

## **(2) Korea**

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### **Prof. Kim:**

Thank you very much, Mr. Sugiura. Let me first express my gratitude to the FSA and Keio University for inviting us to this wonderful conference. I am deeply honored to be invited by two of the most prestigious institutions in Japan.

As far as Korea is concerned, the timing of this conference now is just perfect. The terrain of financial regulation in Korea is now in total flux. Just two weeks ago, the Korean government announced its plan to consolidate its various capital market-related laws into a single code. The plan is just a blueprint, which may be forgotten after some time, but the government issued a detailed report covering many technical issues. So our presentation will be mostly devoted to this report. We are fortunate today because Prof. Jung sitting next to me has played a crucial role in preparing this report. So I would rather let him do all the talking. But before he starts his presentation, I would like to cover first the two parts of the slides, hopefully within 10 minutes.

Before I start, let me call your attention to a slide which is missing from the material—this one. In our economic development, we have been heavily dependent on banks and as you see, if you take a look at the right side of this table, “deposits” occupies more than 50% of our household financial assets. So as you see, we are still heavily dependent upon banks, and as our economy grows, and becomes more mature, we feel a growing need to develop our capital market. I think that is the reason why the government is planning to consolidate the laws related to the capital market.

Let me start with an obvious proposition. A country’s financial regulation may properly function only when it corresponds with the realities of the country’s financial markets. As you all know, financial markets have been changing rapidly and radically in developed countries. So there is a need to reform financial regulation to accommodate these changes. Simply put, this is why the Korean government has come up with a

report on the consolidation bill. I will quickly go through the recent changes in Korean financial markets.

As you have been witnessing similar changes in Japan, you may quickly understand what these changes are just by looking at keywords in the slides. Let me just point to those keywords. First of all, we now have a single regulator, the financial supervisory commission and financial supervisory services, covering all financial sectors including banking, insurance and securities. Second, the changing needs of the investing public. I do not think we need to go into details. Third, this slide is also self-explanatory, dealing with advances in computer and telecommunication technologies.

Let me say a few words about the blurring of sectoral distinctions. The blurring of distinctions among financial sectors is now a familiar phenomenon everywhere. The walls separating different financial sectors such as banking, securities, and insurance are being lowered. The blurring of traditional distinctions is taking place both at the level of financial products and of financial service providers. The most significant factor facilitating financial innovation may be the widespread use of financial derivatives; and regarding these derivatives, I think Prof. Jung will cover in his presentation.

The third is limits of current financial laws. Financial regulation in Korea is based on the institution-based or product-based approach. For example, the Banking Act purports to regulate banks while the Securities Transaction Act and the Insurance Business Act cover financial products such as securities and insurance contracts respectively. This product-based approach is defective in the following three respects. First: insufficient and inflexible regulatory definitions. Second: regulatory inequality among sectors. Third: vertical and horizontal dispersion of regulatory rules. Let me say a few words about these three points, one by one. First: insufficient and inflexible regulatory definitions. In defining securities, for example, the Securities Transaction Act basically employs a strict listing approach.

The act enumerates eight categories of financial products as securities, and delegates the power to add new products to the government. It is not necessarily easy for the government to exercise its power to add new securities. The provision on securities has been strictly interpreted. The general view seems to be that if there is no expressed permission on a financial product, it may be interpreted as impermissible. Such a strict listing approach may prove problematic to financial consumers as well as service

providers. First, a listing approach tends to dampen efforts of financial service providers to develop new financial products. Second, of more significance from the perspective of financial consumers, a listing approach may lead to the lack of protection for new financial products. Where a financial product does not fall within the statutory definition of securities, consumers investing in that product are not entitled to a variety of protections available under the Securities Transaction Act. Regulatory requirements under the current laws often differ depending on the type of financial institutions involved. No reasonable grounds may exist for such difference. Such regulatory inequality may hamper fair competition among different types of financial firms. For example, with regard to over-the-counter derivatives, banks and securities firms are subject to different regulatory requirements. Banks dealing with equity-linked deposits are not subject to the conduct of business regulations under the Banking Act. On the contrary, securities firms selling equity-linked securities must comply with the strict conduct of business regulation under the Securities Transaction Act.

