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Yoon Jeung-Hyun
Chairman, Financial Supervisory Commission
Governor, Financial Supervisory Service

Regulators to Tackle "Too-Big-To-Fail" Syndrome
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As a result of significant strides with reform and restructuring of past several years, Korea's financial service industry has been able to sharply improve its overall soundness. When compared to those of the more advanced economies, however, Korea's financial service sector continues to lag behind in terms of the overall competitive strength and is yet to fully function as the key source of support and stability for the real economy.

Thus, Korea's financial service industry is in a sense faced with the collective challenge of promoting real growth through more efficient capital allocation and strengthening its global competitiveness. For the regulators, it is more important than ever to come up with the right combination of supervisory policies to support a mutually-reinforcing dynamic between the financial sector and the real economy.

Since assuming the helm of the Financial Supervisory Commission and the Financial Supervisory Service on August 4, I have been exploring new approaches and responses to address these and other regulatory issues, and I would like to take this opportunity to take stock of recent developments and trends in the financial markets at home and abroad and what approaches are desirable for the regulators.

Evolving Market Environment

Among the many changes Korea has experienced in the past few years, financial liberalization and globalization have been the most salient. In the course of restructuring following the 1997 financial crisis, restrictions on foreign equity and other investments were significantly eased, and as a result many foreign investors began to expand their presence in Korea.

Since 1998, the number of foreign financial service companies rose by 22, including two banks, and in the case of banking it is estimated that the market share of foreign banks more than doubled from 11% to around 28%.

Moreover, unlike in the past when most foreign financial service companies limited their presence to branch operations, they are now increasingly taking over or making significant equity investments in domestic businesses and establishing locally incorporated subsidiary units.

Another salient change has been the trend toward consolidation and universal banking. With aggressive restructuring and an influx of foreign capital, the market witnessed a number of major mergers and acquisitions and the growing size of financial service companies. Consolidation was particularly active in the banking sector, where a total of 12 mergers occurred since 1998, and the number of commercial banks nearly halved from 26 at the end of 1997 to 14 (as of June this year).

During the same period, the average bank asset holdings jumped from KRW23.3 trillion to KRW60.7 trillion. Along with growing sizes, financial service companies are also increasingly turning to economy of scope. With the blurring of the traditional boundaries among banking, securities business and insurance as well as the introduction of bancassurance and a new law on collective investment schemes, there is also a trend toward universal banking through more business tie-ups.

The third is the accelerating pace of financial innovations fueled in part by advances in telecommunication and information technology. The development and application of innovative financial instruments like derivatives, ABS and MBS are expanding, and we are seeing a continuing growth of online banking, stock trading and other electronic financial transactions through the Internet and wireless mobile devices.

Supervisory Policies

For the regulators, the basic direction of market supervision will be toward a safe and sound growth of the financial service industry. First and foremost, this will entail market supervision that strictly adheres to the law and supervisory principles.

This point cannot be overemphasized because when short-sighted approach is adopted for expediency to deal with a problem in the market, the consistency of supervisory policies suffers, market confidence can plunge, and the safety and the soundness of the financial system as a result can be undermined. With consistent and principled exercise of prudential regulation and supervision, we also intend to banish from our marketplace the notion of “too big to fail” or “too big to discipline.”

Second, we will continue to undertake new efforts to conform to the highest global regulatory and supervisory standards. Following the 1997 financial crisis, the supervisory authorities aggressively and continually embraced international best practices and as a result achieved a credible level of success in raising the quality of supervision and transparency in the financial market. Looking ahead, we will take steps to strengthen cooperation with foreign supervisory authorities and incorporate the work of BIS and other international organizations in our supervisory framework.

To ensure more uniform and coherent supervision across the financial service sectors amid the growing trend toward universal banking, we plan to step up "function-based supervision" that crosses over the traditional boundaries of banking, securities and insurance and focuses on the specific areas of activities across all the financial sectors.

Third, we recognize the need to strike a right balance between "market discipline" and "regulatory discipline." Without effective market discipline, confidence in the financial market inevitably falls, and when regulatory discipline steps in, it is usually at the expense of the market. As part of a concerted effort to promote greater market discipline, the regulators have worked hard to improve and reinforce Korea's accounting and disclosure standards and encourage competition in the marketplace. And we will continue to take new steps to ensure that market discipline remain the first line of defense against market disorder or distress and complement the efficacy of regulatory discipline.

Fourth, consumer protection will continue to remain high on our supervisory agenda. With the rapid pace of innovation and the growing complexity and diversity of financial products and services available to consumers, the likelihood of consumer harm as well as the need for the regulators to adopt sound consumer protection measures is also growing. As such, the regulators will steps up efforts to discipline financial service companies that engage in unfair or abusive business practices. Wherever appropriate, support will also be given to the ongoing efforts to alleviate the problem of consumer credit delinquency and help delinquent borrowers manage their debt or repair their credit. Effort to educate the general public of the importance of responsible personal finance management will also continue.

Lastly, the goals outlined above will require a shift in the role of the supervisory authorities from a mere "regulator" that enforces compliance with laws and regulations to a highly specialized, yet versatile "supervisory service provider" that genuinely serves the market. Such a shift will inevitably involve reorientation of the supervisory functions and processes, and we are well on our way to achieving it.