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THE WORLD BANK

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President Wolfensohn - Briefing Book for President's Meetings - Meeting Material
Mr Young-Hoi Lee - Executive Director - Korea - March 12, 1998

DECLASSIFIED
WBG Archives

Meeting: Mr. Young-Hoi Lee
Exec. Director, Korea

Thursday, March 12, 1998
6:30 - 6:50 p.m.
JDW Office

Archive Management for the President's Office

Document Log

Reference # : Archive-02076

VP

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A. CLASSIFICATION

☒ Meeting Material
☐ Trips
☐ Speeches

☐ Annual Meetings
☐ Corporate Management
☐ Communications with Staff

☐ Phone Logs
☐ Calendar
☐ Press Clippings/Photos

☐ JDW Transcripts
☐ Social Events
☐ Other

B. SUBJECT: MEETING: MR. YOUNG-HOI LEE, EXECUTIVE DIRECTOR, KOREA (B) <CONFIRMED> VENUE: MC 12-750 (OFFICE) TIME: 6:30 - 6:50 P.M. TOPIC: PRICING OF KOREA LOAN (PER ZHANG) CONTACT: ANNIE @ 81018
IN ATTENDANCE: JDW, LEE // NOTE: ALI SPOKE TO SEVERINO'S OFFICE AND REQUESTED ANY APPROPRIATE BRIEFING NOTE (B) PERLIN & SEVERINO // DUE: BY NOON ON MARCH 12 -- OR MARCH 11 IF POSSIBLE
EXC: JDW // ALI (3/11)
Brief includes:
---Proposed Pricing of Korea SAL

DATE: 03/12/98

C. VPU

Corporate

☐ CTR
☐ EXT
☐ LEG
☐ MPS
☐ OED
☐ SEC/Board
☐ TRE

Regional

☐ AFR
☐ EAP
☐ ECA
☐ LAC
☐ MNA
☐ SAS

Central

☐ CFS
☐ DEC
☐ ESD
☐ FPD
☐ FPR
☐ HRO

Affiliates

☐ GEF
☐ ICSID
☐ IFC
☐ Inspection Panel
☐ Kennedy Center
☐ MIGA

D. EXTERNAL PARTNER

☐ IMF
☐ UN
☐ MDB/Other IO
☐ NGO
☐ Private Sector

☐ Part I
☐ Part II
☐ Other

E. COMMENTS:

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: March 12, 1998

TO: Mr. James D. Wolfensohn

FROM: Jean-Michel Severino, EAPVP *JS*

EXTENSION: 3-8896

SUBJECT: Korea - SALYour Meeting with Mr. Lee, Thursday, March 12, 6:30 p.m.

1. I had indicated to you in my memo of February 26 that while SAL negotiations had been completed on all issues, the Koreans had again requested:

- an increase in the loan amount from \$2 billion to \$3 billion; and
- standard loan terms, saying that this was a regular SAL, different from the Economic Reconstruction Loan (ERL).

2. We then communicated to them the Management decision, arrived at a meeting chaired by you on February 27, that the amount could not be increased and that the loan would carry an interest rate of 100 bp over LIBOR and a service charge of 1.5%. The arguments used hinged on the impact of the large Korean disbursements on the Bank's balance sheet and risk-bearing capacity (*the proposed loan terms and the supporting rationale are detailed in the attachment prepared by the finance complex*).

3. The Korean officials replied that it was difficult for them to agree to the proposed terms. Their argument has essentially been twofold: they consider the application of non-standard terms to Korea in the absence of a general Bank policy on such pricing as arbitrary (and therefore difficult to defend in Korea); and they consider the proposed terms to be too high.

4. Since then the Korean Executive Director, Mr. Lee, seems to have mobilized the support of Part II Executive Directors in favor of standard terms for the SAL. This took the form of a memo sent by Mr. Del Bufalo to me on March 6, with copy to all EDs. Mr. Lee then followed this with another memo with his own explanations as to why the loan should carry standard terms, again copied to all EDs. Part I EDs who also met last week on the Korean loan pricing seem split, with the US, UK, and France supporting the Management proposal, the Germans leaning toward it, the Italians and Canadians appearing in favor of some terms between standard and those used for the ERL but without a definite position on the precise level, and the Japanese supporting the Korean position.

