FINANCIAL STABILITY AND FINANCIAL SECTOR SUPERVISION:
LESSONS FROM THE PAST DECADE AND WAY FORWARD
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KOREA'S EXPERIENCE OF FINANCIAL SUPERVISION AND FINANCIAL SECTOR EXAMINATION

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Korea's Experience of Financial Supervision and Financial Sector Examination

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Post-Crisis Financial Supervision Reform

Major reform and restructuring efforts

Asian financial crisis

- **Ineffective regulation**
- **Political interference**

supervisory system reform

- upgrade supervisory capacity
- enhance independence of regulators

- **FSC** (in April 1998)
- **FSS** (in January 1999)

Regulation **Supervision**

All types of financial institutions

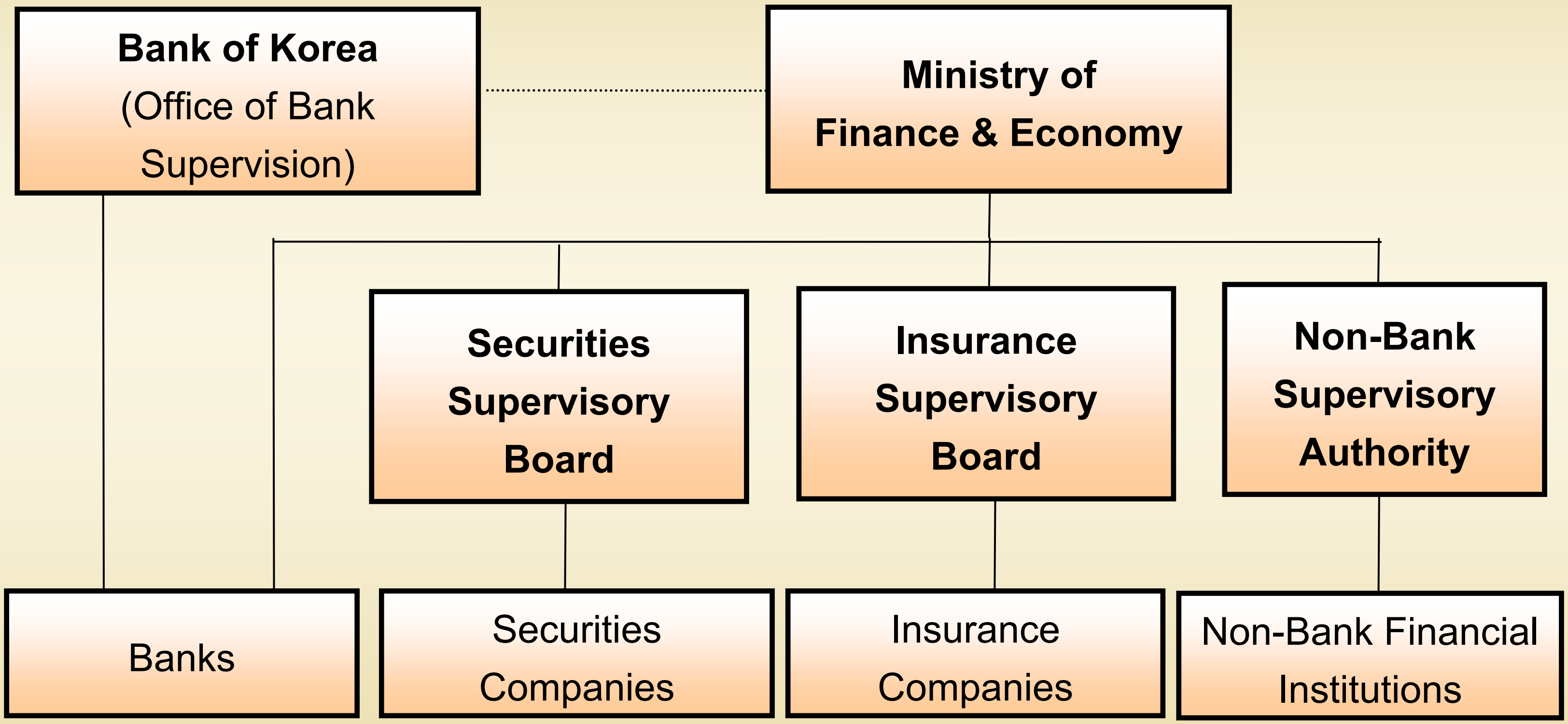
Post-Crisis Financial Supervision Reform

