

International
Presale Report

Korea Asset Funding 2000-1 Limited

Expected Rating*

US\$367,000,000 Secured
Floating-Rate Notes due 2009.....BBB+

*Ratings are contingent on receipt of final documents conforming to information already received and finalisation of all terms and conditions.

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Rating Rationale

Upon satisfactory receipt of final legal documentation, Fitch expects to assign a foreign currency (FC) rating of 'BBB+' to \$367 million secured floating-rate notes due 2009 (issuer notes) to be issued by Korea Asset Funding 2000-1 Limited (issuer), a Cayman Islands incorporated special purpose entity.

The proceeds of the issuer notes will be used to purchase the equivalent US\$367 million of senior floating-rate notes due 2009 (purchaser senior notes) to be issued by KOREA 1st International ABS Specialty Co., Ltd. (purchaser), a bankruptcy-remote, special purpose entity incorporated in South Korea. The purchaser, using the proceeds from the issue of purchaser senior notes and an additional \$52.96 million in subordinated notes, will purchase a portfolio of restructured nonperforming loans (loan portfolio) from the Korea Asset Management Corp. (KAMCO). The loan portfolio is expected to be valued at \$419.96 million based on a report to be filed with the Korean regulatory authority, Financial Supervisory Commission (FSC).

All the underlying loans incorporate recourse provisions to each originating South Korean bank (put option banks). Under the recourse, a put option can be exercised in case borrowers fail to follow the restructured payment schedule or in certain other conditions.

The 'BBB+' rating assigned to the issuer notes is based primarily on the following:

- The close linkage of the transaction rating to Korea Development Bank's (KDB) credit risk ('BBB+'), as KDB accounts for the bulk of the put options (nearly 60%) and also provides a credit facility, initially equal to 30% of the issuer notes (credit facility).
- The reliance on the put option banks as the main source of payments, as Fitch has only given marginal benefit for obligor payments under the loan portfolio.
- The overall credit quality of all the put option banks and their importance in the South Korean economy.
- The aggregate transaction-level credit enhancement (in addition to the loan portfolio put option support) in the form of subordination and the KDB credit facility.
- The fast pay amortisation structure, coupled with the credit facility amortisation schedule, ensures that the transaction credit enhancement (as a percentage of outstanding issuer notes) increases as the issuer notes principal is repaid.
- The integrity of issuer notes repayment under various stressed cash flow scenarios (combinations of loan obligor as well as put option bank[s] defaults) commensurate to the transaction rating.

- The support of currency and interest rate swaps provided by Deutsche Bank AG and UBS AG to mitigate certain currency and basis risks in the transaction.
- The strong overall legal and payment structure of the transaction, supported by the requisite legal and tax opinions.
- The servicing support provided by KAMCO considered as adequate based on Fitch's on-site due diligence. Fitch views KAMCO's experience in domestic securitisations as an added advantage.

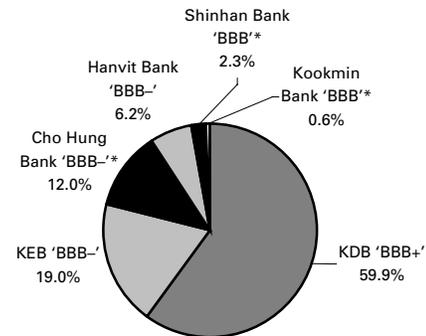
The rating addresses timely payment of interest and ultimate payment of principal by the final legal maturity date. Fitch's current long-term FC sovereign rating of 'BBB+' for South Korea caps the issuer notes ratings of 'BBB+'. Because of the transaction's strong credit reliance on the put option banks, especially KDB (through the put back option and credit facility), Fitch expects that the transaction rating will closely mirror South Korea's sovereign FC rating. Negative and/or positive developments directly affecting South Korean sovereign risk will have a material impact on the rating of the issuer notes.

■ Transaction Summary

The principal asset of the issuer will be the purchaser's senior notes and will have the benefit of a pledge on the underlying loan portfolio assets, including related loan agreements, put option rights, and certain other transaction documents. The main source of repayments of the issuer notes will be payment of purchaser senior notes yield and principal, which, in turn, depends on interest and principal collections from the loan portfolio and/or put option payments from the put option banks in case of default under the loan portfolio.

The repayment on the issuer notes will follow full sequential fast pay amortisation. No repayments will be made on the purchaser's subordinated notes until the purchaser's and issuer's senior notes have been fully repaid. An expected repayment schedule for the issuer notes has been defined. Any shortfall (principal, interest, hedging, and certain other transaction costs) from the expected schedule will be met with draws under the credit facility. Any collections exceeding the amount required as per the expected schedule will be used to pay down the issuer notes.

Put Option Bank Concentration/Ratings



*Shadow ratings.

KEB – Korean Exchange Bank. KDB – Korea Development Bank.

