 billion. Korea had 114 mutual savings banks and 1,104 credit unions as of June 30, 2003, with assets totaling ₩27,004 billion and ₩19,020 billion, respectively.

**Insurance.** As of June 30, 2003, 15 domestic life insurance institutions, three branches of foreign life insurance companies and five wholly-owned subsidiaries of foreign life insurance companies operated in Korea. As of that date, those entities had assets totaling approximately ₩169 trillion. The Korean insurance industry is also comprised of eleven listed fire and marine insurance companies, most of which are chaebol affiliated. As of June 30, 2003, those entities had assets totaling approximately ₩36.4 trillion.

**Credit Card.** As of June 30, 2003, nine credit card companies operated in the country with credit card receivables and loans totaling approximately ₩28 trillion, of which approximately 12.2% were delinquent by one day or more. Of this amount, total credit card receivables were ₩10.2 trillion and total card loans and cash advances were ₩17.8 trillion, on a reported basis.

**Money Markets**

The Korean money markets consist of the call loan market and markets for other short-term financial instruments, including treasury bills, monetary stabilization bonds, negotiable certificates of deposit, repurchase agreements and commercial paper.

**Securities Markets**

The Korea Stock Exchange, a non-profit corporation wholly-owned by its member firms, began operations in 1956. It is Korea’s only stock exchange. The Korea Stock Exchange has a single trading floor located in Seoul. See “The Korean Securities Market.”

**Supervision System**

The Financial Supervisory Service, which was formed in January 1999 through the merger of several existing regulatory bodies, acts as the executive body for the Financial Supervisory Commission. The Financial Supervisory Commission is under, but operates independently of, the Prime Minister’s office.

The Ministry of Finance and Economy focuses on financial policy, foreign currency regulations and the approval process for establishing financial institutions. The Bank of Korea manages monetary policy focusing on price stabilization.
**Insurance System**

Korea’s deposit insurance system insures amounts on deposit with banks, non-bank financial institutions, securities companies and life insurance companies. Deposits at any single financial institution are insured only up to W50 million, regardless of the amount deposited. The Korean government recently excluded certain deposits, such as repurchase agreements, from the insurance system, expanded the definition of unsound financial institutions to which this system would apply and increased the insurance premiums payable by insured financial institutions.
SUPERVISION AND REGULATION

Principal Regulations Applicable to Financial Holding Companies

General

The Financial Holding Company Act (Law No. 6274, October 23, 2000) regulates Korean financial holding companies and their subsidiaries. The entities that regulate and supervise Korean financial holding companies and their subsidiaries are the Financial Supervisory Commission and the Financial Supervisory Service.

The Financial Supervisory Commission exerts direct control over financial holding companies pursuant to the Financial Holding Company Act. Among other things, the Financial Supervisory Commission:

- approves the establishment of financial holding companies;
- issues regulations on the capital adequacy of financial holding companies and their subsidiaries; and
- drafts regulations relating to the supervision of financial holding companies.

Following the instructions and directives of the Financial Supervisory Commission, the Financial Supervisory Service supervises and examines financial holding companies and their subsidiaries. In particular, the Financial Supervisory Service sets requirements relating to Korean financial holding companies’ liquidity and capital adequacy ratios and establishes reporting requirements within the authority delegated under the Financial Supervisory Commission regulations. Financial holding companies must submit quarterly reports to the Financial Supervisory Service discussing business performance, financial status and other matters identified in the Enforcement Decree of the Financial Holding Company Act.

Under the Financial Holding Company Act, a financial holding company must primarily engage in controlling its subsidiaries by holding equity stakes in them equal in aggregate to at least 50% of the financial holding company’s aggregate assets based on its latest balance sheet. A financial holding company may engage only in the following activities:

- controlling the management of its subsidiaries;
- financially supporting its direct and indirect subsidiaries;
- raising capital necessary for investment in its subsidiaries or providing financial support to its direct and indirect subsidiaries;
- supporting the business of its direct and indirect subsidiaries for the joint development and marketing of new products and the joint utilization of facilities or information and technology systems; and
- any other businesses exempted from authorization, permission or approval under the applicable laws and regulations.

The Financial Holding Company Act requires every financial holding company and its subsidiaries to obtain prior approval from, or file a prior report with, the Financial Supervisory Commission before acquiring control of another company. In addition, the Financial Supervisory
Commission must grant permission to liquidate or to merge with any other company before the liquidation or merger. A financial holding company must report to the Financial Supervisory Commission when its officers or largest shareholder changes, and when it ceases to control any of its direct and indirect subsidiaries by disposing of their shares.

**Capital Adequacy**

The Financial Holding Company Act does not provide for a minimum paid-in capital requirement related to financial holding companies. However, all financial holding companies are required to maintain a specified level of solvency. In addition, with respect to the allocation of net profit earned in a fiscal term, a financial holding company must set aside in its legal reserve an amount equal to at least 10% of its net income after tax each time it pays dividends on its net profits earned until its legal reserve reaches at least the aggregate amount of its paid-in capital.

All financial holding companies must have, together with their subsidiaries, a minimum requisite capital ratio of 100%, as defined by the Financial Supervisory Commission. “Requisite capital ratio” is defined as the ratio of net total equity capital as a percentage of requisite capital.

“Net total equity capital” is defined as the sum of:

1. in the case of a financial institution subsidiary (including, for example, banks, merchant banks and securities companies), other than a financial holding company’s indirect subsidiary that is consolidated to a direct subsidiary of a financial holding company, that is subject to minimum capital requirements under the Financial Supervisory Commission regulations, the actual equity capital maintained by that financial institution; and

2. in the case of a financial holding company or a financial holding company’s financial institution subsidiary, other than a financial holding company’s indirect subsidiary that is consolidated to a direct subsidiary of a financial holding company, that has no minimum capital requirements under the Financial Supervisory Commission regulations, the total stockholders’ equity as recorded on that financial holding company’s balance sheet less (x) intangible assets and (y) deferred tax assets, if any; less the sum of:

   (1) the book value of investments among a financial holding company and its direct and indirect subsidiaries, if any; and

   (2) the book value of investments among direct and indirect subsidiaries, if any.

“Requisite capital” means the sum of:

1. in the case of a financial institution subsidiary, other than a financial holding company’s indirect subsidiary that is consolidated to a direct subsidiary of a financial holding company, that is subject to minimum capital requirements under the Financial
Supervisory Commission regulations, the minimum equity capital amount necessary to meet such requirements;

(2) in the case of a financial holding company’s financial institution subsidiary that has no minimum capital requirements under Financial Supervisory Commission regulations, 8% of its total assets on its balance sheet (including off-balance sheet assets, if any) (since it is required under the relevant regulation); and

(3) in the case of a financial holding company, 8% of its total assets on its balance sheet (including off-balance sheet assets, if any, but excluding the book value of investments in and financial supports to its direct and indirect subsidiaries, if any).

