

April 2016

Insights

South Korea

PRECISE. PROVEN. PERFORMANCE.

South Korean Credit Unions and Restructuring

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Introduction

When making international comparisons to Ireland, South Korea does not immediately spring to mind. It is 10,000 kilometres away on the Eastern edge of Asia, with a highly urbanised population of 52 million, and with little economic, social or cultural ties to Ireland. Both countries, however, do have some historical, political and economic similarities; both had relatively recent civil wars, both were partitioned and both experienced major economic revivals in the late 20th century to become “Tiger Economies”; South Korea the Asian Tiger, and, Ireland the Celtic Tiger. It is in the world of credit unions though that the narratives become much more intertwined and compelling. Today, South Korea is one of the leading credit union global economies. It has total assets of \$56bn, roughly 3 times the asset size of the Irish credit unions. In the 2012 Commission Report, it was noted that there were only four mature credit union economies in the world; USA, Canada, Australia and South Korea. Those active in the credit union movement in Ireland are likely to be aware that there are thriving credit union movements in the United States, Canada and Australia. But less are likely to know much about South Korea. Therefore, at Moore Stephens, we decided to research the South Korean movement, and seek to identify any similarities. And there are many striking similarities.

Growth of Credit Union Movement

Following the destruction caused by the Korean War (1950-1953), South Korea emerged as one of poorest countries in the world, with a GDP aligned to the poorest of Sub-Saharan countries. In this environment of extreme poverty, an American Catholic Nun based in Korea, Sister Mary Gabriella, created the first Korean credit union in Busan in 1960 called the Holy Family Credit Union. From these origins, and driven by the Catholic Church, the credit union model flourished all over South Korea. The typical borrower was a peasant farmer who needed a loan



to fund his/her crops until cultivation. The evolution of the movement continued with the establishment of the Korean League of Credit Unions in 1965 and the passing of enabling legislation in 1972. For geopolitical reasons, the South Korean economy had a number of economic supports from the United States and American credit union advisors assisted with the development of the movement throughout this period. By 1985, there were over 1,200 credit unions operating in South Korea. During this time, the South Korean economy witnessed rapid growth and expansion to become a leading global economy and one of the world's highest income economies. Mindful of South Korea's low level of natural resources, this growth was characterised by high levels of industrialisation, and, export orientation. South Korean credit unions rose on this tide of economic revival. By 1997, there were over 1,600 credit unions operating in South Korea with assets of \$11bn.

The 1997 Economic Collapse

In 1997 much of East Asia suffered a deep and chronic financial crisis. South Korea was especially vulnerable, and suffered a severe liquidity crisis. By December 1997, the IMF had agreed a bailout programme of almost \$60bn for South Korea. During 1998, the South Korean economy contracted at a rate of 7% per quarter. South Korean credit unions were part of this narrative. In 1997 there were approximately 1,600 South Korean credit unions. By December of that year, roughly 240 “troublesome” credit unions whose non-performing loans were more than 50% of their assets, were subject to intervention. The Korean League operated a private stabilisation fund, called the “Savings Fund System”, but this was overwhelmed and the State had to intervene by stabilising stressed credit unions and establishing a deposit guarantee scheme to inject stability to the wider movement. As the South Korean government poured money into the credit union movement, this was coupled with a restructuring programme. From 1998 onwards, the number of Korean credit unions fell due to insolvencies and mergers as part of this process. In an article written by Professor In-Soo- Han of the University of Korea on Korean credit unions during the financial crisis, it was noted that the regulatory authority “sued 4,146 directors and employees of 325 credit unions for various violations” as part of this process. We assume (hope) that the article of Professor In-Soo-Han was poorly translated, and, that the regulatory authority took enforcement action, rather than suing credit union officers.

