

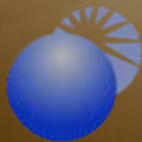


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# Korea's Experience of Financial Supervision and Financial Sector Examination

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Financial Supervisory Service



- **Post-Crisis Financial Supervision Reform**
- **Future Challenges**
- **Conclusion**

# Post-Crisis Financial Supervision Reform



## Major reform and restructuring efforts

**Asian financial crisis**

**supervisory system reform**

- upgrade supervisory capacity
- enhance independence of regulators

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

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

Regulation

Supervision

All types of financial institutions



## Efforts to enhance independence

### ● Financial Supervisory Commission (FSC)

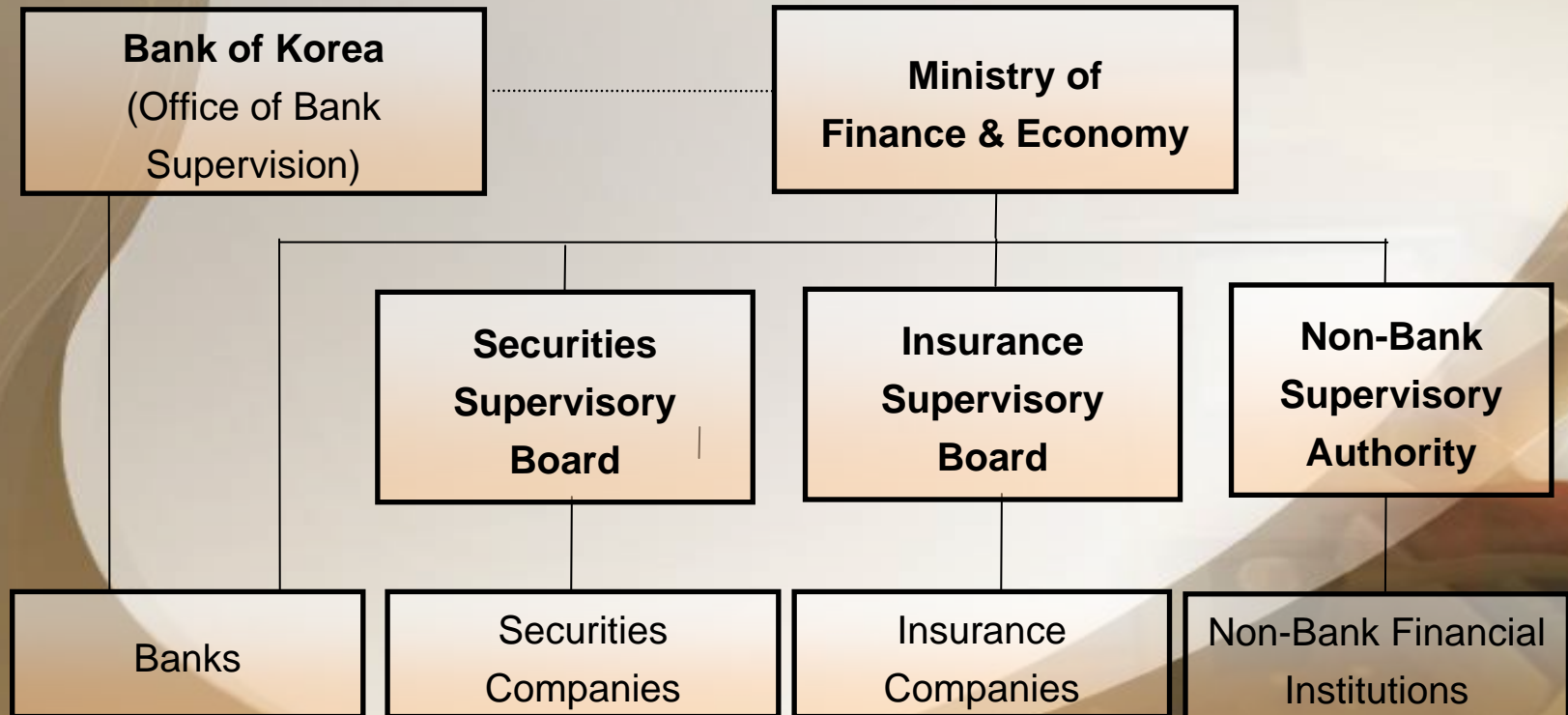
- Government entity which reports to the Prime Minister
- To ensure independence from the Ministry of Finance