Liquidity

All financial holding companies are required to match the maturities of their assets and liabilities on a non-consolidated basis in accordance with the Financial Holding Company Act in order to ensure liquidity. Financial holding companies must:

• maintain a Won liquidity ratio (defined as Won assets due within three months, including marketable securities, divided by Won liabilities due within three months) of not less than 100% on a non-consolidated basis;
• maintain a foreign currency liquidity ratio (defined as foreign currency liquid assets due within three months divided by foreign currency liabilities due within three months) of not less than 80% on a non-consolidated basis;
• maintain a ratio of foreign currency liquid assets due within seven days less foreign currency liabilities due within seven days as a percentage of total foreign currency assets of not less than 0% on a non-consolidated basis;
• maintain a ratio of foreign currency liquid assets due within a month less foreign currency liabilities due within a month as a percentage of total foreign currency assets of not less than negative 10% on a non-consolidated basis; and
• make quarterly reports regarding their liquidity to the Financial Supervisory Service.

A financial holding company may not invest in securities (other than those securities issued by its direct and indirect subsidiaries) in excess of the amount of its shareholders’ equity less the total amount of investment in subsidiaries, subject to certain exceptions.

Financial Exposure to Any Individual Customer and Major Shareholder

Subject to certain exceptions, the aggregate credit (as defined in the Financial Holding Company Act, the Bank Act, the Merchant Bank Act and the Korean Securities and Exchange Act, respectively) of a financial holding company and its direct and indirect subsidiaries that are banks, merchant banks or securities companies (which we refer to as “Financial Holding Company Total Credit”) to a single group of companies that belong to the same conglomerate as defined in the Monopoly Regulations and Fair Trade Act will not be permitted to exceed 25% of equity capital (as defined below).

“Equity capital” is defined as the sum of:
(1) in case of a financial holding company, net assets (which is total assets less total liabilities) on balance sheet as of the end of the most recent quarter;

(2) in case of a bank, the capital amount as defined in Article 2(1), Item 7 of the Bank Act;

(3) in case of a merchant bank, the capital amount as defined in Article 2, Item 3 of the Merchant Bank Act; and

(4) in case of a securities company, total assets less total liabilities on that company’s balance sheet as of the end of the most recent financial year and adjusted as determined by the Financial Supervisory Commission (for example, by including any increase or decrease of paid-in capital after the end of the most recent financial year); less the sum of:

(1) the amount of shares of direct and indirect subsidiaries held by the financial holding company;

(2) the amount of shares that are cross-held by each direct and indirect subsidiary that is a bank, merchant bank or securities company; and

(3) the amount of shares of a financial holding company held by such direct and indirect subsidiaries that are banks, merchant banks or securities companies.

The Financial Holding Company Total Credit to a single individual or judicial person may not exceed 20% of the equity capital. In addition, the Financial Holding Company Total Credit to a shareholder holding (together with the persons who have a “special relationship” with the shareholder, as defined in the Enforcement Decree of the Financial Holding Company Act) in aggregate more than 10% of the total issued and outstanding voting shares of a financial holding company generally may not exceed the lesser of (x) 25% of the equity capital and (y) the amount of the equity capital of the financial holding company multiplied by the shareholding ratio of the shareholder (together with the persons who have a special relationship with the shareholder).

Further, the total sum of credits (as defined in the Financial Holding Company Act, the Bank Act, the Merchant Bank Act and the Korean Securities and Exchange Act, respectively) of a bank holding company controlling banks and its direct and indirect subsidiaries that are banks, merchant banks or securities companies as applicable (“Bank Holding Company Total Credit”) extended to a “major shareholder” (as defined below) (together with the persons who have a special relationship with that major shareholder) will not be permitted to exceed the lesser of (x) 25% of the equity capital and (y) the amount of the equity capital of the bank holding company multiplied by the shareholding ratio of the major shareholder, except for certain cases.

“Major shareholder” is defined as:

- a shareholder holding (together with persons who have a special relationship with that shareholder), in excess of 10% (or in the case of a bank holding company controlling regional banks only, 15%) in the aggregate of the bank holding company’s total issued voting shares; or
• a shareholder holding (together with persons who have a special relationship with that 
shareholder), more than 4% in the aggregate of the total issued voting shares of the bank 
holding company controlling nationwide banks (excluding shares subject to the shareholding 
restrictions on non-financial group business companies as described below), where the 
shareholder is the largest shareholder or has actual control over the major business affairs of 
the bank holding company through, for example, appointment and dismissal of the officers 
pursuant to the Enforcement Decree of the Financial Holding Company Act.

In addition, the total sum of the Bank Holding Company Total Credit granted to all of a 
bank holding company’s major shareholders must not exceed 25% of the bank holding 
company’s equity capital. Furthermore, any bank holding company that, together with its direct 
and indirect subsidiaries, intends to extend credit to the bank holding company’s major 
shareholder in an amount exceeding the lesser of (x) the amount equivalent to 0.1% of the equity 
capital and (y) ₩5 billion, in any single transaction, must obtain prior unanimous board 
resolutions and then, immediately after providing the credit, must file a report to the Financial 
Supervisory Commission and publicly disclose the filing of the report.

Restrictions on Transactions Among Direct and Indirect Subsidiaries and Financial 
Holding Company

Generally, a direct or indirect subsidiary of a financial holding company may not extend 
credits to that financial holding company. In addition, a direct or indirect subsidiary of a 
financial holding company that is engaged in the banking, merchant banking or securities 
business may not extend credits to other direct or indirect subsidiaries of the financial holding 
company in excess of 10% of its capital amount on an individual basis or to those subsidiaries in 
excess of 20% of its capital amount on an aggregate basis. The subsidiary extending the credit 
must also obtain adequate collateral from the other subsidiaries unless the credit is otherwise 
approved by the Financial Supervisory Commission.

Subject to certain exceptions, a direct or indirect subsidiary of a financial holding 
company is prohibited from owning the shares of any other direct or indirect subsidiaries (other 
than those directly controlled by that direct or indirect subsidiary) under the common control of 
the financial holding company. Subject to certain exceptions, a direct or indirect subsidiary of a 
financial holding company is also prohibited from owning the shares of the financial holding 
company controlling that direct or indirect subsidiary. The transfer of certain loans or credits 
classified as precautionary or below between a financial holding company and its direct or 
indirect subsidiary or between the direct and indirect subsidiaries of a financial holding company 
is prohibited except for:

1. transfers to a special purpose company, or entrustment with a trust company, for an 
asset-backed securitization transaction;

2. transfers to a mortgage-backed securities issuance company for a mortgage 
securitization transaction; and

3. transfers or in-kind contributions to a corporate restructuring vehicle under the 
Corporate Restructuring Promotion Act.
Disclosure of Management Performance

For the purpose of protecting the depositors and investors in the subsidiaries of financial holding companies, the Financial Supervisory Commission requires financial holding companies to disclose certain material matters including:

(1) financial condition and profit and loss of the financial holding company and its direct and indirect subsidiaries;

(2) capital raising by the financial holding company and its direct and indirect subsidiaries and the appropriation of such capital;

(3) any sanctions levied on the financial holding company and its direct and indirect subsidiaries under the Financial Holding Company Act or any corrective measures or sanctions under the Law on Improvement of Structure of Financial Industry; and

(4) occurrence of any non-performing assets or financial incident that may have a material adverse effect.

