



**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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LESSONS FROM THE PAST DECADE AND WAY FORWARD*

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Korea's Experience of Financial Supervision and Financial Sector Examination

Dr. Lee Jang Yung
Assistant Governor



Financial Supervisory Service



■ **Post-Crisis Financial Supervision Reform**

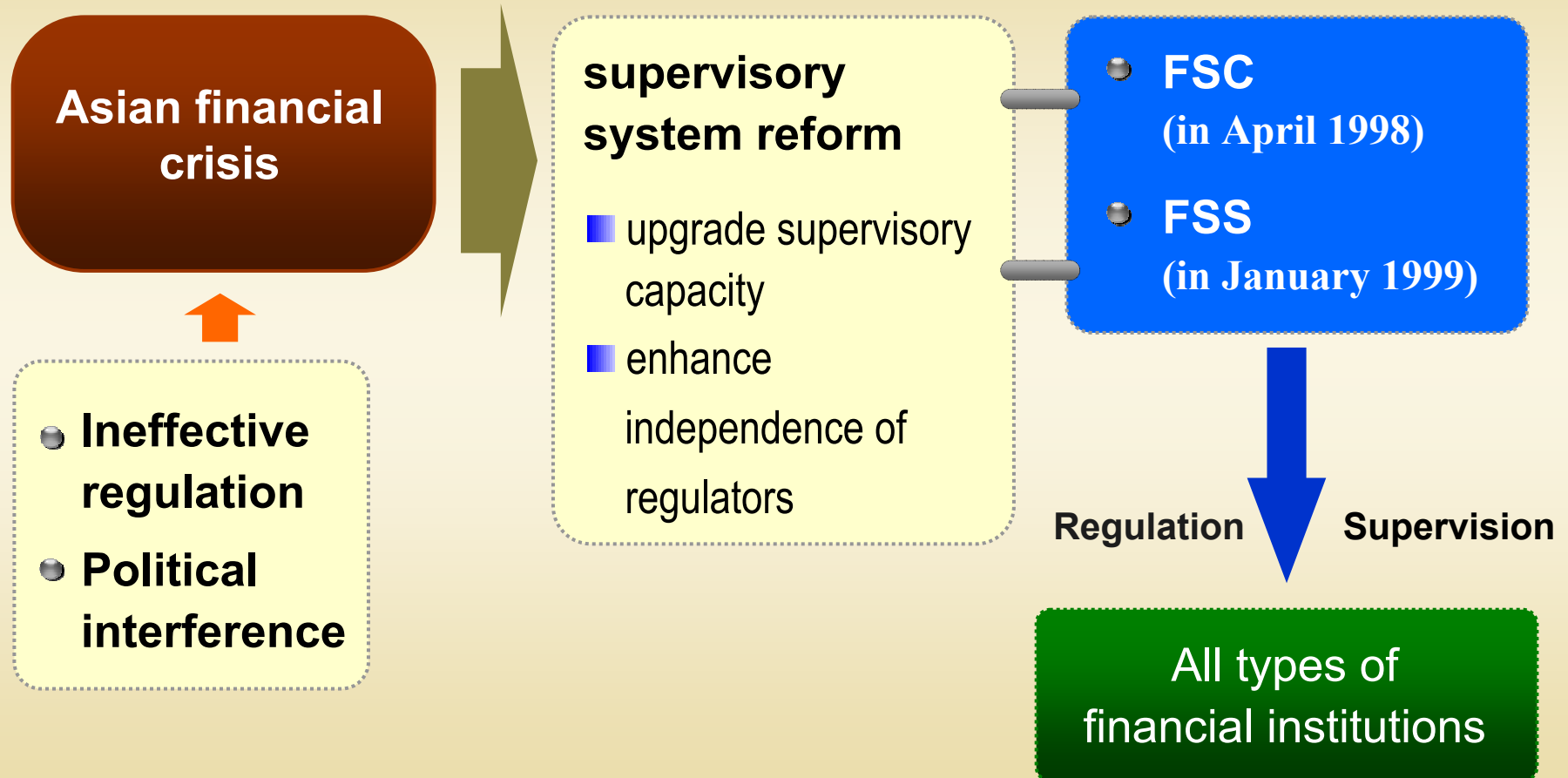
■ **Future Challenges**

■ **Conclusion**

Post-Crisis Financial Supervision Reform



Major reform and restructuring efforts





Efforts to enhance independence

● **Financial Supervisory Commission (FSC)**

- Government entity which reports to the Prime Minister
- To ensure independence from the Ministry of Finance