Finally, one may not underestimate technical difficulties arising from the unsystematic organization of the current regulatory system. In Korea, financial regulation consists of more than 20 acts, covering various aspects of financial services. Moreover, regulatory rules of the same dimension are often provided at different levels of law, such as acts, presidential decrees, rules and regulations. This horizontal and vertical dispersion of regulatory rules not only makes it difficult for market participants to comply with the rules, but also hinders the Ministry of Finance and Economy from reforming the regulatory system in a systematic and consistent manner. As the Minister of Finance and Economy itself is organized along the lines of financial sectors, bureaucrats confess that it takes too much time for them to prepare, say, a simple table comparing entry requirement for different types of financial institutions. Also, as it is unduly cumbersome to revise all the relevant statutes at the same time, the Ministry may have to give up on a desirable change or to accept regulatory inconsistency.

The current regulatory system may be evaluated as follows. First, the current system may not adequately protect the interest of consumers in the financial markets, as it covers only a limited range of products. Second, for financial services providers, the current regulatory system does not provide a level playing field. Third, the current system falls short of satisfying the regulators because its unduly complicated structure makes a systematic reform difficult.

Let me move to our reform efforts. Several alternatives may exist to address the problems I mentioned earlier. First of all, one may suggest that the Ministry attempt to revise diverse financial laws one by one, to achieve a level playing field. This option seems the least different from the status quo. As mentioned earlier, changing so many different statutes at the same time is often not feasible. Moreover, financial laws are the ones which need to be revised most often. The second alternative is to aim for a partial integration, a unified conduct of business regulation, for example. Examples of this alternative include the Financial Services Act of 1986 of U.K., and the financial services reforms act of 2001 of Australia. The third alternative is to consolidate all relevant financial regulations under one roof. The Financial Services and Market Act of 2000 of the United Kingdom is a prime example.

The Ministry of Finance and Economy of Korea announced in 2003 that it would pursue the more ambitious third alternative; i.e. the consolidation of financial services laws. But it changed its mind later and decided to consolidate only statutes related to the capital market first.

Let me skip this slide. Page 20: this picture is also, I think, self-explanatory. Next: this Consolidated Capital Market Law of 2006 is a single-statute, not including the Banking Act and Insurance Business Act. I think Prof. Jung will discuss these issues later in detail. If you see this slide, you may think this looks more like the Japanese plan to enact the Investment Services Act, which will be covered in the afternoon, I guess.

Let me stop here, and let Prof. Jung speak. Thank you very much.

**Prof. Jung:**

That was Prof. Kim's general view of the recent developments in Korean financial markets. We will talk about more specific issues.

At first, the general consumer protection regime in financial services in Korea. We mean, by "consumer protection" in our presentation mainly sales regulations, sale practice regulation. The following things will be included. Currently, there is no comprehensive law for consumer protection in financial services, especially between banks and consumers and between insurance companies and consumers. But there is a Conduct of Business regulation by the Financial Supervisory Commission( FSC ) and the Financial

Supervisory Service ( FSS ) between stock companies and consumers. About the consumer loan, consumer lending business, there is another act; Lending Business Legislation and Financial Cost and Protection Act, 2002. It regulates the consumer lending business. According to the 2002 Lending Business Act, money-lenders should register their business in the Mayor or provincial governor. Actually, they are subject to the regulation of mayor or a provincial governor. There are several sales factors regulations in the 2002 Act, such as duty to provide and keep contract documents and prohibition of excessive lending, and restricting rates—the ceiling is now 66%—and prohibition of illegal promotion and illegal collection activities. Of the newly announced Consolidated Capital Markets Law, there will be included more comprehensive set of sales practice regulations, including a duty to explain, and know your customer and the suitability requirement; prohibition of unsolicited calls or cold-calling and financial promotion regulation.