Restrictions on Shareholdings in Other Companies

Subject to certain exceptions, a financial holding company may not own more than 5% of the total issued and outstanding shares of another finance-related company, other than its direct and indirect subsidiaries. If it does, the financial holding company must exercise its voting rights in the same manner and in the same proportion as the finance-related company’s other shareholders exercise their voting rights.

Generally, a financial holding company may not own outstanding shares of all subsidiaries in the aggregate with an acquisition price in excess of its net assets (i.e., total assets less total liabilities). Exceptions include where the financial holding company:

(1) invests up to 130% of its net assets in a subsidiary to improve the financial condition of a subsidiary classified as an unsound financial institution under the Law on the Improvement of Structure of Financial Industry or as an unsound or potentially unsound financial institution under the Depositor Protection Act;

(2) invests up to 130% of its net assets to make an indirect subsidiary or a company controlled by a subsidiary into a direct subsidiary of the financial holding company;

(3) already holds the outstanding shares of a subsidiary, where that holding constituted not more than 130% of its net assets at the time when it became a financial holding company;

(4) invests up to 130% of its net assets in a subsidiary in order to make it a wholly-owned subsidiary, or in a special purpose company under the Asset Backed Securitization Act to make it a subsidiary;
(5) has net assets that increase such that, as the amount of investments in subsidiaries increases, the ratio of the total amount of investments in subsidiaries to the financial holding company’s net assets does not increase; or

(6) has total investments in its subsidiaries that exceed its net assets due to (a) reduction of the financial holding company’s net assets, (b) spin-off, merger or transfer of the entire business of the financial holding company, (c) spin-off, merger or transfer of the entire business of direct or indirect subsidiaries, or (d) foreclosure of collateral or receipts under accord and satisfaction. (This means receipts of subsidiary shares in lieu of its claim to subsidiary.)

The financial holding company, however, must reduce the ownership of excessive shares within two years in case of (1) through (5) and within six months in case of (6), unless this deadline is otherwise extended by the Financial Supervisory Commission.

Restrictions on Shareholdings by Direct and Indirect Subsidiaries

A direct subsidiary of a financial holding company may not control any other company other than, as an indirect subsidiary of the financial holding company:

- subsidiaries in foreign jurisdictions which are engaged in the same business as the direct subsidiary;
- certain financial institutions which are engaged in any business that the direct subsidiary may conduct without any licenses or permits;
- certain financial institutions whose business is related to the business of the direct subsidiary as described by the Enforcement Decree of the Financial Holding Company Act (for example, a bank subsidiary may control only credit information companies, credit card companies, trust companies, investment trust management companies, investment advisory companies, futures business companies, and asset management companies);
- certain financial institutions whose business is related to the financial business as prescribed by the regulations of the Ministry of Finance and Economy; and
- certain companies which are not financial institutions but whose business is related to the financial business of the financial holding company as prescribed by the Enforcement Decree of the Financial Holding Company Act (for example, a finance-related research company or a finance-related information technology company).

Acquisition of such indirect subsidiaries by direct subsidiaries of a financial holding company requires prior permission from the Financial Supervisory Commission or the submission of a report to the Financial Supervisory Commission, depending on the types of the indirect subsidiaries and the amount of total assets of the indirect subsidiaries.

An indirect subsidiary of a financial holding company may not control any other company.
Restrictions on Transactions between a Bank Holding Company and its Major Shareholder

A bank holding company and its direct and indirect subsidiaries may not acquire (including through their respective trust accounts) shares issued by the bank holding company’s major shareholder in excess of 1% of the equity capital (as defined above). In addition, if those entities intend to acquire shares issued by that major shareholder in any single transaction in excess of the lesser of (x) the amount equivalent to 0.1% of the equity capital and (y) ₩5 billion, that entity must obtain prior unanimous board resolutions and then, immediately after the acquisition, file a report to the Financial Supervisory Commission and publicly disclose the filing of the report.

Restriction on Ownership of a Financial Holding Company

Under the Financial Holding Company Act, a financial institution generally may not control a financial holding company. In addition, any single shareholder and persons who have a special relationship with that shareholder may acquire beneficial ownership of no more than 10% of the total issued and outstanding shares with voting rights of a bank holding company that controls nationwide banks or 15% of the total issued and outstanding shares with voting rights of a bank holding company that controls only regional banks. The Korean government and the KDIC are not subject to this limit. “Non-financial business group companies” (as defined below), however, may not acquire the beneficial ownership of shares of a bank holding company controlling nationwide banks in excess of 4% of that bank holding company’s outstanding voting shares unless they obtain the approval of the Financial Supervisory Commission and agree not to exercise voting rights in respect of shares in excess of the 4% limit, in which case they may acquire beneficial ownership of up to 10%. Any other person (whether a Korean national or a foreign investor) may acquire no more than 10% of total voting shares issued and outstanding of a bank holding company controlling nationwide banks unless they obtain approval from the Financial Supervisory Commission in each instance where the total holding will exceed 10% (or 15% in the case of a bank holding company controlling only regional banks), 25% or 33% of the total voting shares issued and outstanding of that bank holding company controlling nationwide banks.

“Non-financial business group companies” as defined under the Financial Holding Company Act include:

(1) any same shareholder group where the aggregate net assets of all non-financial business companies belonging to that group equals or exceeds 25% of the aggregate net assets of all members of that group;

(2) any same shareholder group where the aggregate assets of all non-financial business companies belonging to that group equals or exceeds ₩2 trillion; or

(3) any mutual fund where a same shareholder group identified in (1) or (2) above owns more than 4% of the total issued and outstanding shares of that mutual fund.
Sharing of Customer Information among Financial Holding Company and its Subsidiaries

Under the Act on Use and Protection of Credit Information, any individual customer’s credit information must be disclosed or otherwise used by financial institutions only to determine, establish or maintain existing commercial transactions with them and only after obtaining written consent to use that information. Under the Financial Holding Company Act, a financial holding company and its direct and indirect subsidiaries, however, may share certain credit information of individual customers among themselves for business purposes without the customers’ written consent. In addition, a subsidiary securities company of a financial holding company may provide that financial holding company and its other direct and indirect subsidiaries information relating to the aggregate of cash or securities that a customer of the securities company has deposited for business purposes at the written request of that customer.

Principal Regulations Applicable to Banks

Capital Adequacy and Allowances

The Bank Act requires nationwide banks, such as Woori Bank, to maintain a minimum paid-in capital of W100 billion and regional banks, such as Kyongnam Bank and Kwangju Bank, to maintain a minimum paid-in capital of W25 billion. All banks, including foreign bank branches in Korea, are also required to maintain a prescribed solvency position. A bank must also set aside in its legal reserve an amount equal to at least 10% of the net income after tax each time it pays dividends on net profits earned until its legal reserve reaches at least the aggregate amount of its paid-in capital.

Under the Bank Act, the capital of a bank is divided into two categories, Tier I and Tier II capital. Tier I capital (core capital) consists of stockholders’ equity, capital surplus, retained earnings, unissued stock dividends and hybrid Tier I capital instrument. Tier II capital (supplementary capital) consists of revaluation reserves, gain on valuation of investment in equity securities, allowance for loan losses set aside for loans classified as “normal” or “precautionary,” perpetual subordinated debt, cumulative preferred shares and certain other subordinated debt.