### ● Financial Supervisory Service (FSS)

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



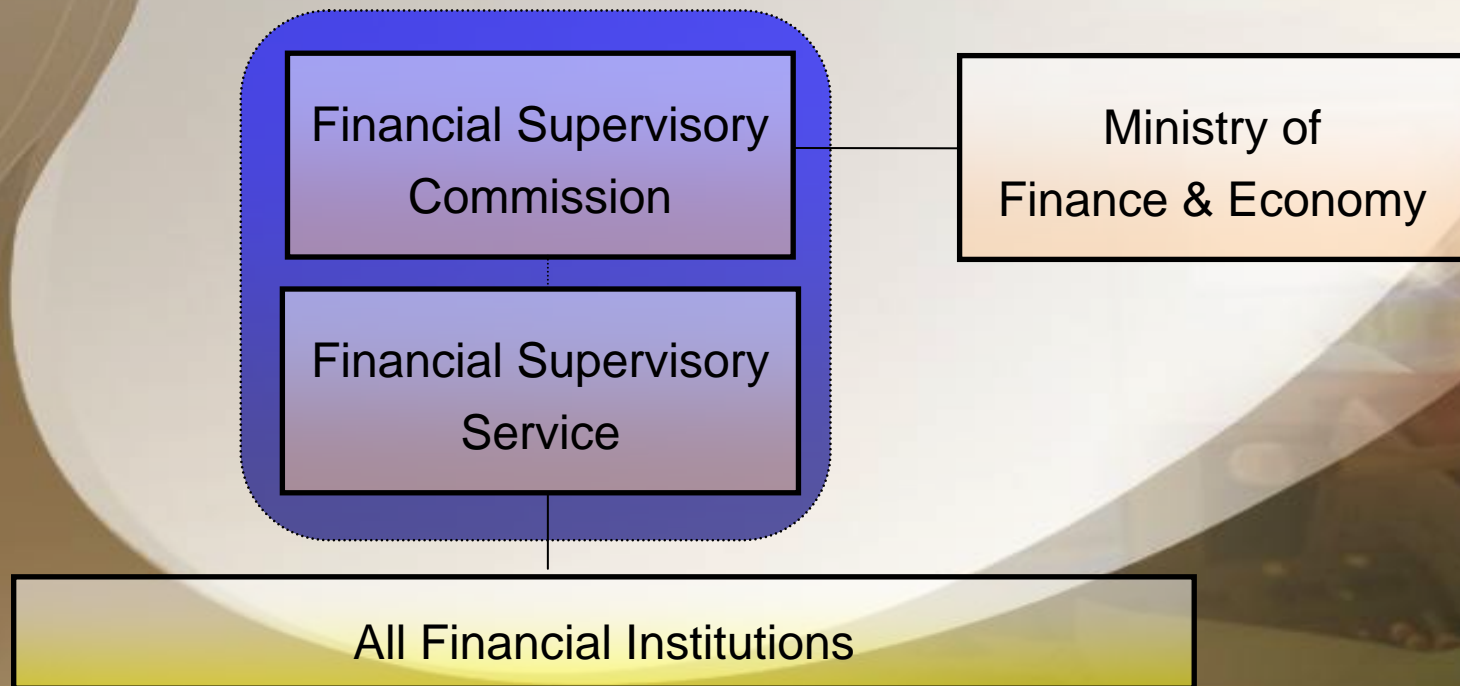
## ● Pre-Crisis Supervisory Framework





## ● Integrated Supervisory System

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

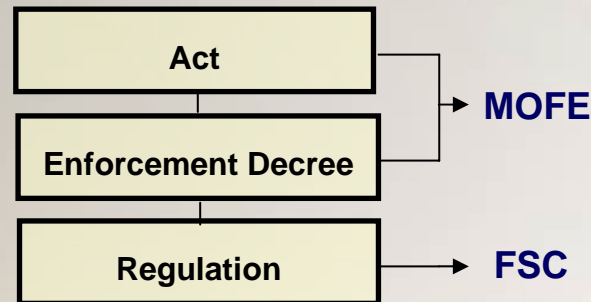




## Regulatory Independence

- 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



## 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.



## ● 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**