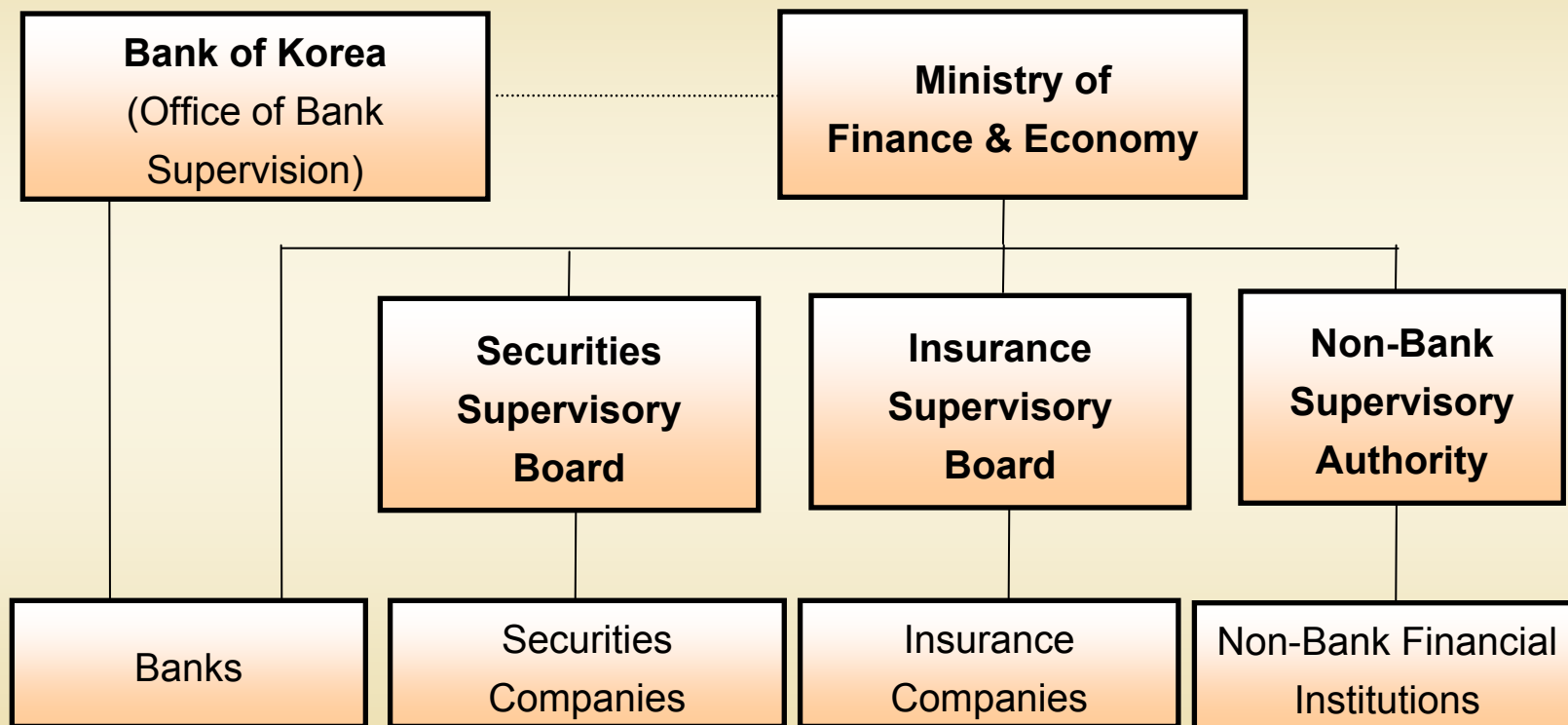
● **Financial Supervisory Service (FSS)**

- Non-government entity
- Responsible for supervision, examination, and sanctions