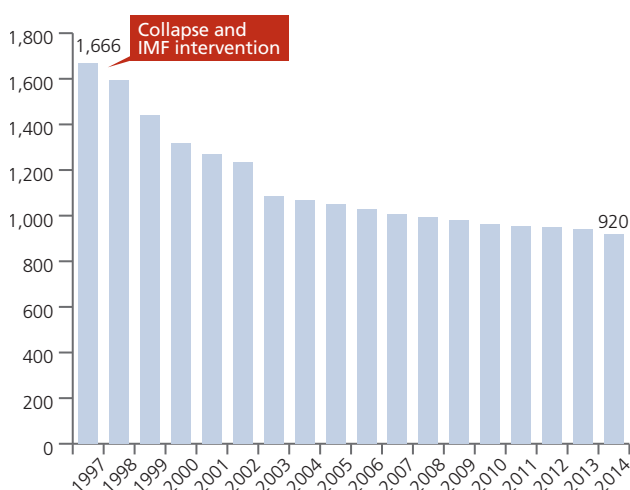
Relevance for Irish credit unions

The above South Korean narrative will immediately chime with the recent Irish credit union narrative; both economies were globally sensitive, both economies suffered immense disturbance and dislocation, both economies required IMF intervention, both credit union movements become embroiled in this economic disturbance, and both countries implemented national policies to resolve and consolidate their respective credit union movements. The obvious difference is that the South Korean narrative occurred 10 years before the Irish narrative. And that of course bestows us with one significant advantage from an Irish perspective; hindsight. We now have 17 years of South Korean macro-economic data to study (adding the 10 year Korean head-start to the 7 elapsed years since the Irish collapse). While it may appear intellectually lazy to assume that the South Korean trends will simply re-occur in Ireland, it would be intellectually remiss not to at least explore this eventuality. The economist Thomas Picketty recently commented that economic analyses often sway between the display of “overly developed tastes for apocalyptic predictions” to “excessive fondness for fairytales”. In completing a comparative analysis with South Korea, we did our best to avoid both.

Rate and Scale of Consolidation

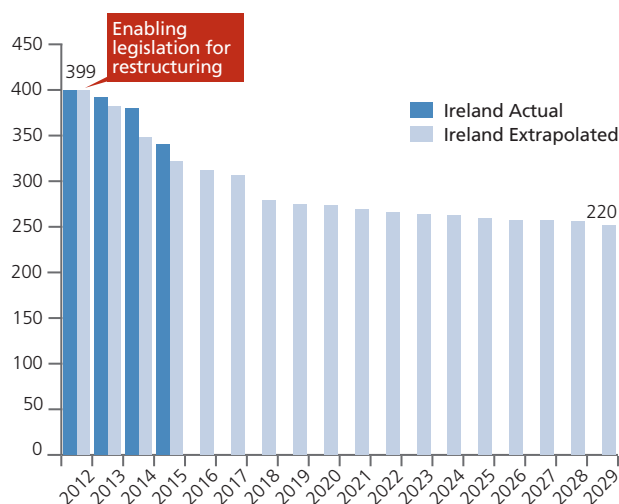
What is interesting is the rate of contraction of South Korean credit unions in the aftermath of the financial collapse and the IMF intervention. This is illustrated below :

**Korean Credit Union Numbers
1997-2014**



What is striking is the gradual yet consistent nature of the contraction. The South Korean credit union movement has contracted in each of the previous 17 years without fail. While the rate was more severe in the earlier years, each year has witnessed a fall nonetheless. If the South Korean experience was replayed in an Irish context from 2012, the contraction would play out as follows:

**Ireland – Played out on Korean Terms
2012-2029**



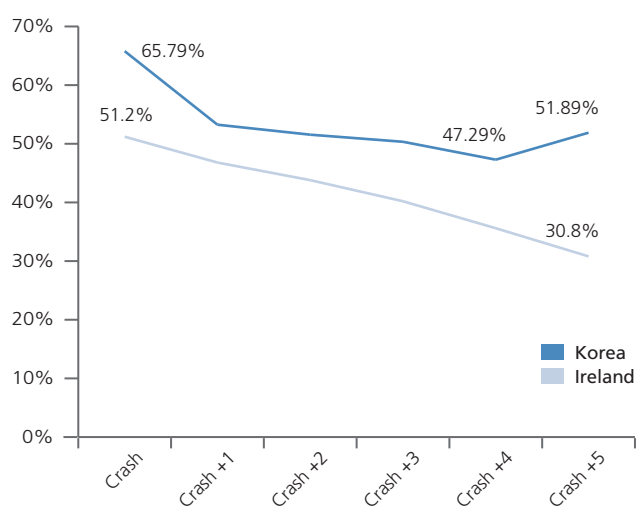
In this scenario, the number of credit unions in Ireland would fall gradually and consistently from a total of 399 in 2012 to 220 by the year 2029. It is worthwhile reflecting on this. In March 2016, the statutory body responsible for facilitating and overseeing the restructuring of credit unions, "ReBo" ceased. If the Irish consolidation experience is to follow similar behavioural patterns to the Korean experience, then the bulk of the restructuring has yet to occur. In this regard, it is likely that the key legacy of ReBo will be the creation of an infrastructure to enable restructuring and this will endure far beyond the life-time of ReBo itself. It would appear from the Korean information, that consolidation is a slow but relentless process. And while it is likely that the driving force behind restructuring will shift over a medium term time horizon (be it economic, technological, regulatory, or governance stimulated), the process itself appears inexorable.

