The 10th Seoul International Financial Forum

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WELCOME REMARK:

Financial Supervision amid a Global Financial Crisis

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Distinguished guests, and
Ladies and gentlemen,

I am pleased to be with you this morning for the Tenth Seoul International Financial Forum. I would first like to thank Mr. Jeon Jae-Ho, President and CEO of the Financial News, for organizing such an important forum and inviting me to speak.

Let me also take a moment to thank Leo Melamed, Chairman Emeritus of the CME Group, William Lang, Senior Vice President of the Federal Reserve Bank of Philadelphia, and other distinguished speakers and panelists who have joined us from afar to take part in the Seoul Forum.

Ladies and gentlemen,

The global economy is experiencing a sharp contraction in the midst of one of the most serious financial crises in modern times. As we step up to deal with the crisis, it is becoming clear that the crisis is a watershed for global finance and economy. It also challenges us to come up with new, forward-looking market rules and systems that will better enable us to prevent future crisis without harming economic growth.

So the theme for this year's forum, New Market Directions after Global Financial Crisis, is more relevant than ever as we ponder a new market paradigm for the future. And I certainly look forward to hearing your insights and wisdom in charting a new course for the markets.

This morning, I would like to share with you a few thoughts on the global financial crisis. There is now a clear recognition that the failure to manage systemic risks in the financial system was at the root of the financial crisis.

Blinded by short-term motives, financial institutions failed to take care of risks stemming from highly leveraged activities. Incentive structures that favored short-term decisions and the failure of internal controls to keep them in check certainly played a role as well.

For regulators, the failure was not having the prudence to preempt the build-up of systemic risks in the financial markets. This is in part due to the failure to deal with structural instability created by years of financial globalization and innovation in a timely fashion. In particular, the bank-centered regulatory frameworks most regulators have relied on have proven inadequate in containing risks created by capital market innovations and expansion.

In a nutshell, I see two important lessons to draw from the crisis. One is that regulators cannot rely on market discipline alone to deal with systemic risks and therefore must provide preemptive systemic oversight at all times. Another is that the financial crisis is truly global in scale and in impact and therefore requires concerted global response.

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The London G-20 Communiqué proposes a number of important steps to restore confidence in the financial system. The overall message from the G-20 countries, which account for 85% of the global output, is a forceful and a hopeful one.

There are also several noteworthy agreements that should be of great interest to all of us. Going forward, the G-20 countries pledged to take steps to improve the consistency and the transparency of financial regulation and supervision. New measures aimed at mitigating procyclicality in the financial system were also pledged. In addition, regulation is to be extended to systemically important financial institutions and markets. More global approaches to the oversight of hedge funds, credit-rating providers, and tax havens have also been pledged. So what's left now for policymakers and regulators is to deliver on the commitments made at the G-20 meeting—both individually and collectively.

As for Korea's part in this endeavor, let me note that Korea is set to gain membership in the Basel Committee and the Financial Stability Board. The membership means Korea will no longer be a passive rule-taker but an active member of rule-setters with expanded role and responsibility in formulating international standards. As the Chair of G-20 in 2010, Korea assumes an important leadership role in the implementation of regulatory reform and other key G-20 agenda. So we are very much looking forward to doing our part—utilizing our crisis management and market supervision experiences—to help establish sound global regulation and supervision.

As we look ahead, beyond the financial crisis, I believe the massive amount of credit injected—and yet to be injected—into the global financial system in response to the crisis warrants our attention. That is, as the global economy resumes growth and the financial system restores stability, we may well face a host of new problems stemming from excess liquidity and other potential risk factors. So we will need to be prudent and forward-looking in our policy approaches to minimize future risks.

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Let me also say a few words about Korea's financial supervision.

Korea adopted integrated financial supervision a decade ago that has proven effective in protecting the stability of the financial system, particularly with respect to sound banking practices. Korean banks' tangible common equity—a conservative measure of capital—averaged about 6.2% at the end of 2008, compared with around 2% for some banks in the developed countries. Non-performing loans stand at less than 1% (at 0.85%), and loan-to-value ratio of mortgage loans at below 50% (at 47%).

In the wake of the financial crisis, some wonder whether tougher regulation, rather than deregulation, is the right course to take for Korea. But the reality is that Korea's financial sector as a whole is not yet where it should be in terms of global competitiveness. So the case for creating a globally competitive, high-value-generating financial industry through deregulation is as compelling as ever.

The Financial Investment Services and Capital Markets Act—a major financial market reform legislation that took effect early this year—is a case in point. It is a culmination of years of collaboration with the financial industry and a major step forward that significantly improves market environment. And as we fine-tune the rules and regulations to address lingering industry concerns, we intend to revamp our oversight of the derivatives market to better protect investors and reinforce financial firm soundness.

Let me finally add that we intend to closely examine what the implications of the financial crisis are for Korea's financial regulation and supervision. It will be an earnest institutional and systemic introspection, something akin to the Turner Review that the U.K. FSA recently issued. It will also be a fresh, candid, and thorough look at what our weaknesses are, what we are doing wrong, and, more importantly, what the future blueprint for our financial supervision and regulation should be.

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In closing, I am sure I speak for everyone here today when I say that we will overcome the crisis. The question isn't "when" but "how," and today's forum can help us clarify answers to the "how" question.

Let me once again stress that a failure to manage risk was at the root of the financial crisis we now face. It teaches us that there is a heavy price to be paid when we are not faithful to the fundamental rules and expectations governing our market activities.

There is much to be said and heard at today's forum. It is a part of the larger debate about how we should re-shape the financial system for the future. We are all stakeholders in it. So it matters to all of us, and I look forward to many great discussions from you.

Thank you.