KAMCO, established in 1962, is currently the principal governmental agency responsible for acquiring, managing, and disposing of nonperforming loans and the distressed assets of Korean financial institutions, a role mandated in 1997. Under the structure, KAMCO will securitise a portfolio of bank recourse nonperforming loans that have been restructured under corporate reorganisations, composition acts, or commercial agreement pursuant to South Korean law. Nearly 91% of the loan portfolio is US dollar-denominated (the balance is yen-denominated).

Of the put backs, 59.9% relate to KDB (rated 'BBB+' by Fitch). KDB and the other main put bank concentrations and their ratings are detailed in the chart above.

Fitch premised the various cash flow stress scenarios on the fact that the underlying loans have all been restructured due to the financially distressed nature of the borrowers. Therefore, the payments under these loans have been drastically reduced (Fitch assumed that nearly 75% of obligors would default, with no recoveries). The put option banks' ability to make payments is, therefore, critical in the transaction analysis. Fitch analysed the transaction based primarily on the put option bank's credit strength. The transaction cash flows withstood stress cases that incorporated a default of weakest put option bank(s) (in this case, the 'BBB-' rated bank[s]) with the largest exposure in the loan portfolio, including a hypothetical merged entity composed of three banks. Fitch considers the subordination level incorporated

and credit facility provided by KDB are sufficient to pay the issuer notes by their final legal maturity date.

As nearly 9% of the underlying loans are yen denominated and the underlying loans are either fixed rate or are floating rate based on different Korean banks' interest indices, the transaction carries currency and basis risks. Certain currency and interest rate hedging mechanisms are incorporated to mitigate yen/US dollar risks and the fixed/floating-rate risks. The Korean banks' prime/US dollar LIBOR risk is not hedged given their historical linkage. Fitch is comfortable with the transaction hedging mechanism incorporated. However, in the stress scenarios, US dollar-denominated LIBOR has been conservatively stressed, as also Korean bank prime rates, to further mitigate the interest rate risks.

All the obligors and put option banks will be issued a notice of assignment for the sale and pledge, and will be required to make payments directly into the purchaser collection account. This mitigates any commingling risk of the transaction. KAMCO, as master servicer, will provide services of collection and management in relation to the loan portfolio. Fitch considers KAMCO's experience as the primary servicer in similar domestic securitisation transactions and nonperforming loans' auctions as positive for the transaction.

The transaction will occur under the provisions of the Korean Securitization Law and will be registered with the FSC. Fitch will rely on the local legal opinions to: confirm that the loan portfolio sale would be considered a true sale pursuant to the Asset-Backed Securities (ABS) Act of Korea; and certain other taxation and other issues.

■ Sovereign Considerations

Currently, Fitch has a 'BBB+' FC rating and an 'A' local currency rating on the Republic of South Korea.

The ratings were upgraded in March 2000 on the grounds of rapidly strengthening external liquidity, progress with banking reforms, and positive developments in corporate restructuring. Three upgrades in the past two years have restored Korea's sovereign credit rating to a level compatible with both its full recovery from the external liquidity crisis of 1997 and Korea's credit strengths relative to other Asian sovereigns. The credit outlook from here will depend on longer term structural improvements in the domestic economy.

The rapidly improving health of the economy was witnessed in last year's spectacular growth rate of nearly 11%, one of the most impressive postcrisis recoveries seen in recent times. Growth has been accompanied by a sharp rebound in external liquidity, with foreign exchange reserves approaching US\$87 billion and set to rise further. The ratio of liquid external assets to liquid external liabilities is expected to rise to more than 200% this year. Despite an expected narrowing in the current account surplus, Korea is expected to become a net external creditor this year.

Extensive reforms over the past two years have resulted in the significant improvement of the health of the banking sector, although these have involved a substantial increase in public ownership of and involvement in the financial system. Progress was also made last year in reducing debt-to-equity ratios in the corporate sector, while the government's decision not to bail out Daewoo Motor America, Inc. sent an important message about market discipline. Government debt has increased sharply in recent years, following expansionary fiscal policy and support for the financial system; however, at about 35% of gross domestic product, it remains relatively low. The recent opening of dialogue with North Korea also bodes well for the sovereign rating in the longer term.

While Korea's credit fundamentals have improved, some concerns remain. It is now becoming clear that the costs to the public sector of resolving problems in the banking sector will be higher than previously thought, with a strong likelihood of further government-guaranteed debt issuance by the financial restructuring agencies. In addition, progress in reforming the nonbank financial sector, including the systemically important investment trust companies, has been slower than with the banks. Recent concerns about liquidity in this sector have led to special measures to stabilise the corporate bond market. This all comes against the backdrop of the crisis' legacy of heavy corporate debt, which leaves the corporate sector vulnerable to macroeconomic shocks.

■ KAMCO

KAMCO was founded in 1962 to deal with the nonperforming loans of the state-owned KDB. In 1966, its role was expanded to include loans of other financial institutions. In November 1997, KAMCO was again reorganised under "the efficient management of nonperforming assets of financial

institutions and establishment of Korea Asset Management Corp.” KAMCO is currently 38% owned by the government, 31% by KDB, and 31% by other Korean banks. The law also created the Nonperforming Assets Management Fund (the Fund). This is a separate legal entity from KAMCO, whose role is to manage the Fund; KAMCO does not contribute capital or provide finance to the Fund.

