금융감독원 FINANCIAL SUPERVISORY SERVICE

FSS Governor Zhin Woong-Seob's ECCK Speech

The following is the text of the speech that Governor Zhin Woong-Seob delivered to a meeting of members of the European Chamber of Commerce in Seoul on April 6, 2017.

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Ladies and gentlemen, it's great to be here with you today.

I want to begin with my thanks to the ECCK for inviting me to speak to such a special audience today. As you know, this year marks the 60th anniversary of the Treaty of Rome that paved the way for the creation of the European Union.

In Korea, the 60th birthday is such a major milestone in one's life and a day of joy that it has its own name—we call it "hwan-gab" in Korean. So, on behalf of the Financial Supervisory Service, I wish to join you in celebrating the EU and the work of ECCK in representing the European business community in Korea.

You know, it was some 350 years ago that a Dutch merchant named Hendrick Hamel first introduced Korea to Europeans in his book entitled, "The Journal of Hamel." After that, it took some time for relations between Europe and Korea to take shape.

Korea started to establish diplomatic relations with European countries beginning with the U.K. and Germany in 1883. This was followed by diplomatic relations with Italy in 1884 and with France in 1886. Although relations paused under the Japanese rule, they resumed after Korea achieved independence.

Since then, relations have matured, and Europe is now one of Korea's most important trade and investment partners. Along the way, the ECCK has taken on the critical role of promoting economic ties and cooperation between Europe and Korea. So I hope the ECCK will continue to play the positive role it has always played in promoting trade and investment between Europe and Korea.

For my time today, I would like to take stock of changes taking place on the market and economic fronts here at home and abroad. I will then go through some of the key supervision policy initiatives we are undertaking and wrap up with some suggestions for you.

Ladies and gentlemen,

The global economy faces uncertainty stemming from three key factors: slow growth, the 4th Industrial Revolution, and trade protectionism.

Let me go through each and share some thoughts with you.

The first is slow growth; that is, the global economy is trapped in low growth. For nearly ten years since the 2008 global financial crisis, the growth of the advanced and the emerging economies has slowed significantly. In fact, according to the IMF World Economic Outlook for 2017, the global economic growth rate reached 3.1% in 2016, much smaller than 5.4% in 2010. For Korea, growth rate fell from 6.5% in 2010 to 2.7% in 2016.

Many countries have tried unconventional stimulus measures such as quantitative easing and historically low interest rates—zero or even negative interest rates—to spark growth. So far, however, it looks as though the strong, sustained growth we have seen in the past is not going to return any time soon. Instead, what we are seeing is non-performing loans growing in the banking sector in the face of falling growth.

We also see financial firms' profitability diminishing as a result of falling interest rates. And on the European front, there were concerns that troubles at several European banks might spill over to others. In emerging markets, worries mounted that capital flow would be reversed when the U.S. and other central banks start to raise interest rates in a bid to return to a more normal interest rate regime.

The second cause for uncertainty is the advent of the 4th Industrial Revolution with promises of global transformation to be driven by the convergence of "intelligent" digital, physical, and biological technologies.

Many speculate that the 4th Industrial Revolution will trigger unprecedented changes throughout human endeavors, the kinds of changes whose impact is simply too difficult to predict. Financial services will most certainly not be spared from the wave unleashed by this revolution. In fact, we already see fintech—or financial technology—fast replacing traditional delivery and consumption of financial services.

Obviously, countries and companies around the world will need to cope with and respond to all the changes that the 4th Industrial Revolution will bring. For businesses, these changes may be leveraged as potential growth drivers to escape the low-growth trap. If this happens, new services and industries will surely emerge, and our economies will grow again.

It is also not too far-fetched to imagine artificial intelligence and robots threatening traditional jobs and industries and in the process creating new classes of winners and losers. Other unexpected risks may emerge as well.

For instance, in the financial sector alone, there are forecasts of banking jobs in the U.S. and Europe decreasing by 30% or more within the next 10 years. In addition, as financial services and systems become ever-more complex, operational risk will likely increase. And more financial firms will likely be exposed to cyber risks such as data and security breach.

So there is a case to be made that we must work to encourage what some describe as “responsible innovation.”

The third point I want to make relates to the prospect of trade protectionism. As you know, pressure has been building on global trade with the U.S. signaling more domestic-driven approach to trade with other countries. Many are alarmed by what this might mean for the global free trade regime.

According to the WTO, trade-restrictive measures imposed by the G20 member countries already reached the highest level since 2009. And, as you know, the failure of G20 finance ministers and central bank governors to include an anti-protectionism pledge in their joint statement in March was widely reported as well.

It is really not that surprising that, in times of prolonged sluggish growth, voices calling for more populist and nationalist trade policies get loud. But I need not tell you that, if protectionism starts to take hold and spread, markets and economies will surely suffer the consequences. As trade and other cross-border relations deteriorate, it will become even more difficult to escape the low-growth trap.

Next, let me make some observations about the “headwinds” that the Korean economy currently faces. I think we should first note the Korean economy’s high degree of openness to the global economy and its sensitivity to external forces.

As an example, trade accounts for close to 85% of Korea’s GDP. The same figures for China and Japan are 41% and 37%, respectively, which clearly demonstrate Korea’s vulnerability to global economic conditions and forces.

As you all know, Korea also has to contend with the ever-present geopolitical risks from the North and competition between the U.S. and China for influence in Asia. More recently, the state of political affairs here at home has become less certain following the impeachment of the president and earlier-than-scheduled presidential election next month.

Household debt continues to grow as well.

