Foreign Agricultural Service
GAIN Report
Global Agriculture Information Network

Voluntary Report - public distribution

Date: 6/14/2000

GAIN Report #KS0072

Korea, Republic of

Agricultural Situation

Korea Tightens Regulations on Short-term Trade Financing - Nominal Impact on GSM-102 and SCGP 2000

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Report Highlights:

On June 10, the Financial Supervisory Service announced measures introducing tighter oversight on short-term offshore borrowing by financial institutions. Measures setting tighter reporting and higher capital reserve requirements and broader application of risk assessment criterion are intended to constrain the rapid growth in short-term offshore borrowing witnessed in recent months. The effect on CCC credit programs should be nominal given Korean banks must already adhere to higher U.S. program standards.

Includes PSD changes: No
Includes Trade Matrix: No
Unscheduled Report
Seoul [KS1], KS

On June 10, 2000, the Financial Supervisory Service (FSS) announced that it would strengthen oversight on financial institutions' short-term offshore borrowing.

The basis for this action was the rise in share of short-term foreign loans relative to total external borrowing. At the end of April, short-term foreign loans accounted for 32.9 percent of all external borrowing, up from the December 1999 share figure of 27.9 percent.

The Ministry of Finance & Economy (MOFE) reports that in April total foreign loans declined $2.8 billion for a total of $140.4 billion outstanding. However, short-term foreign loans during the same period increased $2.8 billion, for a total of $46.2 billion, or 32.9 percent of the total external borrowing. MOFE reports in April short term loans increased $1.6 billion in private sector trade financing and $0.9 billion in offshore borrowing by branch offices of foreign banks.

To discourage financial institutions' short-term external borrowing, the Korean government will implement the following measures:

1. Financial institutions are required to reflect in their liquidity ratio 20 percent of all payment guarantees related to trade credit. Prior to now, payment guarantees were considered contingent liabilities and thus were not included in the ratio calculation.

New Bank for International Settlements guidelines obliging financial institutions to give foreign currency-denominated payment guarantees a 20 percent risk weight when calculating capital adequacy ratios sparked this reporting change. Prior to this measure, commercial banks did not count trade financing provided under such programs as the GSM-102 and Supplier Credit Guarantee Programs (SCGP) when calculating the liquidity ratio.

2. Domestic financial institutions are required to maintain a minimum liquidity ratio of 80 percent, up from the previous 70 percent. The ratio refers to liquid foreign assets with maturities of less than three months divided by liquid foreign liabilities. The higher the ratio, the lower the risk a financial institution faces for a shortfall upon maturity of such loans. The Korean government reports most banks have a minimum liquidity ratio of over 100 percent, so this requirement should not have a major impact on loan operations.

3. FSS will expand application of the forward-looking loan classification criteria to merchant banks by July 2000. Presently only Commercial banks are subject to this loan analysis requirement. Under this requirement a firms creditworthiness is analysed based on its future capacity to pay, not its historical payment record.

Traders assert FSS measures will make it more difficult to obtain trade credits from financial institutions because of the higher capital reserve requirement. From a U.S. perspective, the effect on future GSM-102 and SCGP use should be nominal as Korean banks currently must meet strict CCC standards to participate in either program.