KAMCO’s own balance sheet is limited in size and arises from the “traditional” activities the company engaged in prior to 1997. These are principally managing and disposing of real estate on behalf of the Ministry of Finance and Economy and the National Tax Office. KAMCO is a nonprofit entity, but it is subject to Korea’s commercial laws concerning matters not specified in its own act. It is under the supervision of the FSC, as is the Fund.

KAMCO’s mission is to restore the liquidity and soundness of Korean banks by acquiring and disposing of their nonperforming loans. It does this through the Fund, which purchases nonperforming loans from Korean banks. The total balance sheet of the fund was Korean won (KRW)17.5 trillion at year-end 1999; that of KAMCO totalled KRW876 billion (US\$1=KRW1,120).

Key Financials of KAMCO and the Fund

The Fund does not have ordinary share capital but has “contributions” received from the banks that sold the loans in proportion to their sales. These contributions totalled KRW573 billion at year-end 1999. However, since the Fund had losses in 1998 and 1999, it had a net accumulated deficit of nearly KRW2 trillion. It has been successful in selling assets at a higher price than its acquisition cost, but these gains have been more than offset by interest costs and loan loss provisions. It is not clear who will be responsible for absorbing any losses remaining in the Fund after it has disposed of its assets, but it appears that there is an implicit understanding that the government will absorb the loss.

As of March 31, 2000, the Fund had resolved loans with a face value of KRW24.5 trillion. International bids accounted for KRW3.5 trillion; foreclosure auction, KRW2.6 trillion; domestic ABS, KRW2.4 trillion; and voluntary payment, KRW1.3 trillion, but the majority of collections arose from cancellations, voluntary buybacks, and the exercise of the put back options, totalling KRW13.3 trillion.

KAMCO’s Purchases

(KRW Tril., As of March 31, 2000)

	Face Value (A)	Purchase Price (B)	B/A (%)
Ordinary Loans (Secured)	10.5	6.50	61.9
Ordinary Loans (Unsecured)	11.88	1.50	12.6
Restructured Loans with Recourse	18.69	10.04	53.7
Restructured Loans without Recourse	7.43	1.61	21.7
Daewoo Bonds from ITCs	16.50	5.72	34.7
Guaranteed Loans	<u>1.60</u>	<u>0.69</u>	43.2
Total	66.60	26.06	

KRW – Korean won. ITCs – Investment trust companies.

Outlook

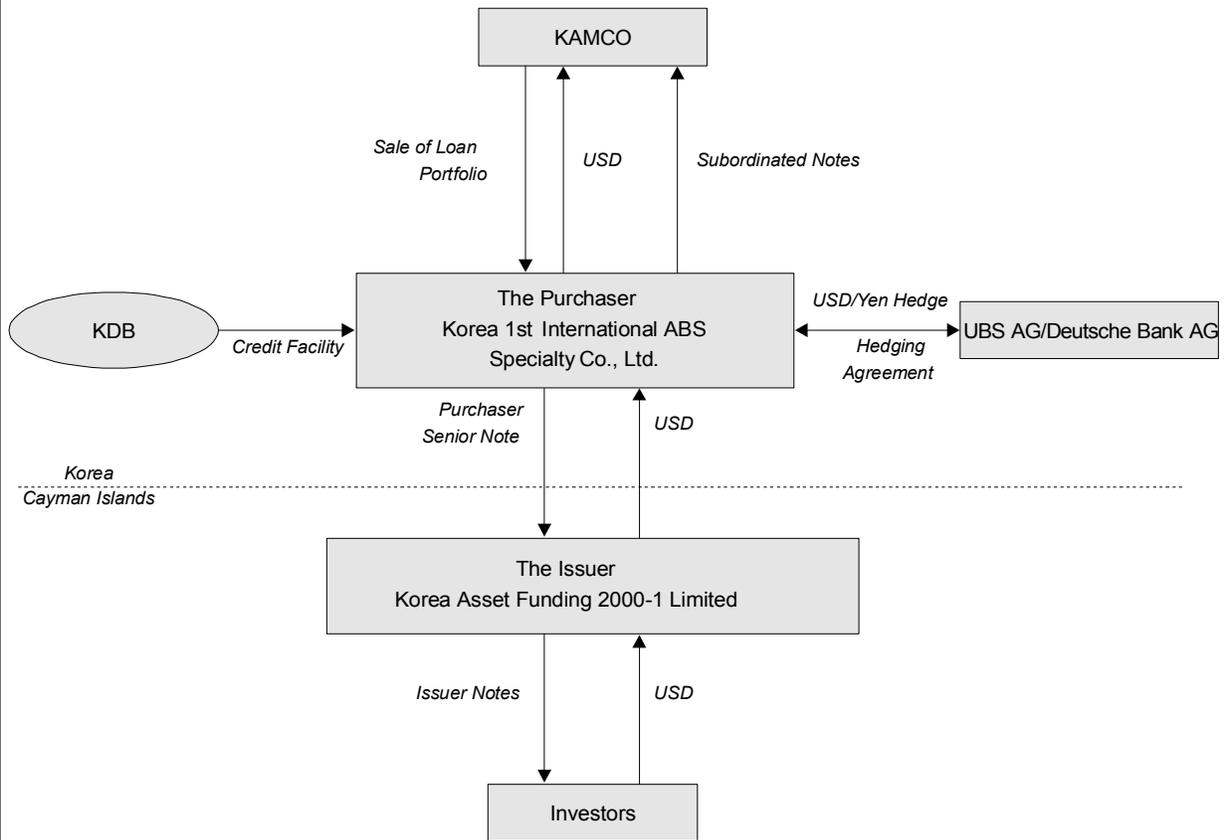
KAMCO plans to complete its tasking of dealing with the nonperforming loans by 2004, which suggests that, after this date, it will assume its former modest role and shrink dramatically in size. Management is keen to make use of the expertise it has accumulated in managing problem assets by applying it in commercial ventures overseas. In addition to providing consultancy services to asset management bodies in China and Southeast Asia, KAMCO also aims to advise investors in nonperforming assets (but not to invest its own funds). Its goal is to become a world class asset management company.