5. It seems clear that the Koreans will have great difficulty in accepting the terms exactly as currently proposed. But I also get signals that they will compromise if offered some flexibility, if only as a face saver. This could take the form of some reduction of the interest rate or the service charge, or allowing eligibility for waivers of interest charges (which is roughly equivalent to a reduction of 25 bp). You could also note that the Bank has already shown flexibility by lowering the service charge by 2 percentage points from the ERL level. The Koreans seem to have become fixated in particular on the interest rate, given its greater political visibility. That suggests that an offer of some reduction in the interest rate may be politically more acceptable to them than an equivalent reduction in loan charges through other means.

6. From the standpoint of country relations, it would be good to bring this matter to closure quickly. The Koreans have acted speedily in taking all the prior actions stipulated in the SAL, including those that you emphasized during your visit there (e.g., reform of bankruptcy laws, strengthening of accounting, auditing and reporting). There have also been expressions of concern in Government circles in Seoul about the delay in the approval of the SAL.

cc: Messrs./Mmes. S. Sandstrom, G. Perlin, B. Wilson, S. Aiyer, Z. Qureshi

Attachment

Proposed Pricing of Korea SAL

The terms currently proposed for the Korea \$2 billion SAL are as follows:

Maturity:	10-15 years, including 5 years' grace
Interest:	6-month USD LIBOR, reset semiannually, plus 1 %
Service charge:	1 ½ % of the principal amount of the loan, financed out of loan proceeds and amortized over the life of the loan
Commitment fee:	0.75 %, beginning 60 days after signing (assuming timely disbursement, no fee would be paid)
Loan charge waivers:	not eligible for current or future waivers of interest or commitment charges
Prepayment:	standard SCL provision (Bank's redeployment cost, not expected to be significant for floating rate SCLs)

These terms are the same as for the \$3 billion ERL approved in December, with the exception that the service charge would now be 1 ½ % rather than the 3 ½ % charge levied over three years in the ERL. This proposed reduction of about 50 % in fee value recognizes that project preparation has been somewhat more standard and that the unit cost of the Korea program is likely to decline in line with its growth.

The principal reason for "non-standard" pricing is the burden which the unprecedented Korea program places on the Bank's risk-bearing capacity. The Bank's commitment to lend the Republic of Korea up to USD 10 billion is equivalent to an increase of about 10 % in the IBRD's outstanding loan book. The concentration of lending in Asia and the size of the Korean program needs to be supported by capital reserves in order to maintain the Bank's financial strength and risk-bearing capacity. A reserve-to-loan ratio of 13-15 % requires the Bank to allocate an additional USD 130-150 million of its net income to reserves for every USD 1 billion of lending to Korea. Our provisioning policy requires that we also expense up to 3 % (USD 30 million) more.

While there is little science to the proposed pricing terms (which do not, of course, come close to covering the capital charges), they are based on previous Board discussions and a desire to achieve a reasonable balance of interests among Korea, other borrowers and the Bank. These terms reflect:

the pressure which the lending places on the Bank's balance sheet;
the potential for new pricing standards to be introduced over time (which apply gradually to the loan books of most borrowers, unlike the case of Korea which – as a former graduate – is in line to borrow up to \$10 billion in 18 months or less);
the nature of the Board discussions on the ERL (where some G7 countries requested much higher pricing); and
the fact that a lower spread on the SAL would encourage the Koreans to prepay the ERL (although this would help reduce pressure on the Bank's balance sheet, it makes little sense to provide differential terms for different elements of the same borrowing program).

We have shared these principles with the Koreans, who continue to feel that “standard products should carry standard prices.” Our position has been that, while SAL documentation and conditionalities may be more standard than for the ERL, the financial package comprised of existing and prospective loans (and their impact on the Bank) cannot be considered “standard.” We have also reminded the Koreans that the terms of the ERL were negotiated by Mr. Wolfensohn in response to their request for: loan volume; maintaining a spread of no more than 100 bps (compared to the much higher levels proposed by many G7 Executive Directors, then as now); and waiving any prepayment penalties. The proposed terms should provide Korea with attractive funding in conjunction with a supportive program of long-term adjustment.

G.L.Perlin/G.P.Wheeler
3/11/98

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