The last question is about the depletion of financial products. The current problem—I think Prof. Kim already talked about it—currently, we have a very strictly limited definition of financial products, about securities and the kinds of underlying assets of derivatives. Under the newly announced Consolidated Capital Markets Law, the definition of financial products will be expanded. The left box is the current situation and the right box is the newly announced plan. Under the current system, financial products consist of deposits insurance products and strictly defined securities and derivatives, and there is no concept to cover newly developed products in the market; but under the new system, the current government is now planning to introduce new concepts of financial investment products which are comprehensive concepts of financial products. It will cover all financial products, other than deposits and insurance products. So financial investment products will include securities on exchange derivatives and off-exchange or OTC derivatives. The Korean government is now trying to make a definition of financial investment products with four factors. I think you can see it on our slide. But it technical and complex and it is still a moving target—open for discussions—so let me skip this issue.

About the securities: our current government is trying—planning—to introduce new concepts of investment contract and securitize derivatives. This issue is still a moving target and open for discussion, so let me skip this issue here. About the derivatives, they will introduce two concepts—OTC derivatives and on exchange derivatives—and the restrictions on the kinds of underlying assets of derivatives will be abolished. Currently,

the underlying assets of derivatives are restricted to securities, currencies, credit risk and commodities; but under the new system, the kinds of underlying asset will be expanded to financial investment products, currencies, commodities, credit and nature, environmental, economic and social phenomena; so, an objective evaluation. It will be expanded.

Next question is the classification of customers according to their investment experience or sophistication. By concentrating resources on retail and non-professional clients, we are trying to promote efficient use of scant resources, and to lower the whole level of regulation in financial markets. Under the current system, there is no such approach in the Korean financial services laws. The only exception is the presidential decree for the Securities Transaction Act. It limits the capacity of counterparties for office due to transactions of securities companies. Under the newly announced Consolidated Capital Market Law, it will classify customers into two categories: professional investors and ordinary investors, according to the investment experiences, knowledge, size of the relevant transaction, and so on, of the investors. Then it will also prohibit sales of OTC derivatives and other high-risk financial investment products to ordinary investors. It means ordinary investors may go to the organized exchanges for derivatives trading.

About the exposed consumer protection: there is no special changes other than under the newly announced Consolidated Capital Markets Law, if there is a breach of the duty, that it is plain in the financial transactions with ordinary customers, financial institutions should pay for the damages and the loss of principle will be assumed to be the damages.

About dispute regulation system, or illegal gains redemption, there will be no special changes under the newly announced Consolidated Capital Markets Law. So we think that the benefits of the Consolidated Capital Markets Law enacted the following three benefits. First, it can enhance the consumer protection regime for financial services. Second, it can address the insufficient regulative definition of financial products, without comprehensive definition especially at the concept of financial investment products. Third, it will eliminate room for regulative inequality without reasonable grounds. That is our presentation; thank you.

**Question:**

A very nice presentation. I have two questions. In 1997, at the crisis, the Korean government let many consumer credit to be expanded. So some of the consumers have been helped by getting credit cards and so on; but after that, lots of accumulated default losses have been created. So from that experience, have you made significant changes in consumer loan market? I would like to know what kind of first protections and maybe advertisement protections and so on...I would like to know the progress of consumer protection, especially focusing on consumer loans and consumer credit. That is the first question.

Second one is: you have often mentioned about “product-based approach.” However, so many products are being created every day, and many, many new derivatives will be created. So I am somewhat difficult whether product-based approach is a good way in this technological progressing environment. Those are two questions.

**Prof. Jung:**

About the first question for the protection of consumer loan and other consumer lending business: the Korean government enacted in 2002 Lending Business Registration and Financial Customer Protection Act. It was enacted in 2002, and I think it was the primary response to the problem Prof. Yoshino talked of. Also, one of the primary purposes of the newly announced Consolidated Capital Markets Law is also to strengthen consumer protection regimes for individuals and other consumers in the financial services.