If KAMCO is to enter into profit-seeking ventures in competition with private companies, the question of its legal status and government backing will inevitably arise. It is not yet clear how this problem will be resolved. One possibility is that the new commercial ventures will be conducted through one or more separate companies, leaving the “old KAMCO” to continue existing operations.

■ Structure Overview

- KAMCO will sell a portfolio of restructured loans with put-back options from originating South Korean banks to the purchaser. KAMCO will assign all the underlying agreements under the loan, including the benefits under the put options, to the purchaser. The purchase price is expected to be valued at US\$419.96 million based on a report to be filed with FSC.
- The purchaser will issue purchaser senior notes of US\$367 million to the issuer and subordinated notes of US\$52.96 million to be held by KAMCO. The proceeds of the senior purchaser notes and subordinated notes will be used as the purchase consideration for the loan portfolio.

Transaction Structure — At Closing



KAMCO – Korea Asset Management Corp. KDB – Korea Development Bank. USD – US dollar.

- The issuer will fund the purchase of the senior purchaser notes by issuing issuer notes of US\$367 million to the investors. All the assets of the purchaser, (including the underlying loan portfolio, benefit under the put options and related documents) will be pledged to the issuer.
- The issuer notes will also be supported by a credit facility from KDB. The facility will initially be equal to US\$110 million (30% of the issuer notes).
- Rating sought is on these issuer notes; Fitch expects to assign a rating of ‘BBB+’ to these notes.

(For details on structure, refer to the transaction structure charts above and on page 6.)