Efforts to enhance independence

- **Financial Supervisory Commission (FSC)**
  - Government entity which reports to the Prime Minister
  - To ensure independence from the Ministry of Finance
- **Financial Supervisory Service (FSS)**
  - Non-government entity
  - Responsible for supervision, examination, and sanctions

Post-Crisis Financial Supervision Reform

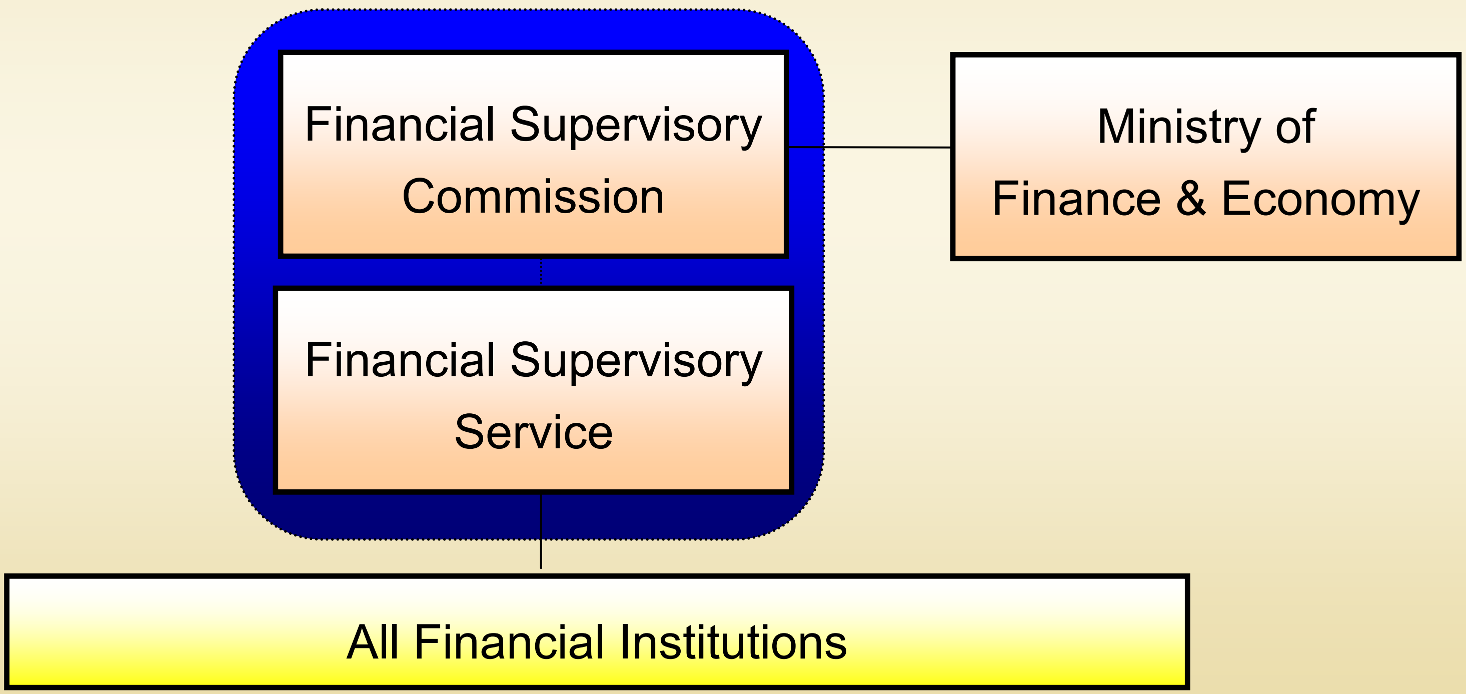
Pre-Crisis Supervisory Framework



Post-Crisis Financial Supervision Reform

Integrated Supervisory System

- Regulatory coordination to deal with market integration and convergence in financial services

