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Speech at Seoul IB Forum: "Investment Banking & Financial Supervision"

October 1, 2008

Ladies and gentlemen,

I am pleased to join you this morning. Before I begin, let me take a moment to thank Professor Min Sang-Gi, chairman of Seoul IB Forum, and Dr. Kim Hyung-Tae, president of Korea Securities Research Institute for organizing today's conference and inviting me to speak.

I would also like to thank distinguished guests at home and from abroad for taking part in today's conference.

As you all know, the U.S. financial landscape was drastically transformed in the past few weeks. It's still very much an ongoing story. But there is no doubt that it is a major development with potentially important ramifications for financial institutions worldwide. So discussion on investment banks—their successes and failures as well as challenges ahead—will certainly prove interesting and useful to all of us.

This morning, I would like to make a few observations about changes in the financial landscape, how we might look at the developments in the investment banking industry, and several priorities for regulators.

Changing Financial Landscape

Financial Globalization

There is a compelling case to be made that the most important change to the financial environment in recent years has been globalization. It has fundamentally reshaped the financial landscape by accelerating the pace of market integration and reinforcing mutual dependencies across markets.

Financial globalization has meant more efficient capital allocation across borders, in particular to the benefit of the emerging economies. On the downside, it has also opened up more markets to the risk of financial contagion originating from places far away from home.

Investment banks, hedge funds, and private equity funds all played a major role in facilitating financial globalization by bringing sophisticated financial engineering to the market. But their high-leverage, short-term investment activities have raised questions about systemic risks that could not be dealt with easily.

Capital Markets

Today's financial system is increasingly shaped by the capital markets on the back of financial engineering as well as the growth of the investment fund industry and asset securitization.

But we know that capital markets are sometimes prone to market failures from problems such as information asymmetry and principal-agent problem. The growth of highly complex structured financial products has also heightened the risk of large-scale market distress and instability.

Subprime mortgage crisis

The subprime mortgage crisis is a clear example of what can happen when we fail to manage the risks I just spoke of.

The failure of financial companies to exercise prudent risk management on excessively leveraged finance activities was one major contributing factor to the crisis. The failure of credit-rating companies to assign reliable ratings to investment assets, together with the failure of investors to exercise due diligence, should not be dismissed either. But the most troubling aspect of the crisis is that regulators failed to put effective oversight on the risky activities of investment banks and others for so long.

Outlook on investment banks

Much is being said about investment banks as the distress in the U.S. financial markets continues to deepen.

I think that the history of investment banking in the U.S. is instructive in putting the ongoing crisis in perspective. The Great Depression of 1929 and the ensuing collapse of the banking system led to the Glass-Steagall Act of 1933 that separated investment banking from commercial banking. At the time, investment business by commercial banks was widely blamed for the near collapse of the banking system. The separation stayed in place until 1999 when it was repealed by the Gramm-Leach-Bliley Act, and investment business was opened up to commercial banks again.

The crisis the U.S. now faces and the demise of the independent investment banks have prompted some to conclude that the business model for investment banks is no longer viable. This may well be the case. But this obviously does not mean an end to the important function that investment banking performs in the marketplace.

In capital markets, where money and information flow together, investment banks have proven their value in leveraging their unique knowledge base and know-how to sharply reduce information asymmetry in the marketplace. This is still relevant and necessary for efficient operation of the capital markets.

The investment bank crisis in the U.S. has prompted a call for an end to efforts to promote investment banking through deregulation here at home. As you know, investment banking in Korea is in its infancy. And encouraging its growth will be necessary to the growth of the high-value-added financial service industry we would like to see. We will do so with effective risk management and regulatory oversight.

Because of the ongoing market distress, some question the need for deregulation of the financial sector. I think it's important to remember that financial sector deregulation is aimed at fostering a globally competitive financial industry, and more broadly Korea's long-term global competitiveness. So I believe we must stay on track and move forward as planned. We will certainly do our part and take all the necessary follow-up and fine-tuning steps to make sure that our deregulation produces the results that we all desire.

Financial Market Supervision

Let me also say a few words about the Financial Investment Services and Capital Market Act. The new Act, which takes effect in February next year, will prove a major boost to the financial services industry in this regard.

The investment bank crisis has also prompted some to challenge the need for the new law. Let me make it clear that the new law provides the essential legal and regulatory frameworks that the financial sector needs for future competitiveness and growth. So it should proceed and take effect as planned.

Macroprudential supervision

The distress in the global financial markets also reinforces the need for strong macroprudential supervision to keep the financial system safe and sound. So we are paying close attention to our early warning systems for potential liquidity risk as well as systemic risks and stepping up our market monitoring.

I can also tell you that we set our priority on maintaining market stability well before problems in the credit markets emerged. In the wake of troubles at Lehman Brothers and AIG, we acted swiftly in concert with the Financial Services Commission to contain the fallout in domestic markets and avoid disruption.

Risk management

Let me quickly add a few words about risk management. We are seeing a noticeable increase in OTC derivatives activities. Because these off-balance sheet activities tend to be highly leveraged, we see a need to get a firm grip on the magnitude of these activities and the potential downside.

Going forward, we intend to strongly encourage financial institutions to boost their internal controls and risk management.

Closing Remark

In closing, let me share with you an old Chinese proverb that points out the foolishness of the bird that fears a tree branch just because it was once struck by an arrow. So it may be said that forsaking deregulation at the first sight of regulatory lapses and distressed assets is not the wise course to take.

Let me reiterate that strengthening our competitiveness through deregulation is a challenge for all of us. Deregulation is a fundamentally sound policy for our markets, a step in the right direction, and the key to the success of our markets.

Thank you.