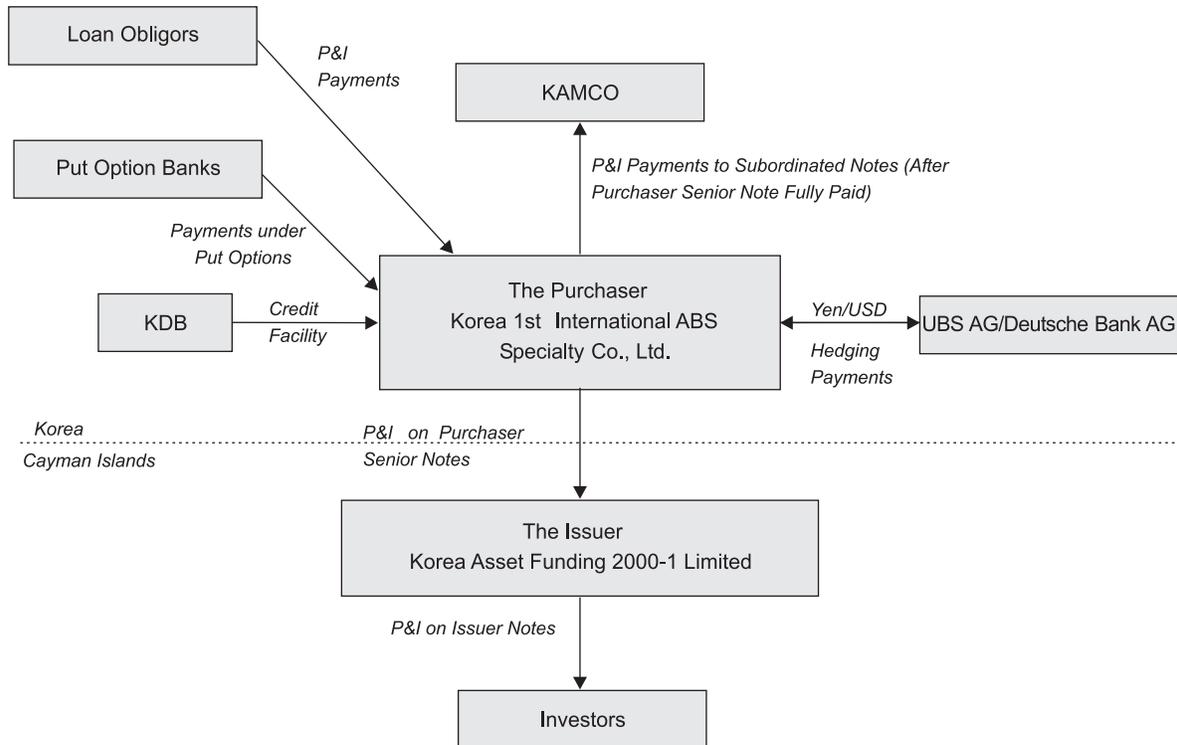
■ The Loan Portfolio

All the loans included in the transaction are restructured loans. The three basic insolvency laws in Korea are the Bankruptcy Act, the Corporate

Reorganization Act, and the Composition Act. For loans under bankruptcy procedure, a receiver is appointed to liquidate the debtor’s assets and distribute the proceeds to unsecured creditors (secured creditors exercise their interests separately). Corporate reorganisation and composition proceedings are used to rehabilitate the company under court-approval plans.

In case of composition proceeding, however, a secured creditor can separately enter into an agreement (right of separation [CRS] agreement) with the obligor. This CRS agreement governs the terms of restructuring and is not subject to the composition proceeding approved by the court. All the loans are approved under reorganisation or composition plans or are CRS claims, and none are under bankruptcy proceedings.

Transaction Structure — Post-Closing



KAMCO – Korea Asset Management Corp. KDB – Korea Development Bank. P&I – Principal and interest. USD – US dollar.

Once the court approves the reorganisation or composition plan or an agreement is reached between the creditor bank and loan obligor under the CRS claims, the loans follow a definite repayment schedule. The principal repayments under the schedule are not uniform, and deferment of interest is common. The restructuring commencement dates of these loans varied from as recently as 1999 to as far back as 1985 (nearly 73% of loans have commencement dates between 1997–1998).

KAMCO purchased the loans by entering into a “settlement agreement” with the respective loan originating banks. All the settlement agreements were executed on Dec. 27, 1999 or Dec. 28, 1999, with the basis date being Nov. 30, 1999. The settlement agreement detailed the terms of purchase of the loans, particularly the put-back options, the value of these put-back options, and conditions under which put-back options can be exercised. The put-back value for

each of these loans is set and based on the present value of future cash flows.

The rate used for discounting the future cash flows was based on following formula:

- Base rate (the then prevailing five-year interest rate of the National Housing Fund) plus the credit added rate (0.5% for KDB, 1.0% for Shinhan and Kookmin, 1.5% for KEB, Cho Hung, and Hanvit) plus the period added rate (0.5% > five years, 1.0% > 10 years, 1.5% > 15 years).

Based on the above calculated discount rate, future cash flow was discounted, and a put option price for each underlying loan was calculated on the settlement date.

- Each loan had a unique and set put option value clearly mentioned in the settlement agreement.
- The put option value could be higher or lower than the outstanding principal, for example:

- If discount rate > loan yield, the put option value < outstanding principal.
- If discount rate < loan yield, the put option value > outstanding principal.

■ Put Option Arrangement

The settlement agreement details the terms for the put options available to KAMCO as the initial purchaser of the loans. Along with the loans, the put option rights will also be assigned to the purchaser (which, in turn, will pledge it to the issuer) in the current transaction.

Under the put option arrangement, the loan can be put back to the relevant put option bank in the following scenarios:

- Default is made for a period of six months or more in the payment of any amount of interest or principal under a loan.
- KAMCO determines that any payment under the loan is not possible due to cancellation of the corporate reorganisation proceeding or composition proceeding.
- The relevant put option bank fails to perform certain covenants of the settlement agreement.
- KAMCO determines that any related loan obligor is not or may not be able to make a payment of principal or interest under the loan due to initiation of litigation or other reasons.

In the event of any of the aforementioned scenarios, the issuer will exercise the put option. In practice, it will be the master servicer (KAMCO, in this case) which will exercise the put option by sending a notice to the appropriate bank. The bank's obligation to pay under the put option is unconditional as long as one of the aforementioned scenarios has occurred.

The put option price is equivalent to the sum of the following:

- The sum of the put option value (calculated as of the settlement agreement date, December 1999) for each unpaid amount due with respect to the loan.
- Interest on the amount (a) above from the period from the settlement agreement date to the relevant payment date of the exercise price. Interest will be accrued at three-month US dollar LIBOR plus 1.0%.

The exercise price will be payable in cash only and in US dollars and will be due within three business days from the date of the put option exercise notice.

■ Put Option Bank Concentration

The put option banks' concentrations and their ratings are detailed in the chart on page 2.

As the underlying loans are restructured as nonperforming loans, Fitch assumed a large proportion of these loans would default in the stress scenario. Therefore, reliance on the put option payment cash flows is critical in the transaction. Fitch, thereby, analysed the transaction from the put option banks' credit perspective. Various scenarios of default by the put option banks on their obligations were also assumed (*for detailed stress scenarios see Credit Enhancement, page 10*).