**Prof. Kim:**

Let me add a few words. The credit card problem was a very serious one, and it was created by excessive marketing activities by credit card companies. For example, credit card companies distributed credit cards to people on the street. In some cases, they even offered a cash bonus to attract more consumers. So it is no wonder that we had a credit card problem. Now they stopped distributing credit cards on the street and they are more cautious in choosing their customers. During the crisis it was very important for the government to boost the economy by all means. In order to promote domestic consumption, the government supported the credit card industry. Also, the government made it easy for the people to get a loan from banks. Bank loans were secured by their

apartments or houses. That lead to a kind of speculation, real estate speculation. So the government later tried to restrain that kind of consumer lending activities by the banks.

Let me answer your second question on the product-based approach. What I was saying was that we are moving from the product-based approach to a different approach. As you have mentioned, the product-based approach cannot survive now as new products appear every day in the financial market. Thank you.

**Question:**

I am slightly confused. You have one 2003 Consolidated Financial Law Project, and that...was this something that actually happened, or no, it did not happen? It was only 2006?

**Prof. Kim:**

Actually, in order to save time, I skipped those slides covering the Consolidated Financial Law Project. In 2003, the government was interested in this all-encompassing financial law, and our Center for Financial Law was asked to prepare a report and even a bill for the government. We did prepare a bill, but it was difficult for the bureaucrats to execute that proposal. They would say, "This kind of bill was only enacted in the UK, and not in other countries, not even in Japan." So they were rather hesitant. Also the person in the MOFE who was in charge of the financial market policy was changed, and the new person was less ambitious. It was a kind of revolutionary change and people in the financial markets, especially those in the securities and insurance sectors, were a little hesitant because they worried that the consolidated law might turn out to favor banks still further. So they became less aggressive and less ambitious, so they chose to consolidate only those related to the capital market. Thank you.

**Question:**

Can I just continue my other question? Sorry. About your exposed consumer protection: you talk a lot about resolving disputes between more obvious cases which are those that are legal activity that sort of thing. But is there a scheme against those in which, they are an ambiguous sort of borderline cases in which there are not necessarily illegal acts

by the financial institutions, but the complaint raised by the consumer is a fair complaint.

**Prof. Kim:**

I am sorry, both of us missed your question. I am sorry.

**Question:**

Yes, exposed consumer protection regime, you have a lot about what treatment, what important action will be taken against illegal activities by financial institutions, which is the straightforward case, I think. But obviously there will be a lot of cases which will be subject to an ambiguous sort of borderline case, in which they are not necessarily an illegal activity by financial institutions; however, the complaint that has been raised by the consumer is a fair complaint. Have you decided on what sort of guidelines will be subjected to that sort of case?

**Prof. Kim:**

I am sorry; we are not familiar with that kind of issue.

**Moderator:**

Well, maybe I can make a supplementary comment for you. When I was in Korea, we also asked the same question to the financial supervisory agency. The financial supervisory agency and the consumer protection agency are two different agencies in Korea who take care of the complaints brought in from the consumers. Dr. Yokoi and myself and Mr. Seo jointly wrote a paper addressing this issue, and of course it is very hard to process the gray-zone cases, because there are not much clear-cut criteria. One and half years ago or so in Korea, there were not any fixed guidelines to be applied to the gray-zone, or borderline cases. So it is rather difficult to build a regulation that meets the requirements of the era. But the situation in Korea is better than in Japan, because they have already built up a certain criterion from many experiences, and they seem to have a certain common understanding of what is OK and what is not. Within the agency there are many lawyers and, as Dr. Yokoi mentioned, they are always facing the difficult task of what to do with borderline cases.

**Question:**

May I? Can I ask you a question in Japanese? I have two questions. You talked about all six Consolidated Capital Markets' Laws. I have a question about that. In the United States or in the Hong Kong branch and Seoul branch, the four institutions may sell new products through the branches in Seoul. So is it right to assume that Consolidated Capital Markets Law also covered the most innovative products offered from the foreign financial institutions? Does it have adequate cover for the consumer protection in the highly state-of-the-art financial products? What about hedge funds? The UK is now strengthening their regulation on that but how the hedge funds are being addressed under the newly announced Consolidated Capital Market...do you think the measures covered in the Consolidated Capital Market are enough to cover the highly innovative financial products, as well as hedge funds?