All banks must meet minimum ratios of Tier I and Tier II capital (less any capital deductions) to risk-weighted assets, determined in accordance with Financial Supervisory Commission requirements that have been formulated based on Bank of International Settlements, or BIS, standards. These standards were adopted and became effective in 1996. All domestic banks and foreign bank branches must meet a minimum ratio of Tier I and Tier II capital (less any capital deductions) to risk-weighted assets of 8%.

In November 2002, the Financial Supervisory Service amended the Enforcement Detailed Rules on the Supervision of the Banking Business to include a more conservative risk-weighting system for certain newly extended home mortgage loans. As a result, for certain home mortgage loans extended after November 13, 2002, Korean banks must apply a risk-weight ratio of 60% if either of the following two conditions are satisfied, and a risk-weight ratio of 70% if both conditions are satisfied:
(1) if the home mortgage loans are overdue for at least 30 consecutive days as of the date of calculating the bank’s BIS capital adequacy ratio, or there were at least 30 overdue days during the one year period preceding the date on which the bank’s BIS capital adequacy ratio is calculated; and

(2) the borrower’s debt ratio (which is the ratio of the borrowers’ total outstanding borrowings, including borrowings from other financial institutions, to the borrower’s annual income) exceeds 250%.

For all other home mortgages, the bank must apply a 50% risk-weight ratio.

Under the Regulation on the Supervision of the Banking Business, banks must generally maintain allowances for credit losses in respect of their outstanding loans and other credits (including confirmed guarantees and acceptances and trust account loans) in an aggregate amount covering not less than:

- 0.5% of normal credits, excluding confirmed guarantees and acceptances (or 0.75% in the case of normal credits comprising loans to individuals and households, and 1% in the case of normal credits comprising outstanding credit card receivables and card loans);
- 2% of precautionary credits, excluding confirmed guarantees and acceptances (or 8% in the case of precautionary credits comprising loans to individuals and households, and 12% in the case of precautionary credits comprising outstanding credit card receivables and card loans);
- 20% of substandard credits;
- 50% of doubtful credits (or 55% in the case of doubtful credits comprising loans to individuals and households, and 60% in the case of doubtful credits comprising outstanding credit card receivables and card loans); and
- 100% of estimated loss credits.

See “—Recent Regulations Relating to Retail Household Loans” and “—Principal Regulations Applicable to Credit Card Companies—Credit Card Business.”

**Liquidity**

All banks are required to ensure adequate liquidity by matching the maturities of their assets and liabilities in accordance with the Bank Act. Banks may not invest an amount exceeding 60% of their Tier I and Tier II capital (less any capital deductions) in stocks and other securities with a maturity of over three years. This stipulation does not apply to Korean government bonds or to Monetary Stabilization Bonds issued by the Bank of Korea. The Financial Supervisory Commission also requires each Korean bank to:

- maintain a Won liquidity ratio (defined as Won assets due within three months, including marketable securities, divided by Won liabilities due within three months) of not less than 100% and to make quarterly reports to the Financial Supervisory Service;
- maintain a foreign currency liquidity ratio (defined as foreign currency liquid assets due within three months divided by foreign-currency liabilities due within three months) of not less than 80%.
• maintain a ratio of foreign currency liquid assets due within seven days less foreign currency liabilities due within seven days, divided by total foreign-currency assets, of not less than 0%;
• maintain a ratio of foreign currency liquid assets due within a month less foreign currency liabilities due within a month, divided by total foreign-currency assets, of not less than negative 10%; and
• submit monthly reports with respect to the maintenance of these ratios.

The Monetary Policy Committee of the Bank of Korea is empowered to fix and alter minimum reserve requirements that banks must maintain against their deposit liabilities. The current minimum reserve ratio is:

• 5% of average balances for Won currency demand deposits outstanding;
• 1% of average balances for Won currency employee asset establishment savings deposits, employee long-term savings deposits, employee house purchase savings deposits, long-term house purchase savings deposits, household long-term savings deposits and employee preferential savings deposits outstanding; and
• 2% of average balances for Won currency time and savings deposits, mutual installments, housing installments and certificates of deposit outstanding.

For foreign currency deposit liabilities, a 2% minimum reserve ratio is applied to savings deposits outstanding and a 5% minimum reserve ratio is applied to demand deposits. A 1% minimum reserve ratio applies to offshore accounts, immigrant accounts and resident accounts opened by foreign exchange banks.

Financial Exposure to Any Individual Customer and Major Shareholder

Under the Bank Act, the sum of large exposures by a bank—in other words, the total sum of its credits to single individuals, juridical persons or business groups that exceed 10% of the sum of Tier I and Tier II capital (less any capital deductions)—generally must not exceed five times the sum of Tier I and Tier II capital (less any capital deductions). In addition, banks generally may not extend credit (including loans, guarantees, purchases of securities (only in the nature of a credit) and any other transactions that directly or indirectly create credit risk) in excess of 20% of the sum of Tier I and Tier II capital (less any capital deductions) to a single individual or juridical person, or grant credit in excess of 25% of the sum of Tier I and Tier II capital (less any capital deductions) to a single group of companies as defined in the Monopoly Regulations and Fair Trade Act.

Recent amendments to the Bank Act, which became effective on July 28, 2002, strengthened restrictions on extending credits to a major shareholder. A “major shareholder” is defined as:

• a shareholder holding (together with persons who have a special relationship with that shareholder) in excess of 10% (or 15% in the case of regional banks) in the aggregate of the bank’s total issued voting shares; or
• a shareholder holding (together with persons who have a special relationship with that shareholder) in excess of 4% in the aggregate of the bank’s (excluding regional banks) total
issued voting shares (excluding shares subject to the shareholding restrictions on non-financial group companies as described above), where the shareholder is the largest shareholder or has actual control over the major business affairs of the bank through, for example, appointment and dismissal of the officers pursuant to the Enforcement Decree of the Bank Act.

Under these amendments, banks may not extend credits to a major shareholder (together with persons who have a special relationship with that shareholder) in an amount greater than the lesser of (x) 25% of the sum of the bank’s Tier I and Tier II capital (less any capital deductions) and (y) the relevant major shareholder’s shareholding ratio multiplied by the sum of the bank’s Tier I and Tier II capital (less any capital deductions). In addition, the total sum of credits granted to all major shareholders must not exceed 25% of the bank’s Tier I and Tier II capital (less any capital deductions).

Interest Rates

Korean banks generally depend on deposits as their primary funding source. There are no legal controls on interest rates on loans in Korea. Historically, interest rates on deposits and lending rates were regulated by the Monetary Policy Committee of the Bank of Korea. Controls on deposit interest rates in Korea have been gradually reduced and, in July 1997, the Korean government removed restrictions on all interest rates, except those on demand deposits. This deregulation process has increased competition for deposits based on interest rates offered and, therefore, may increase a bank’s interest expense. Most recently, in January 2003, the Bank of Korea announced that, as one of its proposed monetary policy objectives for 2003, it is contemplating completing the final phase of interest rate deregulation measures. This would include, for example, lifting the 1% per annum deposit interest rate ceiling applicable to passbook account deposits offered by commercial banks, which had been imposed to protect banks from excessive competition. The Bank of Korea has not, however, indicated when the proposed deregulation will be implemented.

