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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Financial Supervisory Service
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Post-Crisis Financial Supervision Reform

Future Challenges

Conclusion
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
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
Pre-Crisis Supervisory Framework

- Bank of Korea (Office of Bank Supervision)
- Ministry of Finance & Economy
  - Securities Supervisory Board
    - Banks
    - Securities Companies
  - Insurance Supervisory Board
    - Insurance Companies
  - Non-Bank Supervisory Authority
    - Non-Bank Financial Institutions
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>

- Act
- Enforcement Decree
- Regulation

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
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
dfriendlier 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

Post-Crisis Financial Supervision Reform

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
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

Future Challenges

Areas of Improvement

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
Future Challenges

Micro-prudential supervision

- 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
On-site examinations            Paper-based examinations

Focus on financial institutions’ risk exposure and risk management capabilities

Examination : decrease in the regulatory burden

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

Insurance and Securities sector
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.
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