Key Portfolio Characteristics

- Principal outstanding (as of April 1, 2000): US\$395.45 million.
- Aggregate put option price (as of April 1, 2000): US\$405.72 million.
- 135 loans from 45 loan obligors.
- Top 10 obligors: nearly 75% of the loan portfolio.*
- 90.8% US dollar denominated; 9.2% yen denominated.*
- Loans under*:
 - Reorganization Plan: 66.5%
 - Composition Plan: 14.0%
 - Right of Separation Claims: 19.5%
- Final loan repayment date distribution*:

	(%)
2000	0.1
2003	6.2
2004	1.0
2005	6.8
2006	25.2
2007	19.6
2008	5.8
2009	20.8
2012	4.5
2013	8.8
2018	1.2
- Interest rate indices distribution.*
 - US dollar portion:
 - 21.7% fixed-rate loans
 - 76.3% floating-rate loans
 - 2.0% zero coupons
 - Yen portion:
 - 58.4% fixed-rate loans
 - 14.4% floating-rate loans
 - 27.1% zero coupons

*As percentage of principal outstanding as of April 1, 2000.

Hedging Strategy

(%)

Interest Rate Basis	US Dollar Loans	Hedging Strategy
Fixed-Rate/Zero Coupon Three-Month and Six-Month LIBOR Assets	23.7	Partially Hedged
Korean Banks' Prime Rate Floating Assets	25.8	No Hedge
	50.5	No Hedge

LIBOR – London Interbank Offered Rate.

■ Hedging Mechanism

Hedging of Yen Assets

The yen receipts under the portfolio will be hedged by a currency cum interest rate swap. The purchaser will pay yen-denominated receipts (plus interest for delayed payments) or US dollar-denominated receipts in case the put option has been exercised under yen-denominated loans (irrespective of default of the put option bank) to the swap counterparty.

The swap counterparty will pay a fixed US dollar-denominated schedule of payments semiannually plus interest. The schedule will be preset just before closing and will not be changed unless there is a default under the swap by the purchaser.

Hedging of US Dollar Assets

The hedging strategy for the basis risk is as follows: No hedging is being proposed for Korean Banks' prime/US dollar LIBOR risk. KDB and other Korean banks set their prime rates based on their funding costs, which are considerably above the six-month US dollar LIBOR. The past four years of data indicate that Korean bank prime rates have varied between 175–400 basis points (bps) above the six-month US dollar LIBOR. However, considering the unhedged risk, in the cash flow stress scenarios, Fitch assumed the Korean banks' prime rate at a spread of 150 bps over six-month US dollar LIBOR (nearly 25 bps below the lowest historical spread) (see chart at right).

A partial swap covering nearly 75% of fixed-rate loans is being incorporated to mitigate fixed/floating-rate risks. In the stressed cash flows, the six-month LIBOR has been stressed to increase 4.25% in the first two years to analyse the impact on the cash flows of unhedged fixed/floating-rate risk.

The yen swap can be terminated in the year 2007, while the interest rate swap terminates in the same year. This leaves a tail-end period of about two years

as unhedged. The impact is marginal and the risk has been accounted for in the stressed cash flows.

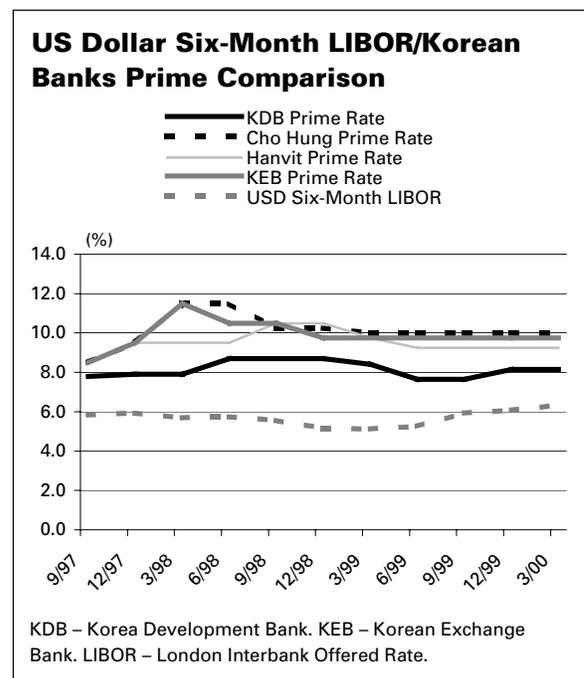
■ Collection Procedures and Payment Waterfall

All the obligors will be instructed to make payments to segregated accounts in the name of the purchaser (depending on the currency of payments):

- KRW collection account for payments made in KRW. Even though the loans are denominated in US dollars or yen, the obligor has the option to make the payments in KRW equivalent.
- US dollar collection account.
- Yen collection account.