Lending to Small- and Medium-Sized Enterprises

In order to obtain funding from the Bank of Korea at concessionary rates for their small- and medium-sized enterprise loans, banks are required to allocate a certain minimum percentage of any monthly increase in their Won currency lending to small- and medium-sized enterprises. Currently, this minimum percentage is 45% in the case of nationwide banks and 60% in the case of regional banks. If a bank does not comply with this requirement, the Bank of Korea may:

- require the bank to prepay all or a portion of funds provided to that bank in support of loans to small- and medium-sized enterprises; or
- lower the bank’s credit limit.

Disclosure of Management Performance

In order to assist the general public, especially depositors and shareholders, in monitoring bank management performance, the Financial Supervisory Commission requires commercial banks to make mandatory public disclosures of the following:
(1) loans bearing no profit made to a single business group in an amount exceeding 10% of the sum of the bank’s Tier I and Tier II capital (less any capital deductions) as of the end of the previous month (where the loan exposure to that borrower is calculated as the sum of substandard credits, doubtful credits and estimated loss credits), unless the loan exposure to that group is not more than \( W4 \) billion;

(2) the occurrence of any financial incident involving embezzlement, malfeasance or misappropriation of funds in an amount exceeding 1% of the sum of the bank’s Tier I and Tier II capital (less any capital deductions), unless the bank has lost or expects to lose not more than \( W1 \) billion as a result of that financial incident, or the governor of the Financial Supervisory Service has made a public announcement regarding the incident; and

(3) any loss due to court judgments or similar decisions in civil proceedings in an amount exceeding 1% of the sum of the bank’s Tier I and Tier II capital (less any capital deductions) as of the end of the previous month, unless the loss is not more than \( W1 \) billion.

Restrictions on Lending

Pursuant to the Bank Act, commercial banks may not provide:

- loans for the purpose of speculation in commodities or securities;
- loans directly or indirectly secured by a pledge of a bank’s own shares, or secured by a pledge of shares in excess of 20% of the issued and outstanding shares of any other corporation (subject to certain exceptions with respect to financing for infrastructure projects);
- loans directly or indirectly to enable a natural or juridical person to buy the bank’s own shares;
- loans directly or indirectly to finance political campaigns or related activities;
- loans to any of the bank’s officers or employees, other than petty loans of up to \( W20 \) million in the case of a general loan, \( W50 \) million in the case of a general loan plus a housing loan or \( W60 \) million in the aggregate for general loans, housing loans and loans to pay damages arising from wrongful acts of employees in financial transactions;
- credit (including loans) secured by a pledge of shares of a subsidiary corporation of the bank or to enable a natural or juridical person to buy shares of a subsidiary corporation of the bank; or
- loans to any officers or employees of a subsidiary corporation of the bank, other than general loans of up to \( W20 \) million or general and housing loans of up to \( W50 \) million in the aggregate.

Recent Regulations Relating to Retail Household Loans

The Financial Supervisory Commission recently implemented a number of changes to the mechanisms by which a bank evaluates and report its retail household loan balances and has proposed implementing further changes. As a result of the rapid increase in retail household loans and related credit risks, the Financial Supervisory Commission and the Financial
Supervisory Service increased the minimum provisioning requirements for retail household loans. These requirements, set forth in the following table, became effective in the second quarter of 2002.

<table>
<thead>
<tr>
<th>Asset Quality Classification</th>
<th>Provisioning Ratio on Retail Household Loans</th>
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<tbody>
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<td>Before</td>
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<tr>
<td>Normal</td>
<td>0.5% or above</td>
</tr>
<tr>
<td>Precautionary</td>
<td>2.0% or above</td>
</tr>
<tr>
<td>Substandard</td>
<td>20.0% or above</td>
</tr>
<tr>
<td>Doubtful</td>
<td>50.0% or above</td>
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<tr>
<td>Estimated loss</td>
<td>100.0%</td>
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<tr>
<td></td>
<td>Current</td>
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<td></td>
<td>0.75% or above</td>
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<td>5.0% or above</td>
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<td></td>
<td>20.0% or above</td>
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<td>55.0% or above</td>
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<td>100.0%</td>
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In addition, due to a rapid increase in loans secured by homes and other forms of housing, the Financial Supervisory Commission and the Financial Supervisory Service implemented regulations designed to reduce the rate of increase in these loans. Effective from the third quarter of 2002, the Financial Supervisory Commission and the Financial Supervisory Service raised minimum provisioning requirements for new loans secured by housing located in the areas of wide-spread real property speculation, with respect to the portion of the new loan that exceeds the loan-to-value ratio of 60%, to 1.0% from 0.75% for normal loans and to 10.0% from 5.0% for precautionary loans. They also raised the minimum provisioning requirements for household loans classified as precautionary from 5.0% to 8.0% with effect from the fourth quarter of 2002. In a further effort to curtail extension of new or refinanced loans secured by housing, the Financial Supervisory Commission and the Financial Supervisory Service subsequently:

- reduced the average loan-to-value ratio (the aggregate principal amount of credit over the approval value of collateral) that Korean commercial banks must maintain for new loans secured by housing located nationwide to below 60%; and
- increased risk-weights for loans secured by housing meeting certain criteria in connection with the capital adequacy calculation for commercial banks.

More recently, on November 8, 2002, the Financial Supervisory Commission and the Financial Supervisory Service issued guidelines that:

- require Korean commercial banks to implement stronger internal control systems and stricter credit review and approval policies with respect to loans secured by housing;
- introduce sharing of information on multiple housing loans to a single borrower within the financial industry;
- require Korean commercial banks to appoint two to three qualified market value appraisal institutions and to use the lowest of the appraisal valuations; and
- discourage the use of incentive-based compensation systems by Korean commercial banks.

Furthermore, on October 29, 2003, the Financial Supervisory Commission announced more stringent guidelines that require Korean commercial banks to maintain loan-to-value ratios equal to or less than 40% for new loans secured by real estate located in the areas of wide-spread real property speculation.
See “Risk Factors—Risks relating to our consumer credit portfolio—Government regulation of consumer lending, particularly mortgage and home equity lending, has become more stringent, which may hurt our consumer banking operations.”

Restrictions on Investments in Property

A bank may possess real estate property only to the extent necessary for the conduct of its business, unless the aggregate value of that property does not exceed 60% of the sum of the bank’s Tier I and Tier II capital (less any capital deductions). Any property that a bank acquires by exercising its rights as a secured party, or which a bank is prohibited from acquiring under the Bank Act, must be disposed of within one year.

Restrictions on Shareholdings in Other Companies

Under the Bank Act, a bank may not own more than 15% of shares outstanding with voting rights of another corporation, except where, among other reasons:

- that corporation engages in a category of financial businesses set forth by the Financial Supervisory Commission;
- the acquisition is necessary for the corporate restructuring of the corporation and is approved by the Financial Supervisory Commission;
- the total investment in corporations in which the bank owns more than 15% of the outstanding shares with voting rights does not exceed 15% of the sum of Tier I and Tier II capital (less any capital deductions); or
- the acquisition satisfies the requirements determined by the Financial Supervisory Commission.