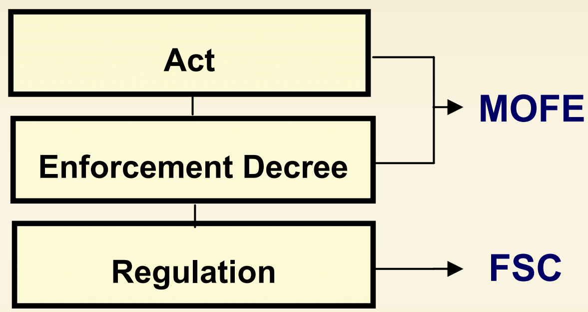


Post-Crisis Financial Supervision Reform

Regulatory Independence

- Little room for independent rule setting by the supervisory authority

<Legal Framework in Korea>



- Must consult with MOFE on changes in laws and decrees

➡ Difficult to respond to the rapidly changing environment flexibly

Post-Crisis Financial Supervision Reform

Example : Credit card debacle of 2002~2003

- Difference in opinion between MOFE and FSS

  FSS : concerned about the deteriorating soundness of companies

  MOFE : encouraged credit card usage for economic growth

↓

- Delay in revision of the relevant enforcement decree

↓

- Failure in prudential regulation (e.g. taking PCA) in a timely manner

Post-Crisis Financial Supervision Reform

Supervisory Independence

- Efforts to minimize its interference in the affairs of financial regulators

➢ FSC : final say on who can enter the financial industry

➢ FSS : legal protection of staffs in the course of performing their duties

Issues

- Immunity weak as compared with the degree of legal protection in other jurisdictions
- Making the supervisory actions and decisions more transparent

Institutional Independence

- Well established legal framework
  - Appointment and dismissal, and the roles and responsibilities of senior officers clearly stipulated under law

Issues

- Rapid turnover of FSC Chairmen / FSS Governor
- Open-door policy between FSC and MOFE

Budgetary Independence

- High degree of budgetary independence
  - FSS can determine the size of budget on its own

Issue

- Enhance budgetary accountability without compromising independence
  - Strengthen outside review of the budget

Regulatory Transparency and Consistency

Northeast Asia's Financial Hub

Regulatory environment friendlier to foreign investors

- Consultation papers seeking public comments
  - Getting advice before and after introducing new regulations
- Extension of the public notice and comment period
- Documentation of informal administrative action

Supervisory Efficiency : Examination Structure

Improve in the efficiency of examinations
Reduce of the compliance burden

Reorganized examination structure and processes

- Introduction of Relationship Managers (RMs)
  - Specialization in off-site monitoring
  - Significant drop in the number of on-site examinations
  - Training programs and workshop

Future Challenges

Areas of Improvement

- **Financial Companies**
  - ➢ Focus on simple management of their assets
  - ➢ Low global competitiveness
- **Financial Supervision**
  - ➢ Overly prescriptive rules and regulations frustrate business
  - ➢ need to improve expertise, transparency, predictability

- **Principles-Based Supervision**
- **Risk-Based Supervision**
- **Enhancing the Supervisory Expertise and Capabilities**

Future Challenges

Principles-Based Approach to Regulation

Rules-Based Approach	Principles-Based Approach
• Regulation based on prescribed rules • Difficult to develop new, innovative financial products	• Regulators just propose supervisory principles • Leave specific details to financial institutions

Principles-based System Roadmap

- First, adopt principles-based approach for product development and asset management
- Prepare best practices or guidelines

Future Challenges

Risk-Based Supervisory Framework

Macro-prudential supervision

- Need to deal with systemic risks

  ⇨ Macro-prudential Supervision Department to monitor, identify, and assess the potential risk factors in late 2004

- Staffs equipped with expertise and in-depth knowledge of overall economic conditions and financial market

Future Challenges

Micro-prudential supervision

Bank sector

➢ **Basel Ⅱ**

- Efforts to implement the New Basel Accord since March 2002
- Expected to take effect for all domestic banks in 2008

➢ **RADARS** (Risk Assessment and Dynamic Analysis Rating System)

- Identify banks' risk exposure and risk management capabilities
- Differentiate the supervisory and examination strategies based on findings

Future Challenges

Insurance and Securities sector

- Insurance sector : Risk-Based Capital (in April 2009)
- Securities sector : Risk-Based Supervision (in April 2008)

Examination : decrease in the regulatory burden

- On-site examinations ⇨ Paper-based examinations
- Focus on financial institutions' risk exposure and risk management capabilities

Future Challenges

Enhancing the Supervisory Expertise and Capabilities

Organizational · personnel system

- Sectoral structure ⇨ Functional structure
- More performance-based criteria for compensation and promotion

Supervisory expertise and skills

- Open positions to outside candidates
  ※ 324 outside specialists have been hired (13.9% of the total workforce)
- Expand training programs with FRB(NY), OCC, SEC, ECB, NAIC, IAIS, etc.

Future Challenges

- **Reliability**
  - Survey views of financial institutions and consumers on major supervisory policies and evaluate them on a regular basis
  - Collect views of employees of financial institutions on our supervisory work and examinations
- **Transparency**
  - Strengthen internal controls

Conclusion

Regulatory consistency across jurisdictions

Cross-border cooperation among financial regulators

Market Uncertainties

Complex financial instruments

Financial globalization

Thank you