In case the payments are made in KRW equivalent, the purchaser transaction administrator will be required to convert the same into US dollars at a spot rate no less favorable than the spot rate offered to the obligor. The exchange risk is expected to be a maximum of one day and will not affect the deal materially.

The yen receipts and US dollar-denominated fixed interest rate payments will be paid to the swap counterparty under the hedging arrangements. The payments received from the swap counterparty and the collection accounts will be deposited in a dollar transaction account.



The payment waterfall from this dollar transaction account on purchaser note payment dates is as follows:

1. Pari passu toward:
 - a) Transaction expenses, including purchaser transaction administrator fees.
 - b) Purchaser senior note yield.
 - c) Master servicer fees.
 - d) Credit facility provider commitment fees.
2. Purchaser senior notes principal due (as per expected schedule).
3. Payment to credit facility provider:
 - a) Interest on credit facility.
 - b) Repayment of credit facility advances drawn.
4. Additional principal payment on purchaser senior notes.
5. Subsequent to 100% principal payment on senior notes, any residual toward subordinated notes.

An expected repayment schedule of purchaser senior notes has been set out based on expected cash flows with no defaults (*see chart at right*). However, in case of excess collections in a particular period due to prepayments or a put option exercise, the surplus will be used to pay down principal on the senior notes. This payment will be in addition to the normal amortisation payment. The interest and principal received on purchaser senior notes will flow toward meeting interest and principal payments on the corresponding issuer notes.

KDB credit facility can be drawn to meet any shortfalls of payments in 1 and 2, as shown above. The broad credit facility terms are as follows:

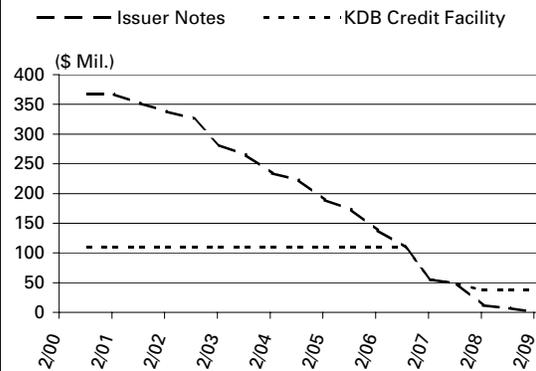
- Initial commitment amount: US\$110 million (30% of the issuer notes).
- Equals issuer notes outstanding if issuer notes < US\$110 million, subject to a floor of US\$36.7 million.
- The available credit facility is equal to commitment amount less any outstanding advances and interest due on such advances.

■ Korean Banking Industry: Sovereign Support Perspective

As mentioned, the key emphasis of Fitch’s transaction analysis is on the credit strength of the six put option banks. The six put option banks are among the largest banks in the Korean economy, and Fitch expects these banks to enjoy explicit or implicit governmental support.

Fitch’s approach to bank ratings places considerable emphasis on the availability of such external support

Issuer Notes Amortizations and Credit Facility



KDB – Korea Development Bank.

should the bank get into difficulties. In the case of some banks, including KDB, such support is explicit and legally binding on the government. In the case of the other five put option banks, Fitch considers the support implicit. The government does not explicitly commit itself to supporting specific banks, but it is likely to do so in the case of large, systemically important banks given their importance to the country’s economy. Fitch evaluates the potential for support based on several criteria, including the size and role of the bank and its relationship with the authorities. Fitch considers the large Korean commercial banks to be systemically important. However, some banks, such as Kookmin and Shinhan, have maintained reasonably sound stand-alone financial strength, and, currently, this support is an important factor in the ratings of KDB, Hanvit, Cho Hung, and KEB.

It is clearly a prerequisite that the government possess the resources to support the country’s banks. The risk clearly exists — and was demonstrated during the crisis — that the government may not possess the necessary resources. In this case, it may need to choose which banks to rescue. Given the obligations under the law, KDB and other policy banks would clearly have the first claim on those resources. After them, would rank the large commercial banks — Hanvit, with its market share of loans and deposits of about 15% among Korean commercial banks, and Cho Hung, with about 10%. Although it is only slightly smaller than Cho Hung, KEB’s claim would be based on its long relationship with the central bank — for many years its majority shareholder — and its international importance. Since it has the largest market share in handling Korea’s

foreign trade, its failure would be devastating to the economy.

It has been reported in the media that the government is keen to merge KEB into a new entity that includes Cho Hung and Hanvit. The credit implications would be broadly positive as such an entity would be the dominant bank in Korea, with a large market share, and its systemic importance would be high.

With the aforementioned in perspective and given the current composition of the six put option banks in the portfolio (by Fitch ratings: 'BBB+', 59.9%; 'BBB', 2.9%; and 'BBB-', 37.2%), Fitch expects that the default of the largest bank with the lowest rating ('BBB-', in this case) will be the base default scenario commensurate to the 'BBB+' transaction rating. Given the possibility of a merger of Cho Hung, Hanvit, and KEB, a stress scenario has been run for default by this merged entity as well. Based on historical instances and experience, Fitch expects that the recovery from a default of a large systematically important bank (KEB, Hanvit, or Cho Hung, in this case) should be well above 60%. In the stress scenario, a conservative recovery rate of 40% is assumed.