**Prof. Kim:**

I am not sure whether I understand your question. A main purpose of this Capital Market Consolidation Law of 2006 is to allow securities companies to deal with new products which appear every day in developed financial markets, and to protect investors who buy these financial products. The second question is related to the regulation of hedge funds. I think Prof. Jung knows better. This act does not directly deal with the hedge fund problem, which is not really very serious in Korea. There is one exception, though. Private equity funds including hedge funds are sometimes very aggressive in dealing with Korean companies. As you may know, recently Mr. Carl Icahn was reported to be interested in a bid to take over KT&G (Korea Tobacco and Ginseng), a former government-owned firm that has been recently privatized. Many Korean people are now concerned about the active intervention by foreign investors. But in general, I do not think there is any serious concern about hedge fund activities, at this stage at least. Thank you.

**Question:**

In the case of Korea before 1998 you had several supervisors. But since then you have integrated into one single regulatory system. How has this improved your consumer protection mechanisms and in what ways?

The second question is when you talk about consumer protection one can talk about ex-ante or pre-borrowing protection and ex-post protection. With regards to ex-ante of pre-borrowing consumer protection, one can argue that in some countries there are certain specific laws such as equal credit opportunity act meaning that everyone is entitled to receive credit no matter their religion, their origins, their sex, their racial status. As well as some laws like Fair Credit Report Act which our citizen is entitled to see what kind of reports about that credit standing, what kind of reports are being written on their credit standing, so they know their weaknesses and what they have to do to improve their credit standing and borrowing opportunities.

The ex-post consumer protection can involve some kind of legal procedure and opportunity for those who are in debt to have a temporary relief or get out of the debt, so called the bankruptcy solution. This is also popular in some countries like in Japan, you have a lot of legal firms and lawyers who advertise their services for those who are in debt and can get out of the debt if you seek the services of this legal lawyer firms. I do not know whether this exists in the case of Korea or not.

Also post or ex-post credit counseling can be in terms of credit counseling to give advice to those who are in debt because some people have psychological detriment when they incur debt, some people are addicted to borrowing and they are in a vicious circle of borrowing. Some kind of personal finance advice, some kind of counseling or education some times is needed to help these people. I do not know whether in the case of Korea you have such a system because I think that would help a lot in trying to promote discipline among the borrowers and plan themselves to be able to pay debt accordingly. Thank you.

**Prof. Kim:**

I guess your question is more instructive than my answer. The first question relates to the consolidated financial regulator. I have not seen any empirical research on the performance of this consolidated financial regulator. I am not sure whether or not it is more competent or more active in protecting consumer interests. I guess there are some people from this financial regulator in the audience. You do not expect too much from these regulators. I think they may say that they are better now in protecting consumer interests. Of course this consolidated financial regulator is now very strong. So when

they have certain complaints from a consumer, even if the case falls on this kind of borderline category, they can still put some pressure on the financial institution involved. In such a situation, it may be very difficult for the financial institution to resist the pressure from the financial regulator. So maybe that kind of problem is being solved informally, not formally.

Your next question relates to the ex-ante protection. I can point out only one aspect of financial regulation. As you know, all these financial institutions, insurance companies and securities companies and also banks, need a license and the government does not issue a license generously. The government is very, very cautious in issuing a license. Korea now has only a limited number of financial institutions. So there is a relatively less likelihood of consumers being hurt by acts of these financial institutions. But we still need more protection. That is why we try to add some protective measures in the new consolidated capital market law.

Your last point relates to the bankruptcy. Actually, bankruptcy law was almost ignored by legal scholars and practitioners alike. There were not so many bankruptcy cases, maybe less than 10 before the crisis. Now, we have many, many bankruptcies and many consumer bankruptcies as well. There are a small number of lawyers who specialize in these consumer bankruptcies. I am sorry I am no expert in bankruptcy. I am sure that my answer does not satisfy your advanced question. Thank you.