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Press Release

July 22, 2005

Deutsche Bank Seoul Branch and BNP Paribas Seoul Branch Issued Severe Disciplinary Warning for Improper Derivatives Transactions

The Financial Supervisory Commission announced on July 22 that the Seoul branch of Deutsche Bank and the Seoul branch of BNP Paribas would be issued a severe disciplinary warning for engaging in improper non-standardized OTC derivatives contracts with state-owned companies. The FSC also issued (1) suspension of duties for a period of one month for the head of the Seoul branch of Deutsche Bank, and (2) a censure for the head of the Seoul branch of BNP Paribas and recommended (3) dismissal for one employee and a reprimand for another of the Seoul branch of Deutsche Bank, (4) a three-month pay reduction for one employee of the Seoul branch of BNP Paribas, and (5) a three-month pay reduction for one employee and a reprimand for another of the Seoul branch of Barclays Bank for their involvement in the derivatives contracts. Each of the three banks cited by the FSC today will also be expected to submit a written agreement detailing specific steps to be taken to prevent improper derivatives business activities. In announcing the decision on foreign bank branches, the FSC noted that, because there was no precedent to the actions it took, regulators conducted extensive and thorough review of actions taken by foreign regulators in similar cases and the trading customs and practices in overseas derivatives markets as well as actions taken on domestic banks for poor internal controls and the customs and practices in the derivatives market at home.

The actions the FSC announced today are based on the findings of examinations the Financial Supervisory Service conducted on four foreign bank branches—including the two Seoul branches of Deutsche Bank and BNP Paribas—following the general examination of the National Agricultural Cooperative Federation the FSS conducted in July 2004. The July 2004 examination of the NACF uncovered, among others, a large illicit payment scheme involving employees of the NACF and the Seoul branch of Deutsche Bank and intermediaries who helped to arrange and close derivatives contracts with a state-owned company. In August of the same year, seven individuals involved in the case—one at the Seoul branch of Deutsche Bank, one at the NACF, four intermediaries, and one at the state-owned company—were charged with criminal wrongdoing and were given prison sentences ranging from one year and six months to six years (January 2005, pending appeal). A severe disciplinary warning against the NACF and sanctions including dismissal against six of its officers and employees involved in the illicit payment scheme were also issued.

In September 2004, during a regularly scheduled general examination of the Seoul branch of Deutsche Bank, FSS examiners uncovered improprieties involving derivatives contracts with state-owned companies in addition to the involvement of one of the branch employees in the NACF payment scheme.

After confirming questionable derivatives contracts at other banks and conducting additional examinations of four foreign bank branches—including the Seoul branch of Deutsche Bank—in March this year, the FSS determined that supervisory actions were needed in order to protect the safety and the soundness of the derivatives market and ensure compliance with the expected business conduct and practices.

Foreign bank branches' engagement in non-standardized derivatives contracts

The FSS determined that reducing interest expenses was the primary objective for the state-owned companies that were involved in the OTC derivatives contracts with the foreign bank branches. When state-owned companies borrow from overseas lenders, they can hedge their currency risk at a minimum cost with no unusual additional risk by entering into typical "plain vanilla" currency swap agreements. However, some state-owned companies entered into customized OTC derivatives contracts with foreign bank branches with the goal of reducing interest expenses on their foreign-currency-denominated borrowings despite the sizable transaction costs and risks involved. The state-owned companies' desire for lower interest payments on their foreign-currency-denominated borrowings through non-standardized OTC derivatives contracts appeared to have coincided with the foreign bank branches' growing focus on such instruments as they are less susceptible to market pricing and thus typically generate more revenues than the standard derivatives contracts.

Findings of FSS examination

The foreign bank branches the FSC cited failed to adequately disclose material information on the potentially substantial financial losses and other downside risks of the derivatives contracts they offered to the state-owned companies despite the complex nature of the transactions involved. As a result, the state-owned companies, whose level of financial expertise is not on par with that of the more sophisticated financial institutions, came to understand the transactions as a way to effectively reduce borrowing expenses without taking on any additional material risk.