The Bank Act provides that a bank using its bank accounts and its trust accounts may not acquire the shares of another corporation that is a major shareholder of the bank in excess of an amount equal to 1% of the sum of Tier I and Tier II capital (less any capital deductions).

Restrictions on Bank Ownership

Under the Bank Act, a single shareholder and persons who have a special relationship with that shareholder generally may acquire beneficial ownership of no more than 10% of a nationwide bank’s total issued and outstanding shares with voting rights and no more than 15% of a regional bank’s total issued and outstanding shares with voting rights. The Korean government, the KDIC and bank holding companies qualifying under the Financial Holding Company Act are not subject to this limit. However, non-financial group companies may not acquire beneficial ownership of shares of a nationwide bank in excess of 4% of that bank’s outstanding voting shares, unless they obtain the approval of the Financial Supervisory Commission and agree not to exercise voting rights in respect of shares in excess of the 4% limit, in which case they may acquire beneficial ownership of up to 10% of a nationwide bank’s outstanding voting shares. In addition, if a foreign investor, as defined in the Foreign Investment Promotion Act, owns in excess of 4% of a nationwide bank’s outstanding voting shares, non-financial group companies may acquire beneficial ownership of up to 10% of that bank’s outstanding voting shares, and in excess of 10%, 25% or 33% of that bank’s outstanding voting
shares with the approval of the Financial Supervisory Commission in each instance, up to the number of shares owned by the foreign investor. Any other person (whether a Korean national or a foreign investor) may acquire no more than 10% of a nationwide bank’s total voting shares issued and outstanding, unless they obtain approval from the Financial Supervisory Commission in each instance where the total holding will exceed 10% (or 15% in the case of regional banks), 25% or 33% of the bank’s total voting shares issued and outstanding provided that, in addition to the foregoing threshold shareholding ratios, the Financial Supervisory Commission may, at its discretion, designate a separate and additional threshold shareholding ratio.

Deposit Insurance System

The Depositor Protection Act provides insurance for certain deposits of banks in Korea through a deposit insurance system. Under the Depositor Protection Act, all banks governed by the Bank Act are required to pay an insurance premium to the KDIC on a quarterly basis. The rate is determined under the Enforcement Decree to the Depositor Protection Act, and may not exceed 0.5% of the bank’s insurable deposits in any given year. The current insurance premium is 0.025% of insurable deposits for each quarter. If the KDIC makes a payment on an insured amount, it will acquire the depositors’ claims with respect to that payment amount. The KDIC insures a maximum of Ⴊ50 million for deposits and interest, regardless of when the deposits were made and the size of the deposits. This limit does not apply to interest-free settlement accounts (for example, a checking account) during the period from January 1, 2001 to December 31, 2003 and therefore the whole amount deposited in such accounts is protected.

Restrictions on Foreign Exchange Position

Under the Korean Foreign Exchange Transaction Law, a bank’s net overpurchased and oversold positions may not exceed 20% of its shareholders’ equity as of the end of the prior month.

Laws and Regulations Governing Other Business Activities

A bank must register with the Ministry of Finance and Economy to enter the foreign exchange business, which is governed by the Foreign Exchange Transaction Law. A bank must obtain the permission of the Financial Supervisory Commission to enter the securities business, which is governed by regulations under the Korean Securities and Exchange Act. Under these laws, a bank may engage in the foreign exchange business, securities repurchase business, governmental/public bond underwriting business and governmental bond dealing business.

Trust Business

A bank must obtain approval from the Financial Supervisory Commission to engage in trust businesses. The Trust Act and the Trust Business Act govern the trust activities of banks, and they are subject to various legal and accounting procedures and requirements, including the following:

- under the Bank Act, assets accepted in trust by a bank in Korea must be segregated from other assets in the accounts of that bank, which requires that banks engaged in both banking
and trust businesses must maintain two separate accounts and two separate sets of records; and

- depositors and other general creditors cannot obtain the assets comprising the trust accounts if the bank is liquidated or wound-up.

The bank must make a special reserve of 25% or more of fees and commissions from each unspecified money trust account for which a bank guarantees the principal amount and a minimum yield until the total reserve for that account equals 5% of the trust amount. Since January 1999, the Korean government has prohibited Korean banks from offering new guaranteed fixed rate trust account products whose principal and interest are guaranteed. In addition, a trustee bank must deposit with a court an amount equal to 0.05% of its paid-in capital each year until the aggregate amount of those deposits equals 10% or more of its paid-in capital. If that bank breaches its duty of care as a trustee and causes losses to its customers, the court deposits are available as compensation.

On October 4, 2003, the National Assembly promulgated the Indirect Investment Asset Management Business Act, which will apply to trust account products under the Trust Business Act, securities investment trusts under the Securities Investment Trust Business Act, securities investment companies under the Securities Investment Company Act and variable insurance products under the Insurance Business Act, effective from January 2004. Under the Indirect Investment Asset Management Business Act, a bank will not be permitted to offer current trust account products (other than specified money trust products) after July 2004 and will be required to qualify as an asset management company by such date in order to be able to provide any investment trust products. Investment trust products will need to be established pursuant to a trust deed entered into between an asset management company and a trustee and will have to be sold through a distributor.

Principal Regulations Applicable to Credit Card Companies

General

The Specialized Credit Financial Business Act, enacted on August 28, 1997 and last amended on August 26, 2002, establishes guidelines on capital adequacy and provides for other regulations relating to the supervision of credit card companies. The Specialized Credit Financial Business Act delegates regulatory authority over credit card companies to the Financial Supervisory Commission and the Financial Supervisory Service. Any person engaging in the credit card business must obtain a license from the Financial Supervisory Commission.

Restrictions on Scope of Business

A credit card company may conduct only the following types of business:

- operating its credit card business, as licensed pursuant to the Specialized Credit Financial Business Act;
- operating any businesses ancillary to its credit card business, such as providing funds to existing credit card members, issuing and settling of debit cards and issuing, selling and settling of pre-paid cards;
• providing unsecured or secured loans;
• discounting notes;
• purchasing, managing and collecting accounts receivable originated by companies providing goods and services;
• providing payment guarantees;
• managing assets pursuant to the Asset Backed Securitization Act;
• investigating credit; and
• operating other incidental businesses related to the foregoing.

Capital Adequacy and Allowances

The Specialized Credit Financial Business Act provides that a credit card company must have a minimum paid-in capital amount of:

- ₩20 billion in the case of a specialized credit financial business company that engages in one or two core business lines (such as credit card, installment finance, leasing and new technology business); or
- ₩40 billion in the case of a specialized credit financial business company that engages in three or more core business lines.

Under the Specialized Credit Financial Business Act and related regulations, a credit card company must maintain an aggregate Tier I and Tier II capital adequacy ratio of at least 8%.

Under the Specialized Credit Financial Business Act and related regulations, a credit card company must maintain a default ratio (defined as defaulted claims (including subrogated amounts of guaranteed payment) divided by total claims (including subrogated amounts of guaranteed payment and assets that have been already securitized pursuant to the Act on Asset Backed Securitization which are not written-off) of less than 10%.