■ Credit Enhancement

The overall credit enhancement is as follows:

- Nearly 12% subordination on expected collateral value.
- Credit facility initially equal to 30% of the issuer notes.

Fitch has run various cash flow stress scenarios on defaults by the underlying obligors and subsequent defaults by the put option banks on their obligations. The timing of defaults of the obligors and put option banks has been varied in such stress scenarios. Fitch considers the following as the two worst case stress scenarios commensurate to the transaction rating.

Stress scenario (default the largest 'BBB-' rated bank, KEB, in this case):

- Default by top 10 obligors (nearly 75% of the loans) in the first three payment dates.
- Default by KEB 12 months from the closing.
- Recovery of 40% from KEB 18 months from the date of default on put option.

Stress scenario (default all the three 'BBB-' rated banks, in view of the possibility of their merging):

- Default by top 10 obligors (75% of the loans), timing wise, in the first three payment dates.

- Default by the three 'BBB-' rated banks (KEB, Chohung, and Hanvit), 24 months after closing.
- Recovery of 40% from defaulted banks 18 months after default.

Fitch considers the default by the largest 'BBB-' rated bank its base stress scenario. However, a stress scenario of default by the three 'BBB-' rated banks has also been analysed given the public reports of a merger proposal for the three banks.

Fitch considers the timing of default assumed on the top 10 obligors on the first three payment dates as a conservative assumption. According to Korea Management Consulting & Credit Rating Corp., defaults by obligors in domestic KAMCO ABS transactions are approximately 10% during the first year after closing. The actual defaults are significantly lower than those assumptions used in Fitch cash flow stress scenarios.

The aforementioned stress scenarios also assume a ceiling on floating-rate Korean bank prime rates at LIBOR plus 1.5% and increasing the six-month LIBOR by 4.25% for fixed/floating risk.

■ Servicing

KAMCO, as master servicer, will provide collection and management services in relation to the loan portfolio, including receiving payments and enforcing payment obligations and lawful dealings with obligors. KAMCO will have the right to delegate some of the servicing duties to a subservicer (limited to put option banks). However, certain servicing duties, including the exercise of put options and preparation of reports, will be retained by KAMCO and cannot be delegated. The transaction trustee will have the right to change servicer in certain circumstances.

Fitch examined the servicing set-up in detail during its on-site review with KAMCO. KAMCO has been managing the nonperforming loans since 1997. There are two different departments that keep records and monitor the loans — restructured corporate loan management (for loans under KAMCO's ownership) and disposed asset management (for securitised loans). KAMCO has been an active issuer in domestic asset securitization. The disposed asset management department has been managing the servicing of domestic securitization transactions and, accordingly, has requisite experience. The department keeps the settlement agreement and related account filed in a fireproof cabinet. A scanned

copy of the settlement agreement is also kept separately. This department will also be responsible for issuing letters relating to the exercise of put options.

KAMCO uses software called Powerbuild to maintain records of the loan portfolio. The portfolio has all the essential information pertaining to the loans — obligor details, payment schedules, interest rates, put option banks, and collateral information, among others. All the loans, including the proposed securitization, will be appropriately identified in the system to avoid commingling with the other KAMCO loans.

Fitch considers KAMCO's experience in managing nonperforming loans, particularly the experience gained as a servicer in a domestic securitization transaction, as a positive credit factor for the transaction.

■ Legal Issues

- Under the loan portfolio transfer agreement, KAMCO will sell, assign, and transfer to the purchaser all its rights, title, and interest in each of the underlying loan agreements, put options, any security, and other related documents.
- The purchaser will issue purchaser senior notes to the issuer, which will be backed by a purchaser security created pursuant to the following:
 - Pledge agreement — pledge of the loan portfolio assets (including benefit of put options), transaction documents, and various accounts.

- Yangdo tambo agreement — transfer of title and assignment for security of shareholders' equity interests.
- Account assignment agreement — assignment by way of security of all the purchasers' rights under the dollar transaction account and any eligible investments.

After creation of a valid pledge, the purchaser would not have the right to dispose of the security. The notices to obligors and put back banks will explicitly provide for the issuer to authorise the purchaser and/or the master servicer to enforce such rights.

- A notice of assignment for the sale and pledge will be forwarded to the obligors and put option banks for perfection reasons. The obligors will be required to make payments directly into the purchaser account. Any payments under the exercise of put options will also go directly into the purchaser account.
- The transaction will be done under the provisions of the Korean Securitization Law and will be registered with the FSC. Fitch will rely on Korean legal opinion to confirm that:
 - The transfer of loans would be considered as true sale pursuant to the ABS Act of Korea.
 - Such transfer would not be set aside or avoided under the Korean Civil Code, Bankruptcy Law, or Corporate Reorganization Law.
 - No transfer or any other taxes will be applicable on initial portfolio.
 - No withholding or any other taxes will be applicable on payment of interests on the senior purchaser notes to the issuer.

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