The FSS also determined that the foreign bank branches neglected to provide their counterparties with the necessary information on pricing of the derivatives despite the difficulties of the counterparties to do so, leaving their counterparties with substantial valuation losses on the day of the transaction.

In addition, the Seoul branch of Deutsche Bank was found to have failed to inform its counterparties of early termination reserves included in the price of the derivatives which are to be returned to the counterparties in the event of early contract termination. The failure took place even though information on early termination reserve is crucial in deciding whether the derivatives contract is to be terminated and in choosing the timing of such decision in order to avoid potentially large losses. Separately, one of the branch employees was found to have collected illicit payments and offered bribery to an employee of the counterparty company, thus gravely undermining the integrity of the branch's banking operation. But the branch management failed to take appropriate steps even after suspicions rose internally about the employee's questionable activities.

The Seoul branch of BNP Paribas received a disciplinary warning in June, 2002, for improperly assigning one of its core branch activities (trading of won-denominated bonds) to an employee of the Hong Kong branch and as a follow-up remedial measure submitted a letter pledging its future legal and regulatory compliance to the FSS. But despite the assurance to the regulators, the Seoul branch of BNP Paribas was once again found to have improperly engaged the Hong Kong branch for its core activities related to pricing and closing of derivatives contracts.

Follow-up supervisory actions

The FSC/FSS plans to extensively and closely examine regulatory and supervisory issues that have been raised about the derivative market and take steps where needed to provide clear rules and regulations for the derivatives market so as to promote sound market growth in Korea. The oversight of derivatives activities of financial services companies has been continually strengthened through such measures as the adoption of relationship manager system and upgrading of the supervisory information management system. As before, the FSC/FSS will also continue to take steps to ensure orderly, safe and sound conduct by all participants in the derivatives market.

Attached: Profile of Deutsche Bank and BNP Paribas

Profile of Deutsche Bank and BNP Paribas

Deutsche Bank, Germany (As of December, 2004)

- Assets: US$1,162.1 billion
- Capital: US$29.6 billion
- Net Income: US$1.2 billion
- BIS Capital Adequacy Ratio: 10.00%
- Credit Rating: Aa3 (Moody's)

Deutsche Bank, Seoul Branch

- Branch head: Kim Jin-Il (No. of Employees: 136, as of May 2005)

(In billions of won, percent)

	2002	2003	2004	March 2005
Assets	3,634.1	8,067.6	8,263.8	7,820.2
Capital	103.4	178.0	255.7	253.9
Net income	47.8	74.6	30.4	-1.9
New BIS ratio (market-risk-weighted)	14.11	11.33	12.08	9.90
Loss-risk-weighted loan ratio	0.04	-	-	-
ROA	1.27	1.47	0.37	0.20
Liquidity ratio (won)	196.99	124.06	136.17	125.50

BNP Paribas, France (As of December, 2004)

- Assets: €905.9 billion
- Capital: €30.2 billion
- Net Income: €4.7 billion
- BIS Capital Adequacy Ratio: 10.3%
- Credit Rating: AA (S&P)

BNP Paribas, Seoul Branch

- Branch head: Philippe Reynieix (No. of Employees: 89, as of May 2005)

(In billions of won, percent)

	2002	2003	2004	March 2005
Assets	2,471.5	3,378.7	5,554.5	5,383.9
Capital	98.6	119.1	113.5	112.6
Net income	21.7	21.4	6.7	7.4
New BIS ratio (market-risk-weighted)	11.80	9.19	9.25	13.42
Loss-risk-weighted loan ratio	0.16	0.15	0.09	0.08
ROA	0.94	0.72	0.16	0.35
Liquidity ratio (won)	131.72	130.71	104.73	114.98

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