Loan To Asset Ratios Post Crash

The low loan to asset level is a key (the key) strategic challenge facing Irish credit unions. Loan to asset ratios have fallen consistently in Ireland over the past 7 years. Again, bestowed with hindsight, we attempted to complete a comparative analysis between Ireland and Korea to identify similarities. We compared the loan to asset ratios of both movements in the 5 year period after the financial collapse (1997 for South Korea and 2008 for Ireland) and traced the patterns after this date (Crash +1, Crash +2 and so forth). The results are set out below:

Loan to Asset Ratios

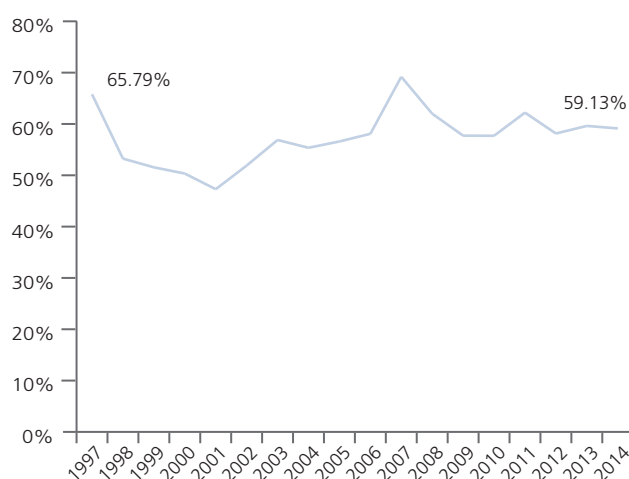
Ireland vs. Korea



As can be seen from the above, Ireland entered the crash less lent than South Korea. In Ireland in 2008, the loan to asset ratio stood at 51.2%. In South Korea in 1997, the loan to asset ratio stood at 65.79%. However, within a 5 year post-crash period, both loan to asset ratios had fallen by a broadly similar absolute level. In South Korea in Year Crash +4, the loan to asset ratio had fallen by 18.5%. In Ireland in Year Crash +5, the loan to asset ratio had fallen by 20.4%. It is important to note the (multi-billion dollar) enormity of these shifts in fortune in such a short time horizon.

Korean Credit Unions

Loans to Asset Ratios



The core strategic challenge of growing loan books has dominated the strategic agenda of Irish credit unions over the past number of years and this debate has been exacerbated by the onset of a low interest rate environment. It therefore may come as some comfort to the Irish credit union movement that similar trends did occur in the early stages of the South Korean post-crash period. But it is important to emphasise that the driving force behind loan to asset ratios is hugely complex and cannot be attributable to any one particular factor. There are dangers in oversimplifying something which is far from simple. Economic factors are central to loan to asset ratios, but legal, regulatory, social, demographic, cultural and psychological factors also play roles in shaping the loan to asset ratio. It is also important to note that in South Korea, in Year Crash +5, a strong rise in the loan to asset ratio was noted (this has not yet happened in Ireland). In a broader time horizon, the loan to asset ratio in South Korea did recover and stabilise, but never to the level experienced post-crash (apart from one year in the data studied, which may be considered an atypical blip – either in the information or the behaviour that shapes that information).



Conclusion

Although the Irish credit union movement and the South Korean credit union movement are 10,000kms apart not only geographically, but also in social and cultural contexts, the historical evolution of both movements share many similarities.

The events surrounding the 1997 South Korean financial collapse and subsequent restructuring, and its parallels with the 2008 Irish financial collapse and subsequent restructuring enable some very interesting and compelling comparisons to be made. The two key normative lessons we learnt from the analysis were as follows:

1. Restructuring is likely to be a feature of the credit union landscape for many years to come, and while it may not be incentivised by ReBo, it is likely to be inspired by more visceral business oriented factors.
2. Ireland is not alone with a post-crash depressed loan to asset ratio; South Korea experienced similar misfortunes and did manage to correct the ratio in a reasonably short space of time.

It may therefore be appropriate to conclude with another quote from Thomas Picketty; "Optimism is not forbidden".

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