Under the Specialized Credit Financial Business Act and related regulations, the minimum ratio of allowances by a credit card company for credit losses in respect of loans, leased assets (including related account receivables) and suspense payments of a loan nature as of the date of accounting settlement (including semi-annual preliminary accounts settlement) are:

- 0.5% of normal assets;
- 1% of precautionary assets;
- 20% of substandard assets;
- 75% of doubtful assets; and
- 100% of estimated loss assets.

The minimum ratio of allowances for credit losses in respect of credit card receivables, card loans and cash advances are:

- 1% of normal assets;
- 0.5% of the amount calculated by deducting the sum of cash advances that were actually drawn by card members from the maximum limit of the sum of cash advances times 0.75
(excluding the maximum limit of sum of cash advances for card members who have not drawn cash advances for the latest 6 months);

- 12% of precautionary assets;
- 20% of substandard assets;
- 60% of doubtful assets; and
- 100% of estimated loss assets.

**Liquidity**

Under the Specialized Credit Financial Business Act and related regulations, a credit card company must maintain a Won liquidity ratio (defined as its Won-denominated current assets due within three months divided by its Won-denominated current liabilities due within three months) of 100% or more. In addition, once that company registers as a foreign exchange business institution with the Ministry of Finance and Economy, it is required to:

- maintain a foreign-currency liquidity ratio (defined as foreign currency liquid assets due within three months divided by foreign-currency liabilities due within three months) of not less than 80%;
- maintain a ratio of foreign currency liquid assets due within seven days less foreign currency liabilities due within seven days, divided by total foreign-currency assets, of not less than 0%;
- maintain a ratio of foreign currency liquid assets due within a month less foreign currency liabilities due within a month, divided by total foreign-currency assets, of not less than negative 10%; and
- make quarterly reports regarding maintenance of these ratios.

**Restrictions on Funding**

Under the Specialized Credit Financial Business Act, a credit card company may raise funds using only the following methods:

- borrowing from financial institutions;
- issuing corporate debentures or notes;
- selling securities it holds;
- transferring loans it holds;
- transferring claims it holds in connection with its businesses; or
- issuing securities backed by the claims it holds relating to its businesses.

A credit card company may also borrow funds offshore or issue foreign currency-denominated securities after it registers as a foreign exchange business institution with the Ministry of Finance and Economy.

A credit card company may issue debentures up to an amount equal to ten times its total Tier I capital. A credit card company may issue, on a temporary basis, debentures exceeding that limit in order to redeem outstanding debentures, but must repay those outstanding debentures within one month after the date of issuance of new debentures.
Restrictions on Loans to Affiliate Companies

Pursuant to the Specialized Credit Financial Business Act and related regulations, a credit card company may not provide loans exceeding 100% of its equity capital, in the aggregate, to all persons that have a special relationship with that company including, but not limited to, its affiliates.

Restrictions on Assistance to Other Companies

Pursuant to the Specialized Credit Financial Business Act, a credit card company may not engage in any of the following in conjunction with other financial institutions:

- holding voting shares under mutual cross-holding arrangements or providing credit to avoid applicable restrictions on loans to affiliates;
- acquiring shares of each other to avoid the limit on acquiring its treasury shares under the Korean Commercial Code or the Korean Securities and Exchange Act; or
- other acts which are likely to greatly harm the interests of transaction parties as stipulated by the Enforcement Decree to the Specialized Credit Financial Business Act, but which have not yet been identified.

A credit card company may not grant credit to any third party to enable such third party to purchase the credit card company’s shares. In addition, a credit card company may not extend credit through intermediaries to avoid applicable restrictions on loans to affiliate companies.

Restrictions on Investment in Property

Under the Specialized Credit Financial Business Act and related regulations, the Financial Supervisory Commission may limit the maximum amount a credit card company may invest in real estate investments for business purposes to a percentage equal to or in excess of 100% of its equity capital. The Financial Supervisory Commission has not yet set a limit with respect to this restriction.

Restrictions on Shareholding in Other Companies

Under the Law on Improvement of Structure of Financial Industry, a credit card company and financial institutions belonging to the same business group to which the credit card company belongs (which we refer to as “affiliated financial institutions”) must obtain prior approval of the Financial Supervisory Commission if the credit card company and the affiliated financial institutions:

1. own 20% or more of shares outstanding with voting rights of another company; or

2. own 5% or more of the total shares outstanding with voting rights of another company, and any affiliated financial institution or business group to which the affiliated financial institutions belong is deemed as controlling that company and (x) where that holding represents the largest holding of those shares or (y) as a result of the share dispersion level, the exercise of shareholder’s rights with respect to those shares can establish a controlling relationship.
Disclosure and Reports

Pursuant to the Specialized Credit Financial Business Act, a credit card company must publicly disclose any material matters relating to management of the company within four months, or within two months for disclosures relating to the first half of the fiscal year, from the date of the closing of books for each fiscal year period. A credit card company must also publicly disclose certain material matters when they occur, such as the occurrence of non-performing loans, a financial accident or the occurrence of losses exceeding certain amounts.

A credit card company must submit its business reports and reports on results of operations to the Financial Supervisory Commission through the Korea Non-Bank Financing Association within one month from the end of each quarter.

Risk of Loss Due to Lost, Stolen, Forged or Altered Credit Cards

Under the Specialized Credit Financial Business Act, a credit card company is liable for any loss arising from the unauthorized use of credit cards or debit cards after it has received notice from the holder of the loss or theft of the card. A credit card company is also responsible for any losses resulting from the use of forged or altered credit cards, debit cards and pre-paid cards. A credit card company may, however, transfer all or part of this latter risk of loss to holders of those cards in the event of willful misconduct or gross negligence by holders of those cards if the terms and conditions of the agreement entered between the credit card company and members of such cards specifically provide for that transfer.

For these purposes, disclosure of a customer’s password that is made intentionally or through gross negligence, or the transfer of or giving as collateral of the credit card or debit card, is considered willful misconduct or gross negligence.

Each credit card company must institute appropriate measures to fulfill these obligations, such as establishing provisions, purchasing insurance or joining a cooperative association.

In April 2003, the Korean government announced a plan to amend the Specialized Credit Financial Business Act to make a card holder liable for any losses arising from the unauthorized use of his or her credit card or debit card, up to a maximum of ₩100,000, so long as those losses do not arise from that holder’s willful misconduct or gross negligence. This limitation on liability would apply whether the losses arose before or after notice from the holder of the loss or theft of his or her credit or debit card. However, the government has not yet reflected this amendment in the Specialized Credit Financial Business Act.

Recently, a bill for the amendment to the Specialized Credit Financial Business Act was submitted to the National Assembly. Among other things, the proposed amendment provides that a credit card company will be liable for any losses arising from loss or theft of a credit card (which was not from the holder’s willful misconduct or negligence) during the period starting 60 days before the notice by the holder to the credit card company. Furthermore, according to the proposed amendment, a disclosure of a cardholder’s password that is made under force or threat of other people will not be deemed as willful misconduct or negligence of the cardholder.
Pursuant to the Specialized Credit Financial Business Act, the Financial Supervisory Commission may either restrict the limit or take other necessary measures against the credit card company with respect to the following:

- maximum limits for cash advances on credit cards;
- use restrictions on debit cards with respect to per day or per transaction usage; or
- aggregate issuance limits and maximum limits on the amount per card on pre-paid cards.