Post-Crisis Financial Supervision Reform



● Pre-Crisis Supervisory Framework

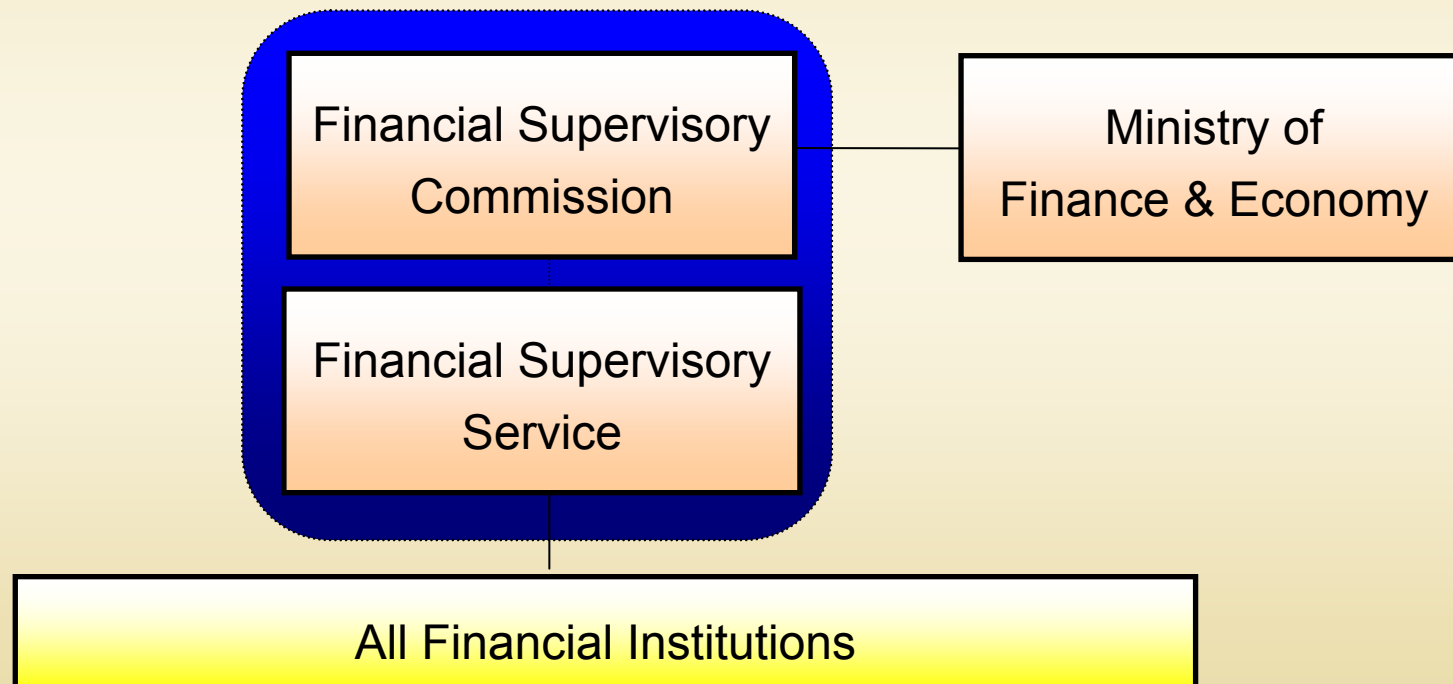


Post-Crisis Financial Supervision Reform



● Integrated Supervisory System

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

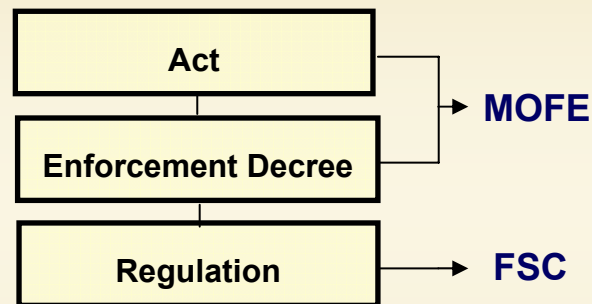




Regulatory Independence

- 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



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



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



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**



Principles-Based Approach to Regulation

Rules-Based Approach

- Regulation based on prescribed rules
- Difficult to develop new, innovative financial products

Principles-Based Approach

- 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



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



● 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



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

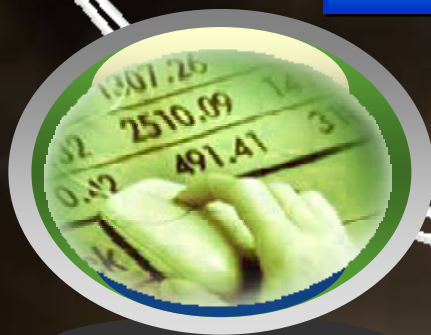
Conclusion



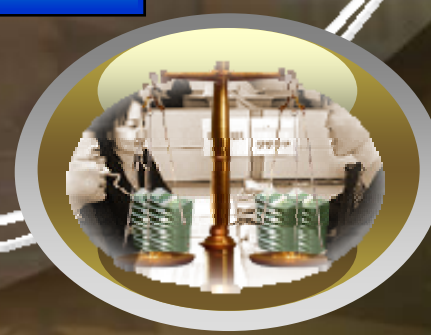
Regulatory consistency across jurisdictions

Cross-border cooperation
among financial regulators

Market Uncertainties



**Complex financial
instruments**



Financial globalization



Thank you