**Lending Ratio in Ancillary Business**

Pursuant to the Enforcement Decree to the Specialized Credit Financial Business Act issued in June 2002, a credit card company must maintain an aggregate quarterly average outstanding lending balance to credit card holders (including cash advances and credit card loans) no greater than its aggregate quarterly average outstanding credit card balance arising from the purchase of goods and services. This decree will be effective from December 31, 2003. Until December 31, 2004, credit card receivables that have been already disposed of or sold by a credit card company will not be considered for purposes of calculating the outstanding credit card balance of credit card members. In September 2003, the Korean government announced its plan to postpone the effective dates of these requirements by three years.

The Korean government has also announced its plan to amend the Specialized Credit Financial Business Act to impose lending restrictions similar to those imposed on credit card companies in the manner described in the above paragraph on all specialized credit financial business companies during 2003. This amendment will require each specialized credit financial business company to ensure that transactions entered into as part of its licensed or registered business and that provide credit in connection with goods purchases (including among other things, factoring and purchase of promissory notes) do not exceed the volume of its lending transactions. The proposed amendment would also require credit card agents to register with the Korea Non-Bank Financing Association.

**Issuance of New Cards and Solicitation of New Card Holders**

The Enforcement Decree to the Specialized Credit Financial Business Act establishes the conditions under which a credit card company may issue new cards and solicit new members. New credit cards may be issued only to the following persons:

- persons who are at least 18 years old when they apply for a credit card;
- persons whose capability to pay bills as they come due has been verified using standards established by the credit card company; and
- in the case of minors who are at least 18 years and younger than 20 years, persons who submit a guardian’s consent along with documents evidencing income, such as an employment certificate or a tax certificate.

In addition, a credit card company may not solicit credit card members by:
• providing economic benefits or promising to provide economic benefits in excess of 10% of the annual credit card fee (in the case of no-annual fee credit cards, the average annual fees will be deemed to be ₩10,000) in connection with issuing a credit card;
• soliciting applicants members on roads, public places or along corridors used by the general public; and
• soliciting applicants through visits, except those visits made upon prior consent and visits to a business area.

Compliance Rules on Collection of Receivable Claims

Pursuant to Supervisory Regulation of the Specialized Credit Financial Business, a credit card company may not:

• exert violence or threaten violence;
• demand payment from or pressure a related party (a guarantor of the debtor, blood relative or fiancée of the debtor, a person living in the same household as the debtor or a person working in the same workplace as the debtor) without just cause with respect to payment for the debtor’s obligations;
• provide false information relating to the debtor’s obligation to the debtor or his or her related parties;
• provide false information or overstate the negative consequences of being registered as a person of poor credit;
• threaten to sue or sue the debtor for fraud despite lack of affirmative evidence to establish that the debtor has submitted forged or false documentation with respect to his/her capacity to make payment;
• visit or telephone the debtor during late evening hours (between the hours of 9:00 p.m. and 8:00 a.m.); or
• utilize other uncustomary methods to collect the receivables that interfere with the privacy or the peace in the workplace of the debtor or his or her related parties.

Regulations Applicable to Securities Companies

General

The Korean Securities and Exchange Act regulates and governs the securities business. The entities that regulate and supervise securities companies are the Financial Supervisory Commission, the Financial Supervisory Service and the Securities and Futures Commission.

Under the Korean Securities and Exchange Act, a company must obtain permission from the Financial Supervisory Commission to commence a primary business such as a brokerage business, a dealing business or an underwriting business. A securities company may also engage in certain businesses ancillary to that business without obtaining any separate license and certain other businesses if it obtains separate licenses from the Financial Supervisory Commission. A securities company must also obtain permission from the Financial Supervisory Commission to merge with any other entity or transfer all or a part of its business.
If the Financial Supervisory Commission deems a securities company’s financial condition to be unsound or if a securities company fails to meet the applicable “net operating equity ratio” (as defined below), the Financial Supervisory Commission may order the securities company to:

- increase or reduce its capital;
- cancel or consolidate its stock;
- transfer all or part of its business;
- close branch offices;
- merge with another financial institution;
- suspend a part or all of its business operations; or
- assign contractual rights and obligations relating to its financial transactions.

**Regulations on Financial Soundness**

The Financial Supervisory Commission regulations require that the financial soundness of a securities company be assessed in accordance with its net operating equity ratio, which is calculated as follows and expressed as a percentage:

$$\text{Net operating equity ratio} = \left( \frac{\text{net operating equity}}{\text{total risk}} \right) \times 100$$

The terms “net operating equity” and “total risk” for the purpose of the above formula are defined in the Financial Supervisory Commission’s regulations. Generally, the net operating equity and the total risk are calculated according to the following formulas:

Net operating equity = net assets (total assets – total liabilities) – total deductible items + total creditable items

Total risk = market risk + counterparty risk + basic risk + credit concentration risk – risk offsetting factor

The regulations require that securities companies maintain their net operating equity ratio at a level equal to or higher than 150% at the end of each half of their fiscal year.

**Other Provisions on Financial Soundness**

The Korean Securities and Exchange Act, the Enforcement Decree of the Korean Securities and Exchange Act and Financial Supervisory Commission regulations also include provisions designed to regulate certain types of activities relating to the management of the assets of a securities company. These provisions include:

- restrictions on the holdings by a securities company of securities issued by another company which is the largest shareholder or the major shareholder (each as defined under the Korean Securities and Exchange Act) of that securities company;
- restrictions on providing money or credit to the largest shareholder, major shareholder, officers and related persons of the securities company; and
- special provisions concerning payment guarantees by a securities company. For instance, a securities company may not provide payment guarantees for third parties other than its
overseas subsidiaries or provide new guarantees for corporate bonds, other than, subject to certain restrictions, roll-over guarantees in connection with the repayment of bonds previously guaranteed by it.

A securities company may invest in shares, bonds (whether listed or unlisted) and stock price index futures and options. However, a securities company may not enter into cross-border financial futures, swaps, options and other derivative transactions without obtaining prior approval from the Bank of Korea.

**Business Conduct Rules**

Effective from August 2001, the Financial Supervisory Commission adopted “business conduct rules” applicable to securities companies. These rules impose greater responsibilities on securities companies, strictly banning certain unfair practices and ensuring that the potential investors solicited by securities companies are suitable.

**Disclosure and Reports**

Pursuant to the Korean Securities and Exchange Act, a securities company is required to disclose certain material matters, including:

- its financial condition, including profit and loss;
- any sanctions levied on it under the Korean Securities and Exchange Act or any corrective measures or sanctions under the Law on Improvement of Structure of Financial Industry; and
- the occurrence of any matters which may have a material adverse effect on its operation or management.

A securities company must submit a report on its financial results to the Financial Supervisory Commission within 45 days from the end of each quarter.