But, ladies and gentlemen, you also know that what I just described is only part of a much larger picture of Korea. Let me tell you why. To start with, Korea’s foreign exchange reserves, which stood at about 374 billion U.S. dollars at the end of February, are the 8th largest in the world. And Korea’s current account surplus has continued for 62 months since February 2012.

By recovering quickly from two major financial crises, the economy has amply demonstrated its resilience. And this gives us the confidence that any likely external shock to our economy will have only a limited, short-lived effect at best.

With respect to household debt, we have been working to improve the structural soundness of household debt and have been taking other proactive measures for a gradual reduction or a soft landing.

The broadly positive outlook and confidence on Korea can also be seen in financial markets. In the stock market, robust investor confidence has been driving the KOSPI higher. And the Korean won has been faring well against the major currencies in the foreign exchange market. It is also noteworthy that stocks held by foreign investors reached more than 500 trillion won for the first time in February.

At the FSS, we are implementing proactive supervision against wide-ranging contingencies. As part of this, we have set "financial market stability" as our first supervision objective for this year and are working to identify and prevent potential problems. We are also looking to conduct capital adequacy stress tests across the financial sector and help financial institutions raise their capital soundness.

In short, I think all of us need to be mindful of the risk of falling into an "uncertainty trap," in which consumers and investors continue to cling to negative sentiment and outlook well after the economy improves.

So I would urge you to put your confidence in our economy and move forward together with us.

Let me now turn to financial supervision, specifically how we intend to help the financial industry move to the next level and make the financial sector more relevant for the real economy.

First, we are going to continue to push for strong regulatory reform. One example I would like to give on this is our plans for a negative-list system. Our current oversight structure can be aptly described as a rule-based positive-list system. One key advantage of this system is that it makes rules and regulations predictable.

But it also tends to hold back the creative and dynamic powers of the market and set high entry barriers for new competitors. At the same time, it encourages financial firms to become complacent and resistant to change, diminishing their ability to allocate capital to productive real economic activities.

For these reasons, we are now setting our sights on negative-list system as one of our top regulatory reform agenda. As part of this, we are taking steps to improve or repeal ineffective regulations so that financial firms are given the discretion and flexibility they need to run their business as they see fit. Financial firms will of course have to be held accountable for what they do.

Our regulatory paradigm is also shifting from ex ante to ex post supervision. For example, we had rules limiting financial firms' ability to outsource data processing. This was intended to protect consumer privacy rights and prevent any potential for conflict of business interest. The rules have now been repealed, and such outsourcing is now permitted to an off-shore IT service provider. In addition, employees of small-scale foreign financial firms operating in Korea can now concurrently hold different positions in a subsidiary for back-office operations. These are all positive developments. And what we often hear is that these changes have brought cost savings and efficiency gains for foreign financial firms.

We are not stopping here. In addition to the transition to a negative-list system, we are looking to establish a set of core supervision principles that will be applied across the board. In a way, what we are doing is to pave the way for a new wave of dynamism in the marketplace and to eliminate uncertainty in our financial regulation and supervision.

We are also looking to promote fintech and other new growth industries to help the financial industry advance to the next level. It is said that the 4th Industrial Revolution has the potential to jump-start sluggish economies around the world. One thinking behind this is that a growing supply of venture capital into new growth industries will inject fresh dynamism in the financial markets and revitalize the financial industry. So we set up Fintech Support Center to provide policy support for fintech service companies.

We also introduced crowdfunding with a particular emphasis on helping promising start-up companies. And we recently formed a new growth committee to perform the role of “control tower” for emerging growth industries. The Internet bank that started operations on Monday this week—the first of its kind in Korea—is another example of exciting developments taking place in our markets.
To help promising start-ups get a chance to compete and succeed, we also put into effect what we call “Tesla Conditions” that make loss-making companies eligible for KOSDAQ IPO if they can satisfy certain growth conditions.

However, despite the positive developments and advances to date, Korea’s fintech industry is widely seen as falling behind the world’s fintech leaders. Most likely, this has something to do with the limitations of existing regulations in fostering innovations in financial services. So we are looking at the “regulatory sandbox” that the U.K.’s Financial Conduct Authority promotes as a benchmark for our own regulatory test bed. What we hope is that this will significantly reduce regulatory burden on financial firms and fintech companies and help unleash wide-ranging innovative fintech services.

We also intend to allocate more supervisory resources to fintech and fine-tune our supervisory approaches to ensure effective and supportive fintech oversight.
For this, I can tell you that we will be setting up a committee under the FSS with outside experts. The committee’s primary function will be to help resolve disputes and frictions arising from new fintech services and promote fintech policy coordination.

Moreover, we expect to create new supervision offices dedicated to fintech services and bring in more fintech specialists. And we do intend to actively engage foreign supervisors and international organizations on fintech services and supervision.

The third is creating a business-friendly environment.

Together with regulatory reform and fintech, we intend to make sure that we never stop the work to create a positive, business-friendly environment for all.
Some of you may know that Korea was ranked 5th in the World Bank’s Doing

Business 2017, which measures regulations affecting 11 areas of the life of a business. Korea has also been ranked first in the Bloomberg Innovation Index for the past 4 consecutive years and topped the list of European Innovation Scoreboard 2016. And for six of the previous seven years, Korea took the top spot in the country ranking of information and communication technology development by the U.N. agency ITU. As I am sure you agree, these rankings reflect Korea's strong commitment to creating a business-friendly environment for all, especially foreign businesses.

To be sure, some foreign businesses continue to find Korea's regulatory landscape not predictable enough or not transparent enough. We understand this. And we are in fact taking actions and implementing reform measures to bring about meaningful improvement to the consistency and transparency of our rules and regulations. And we do emphasize staying engaged and being responsive to the market through FSS Speaks, regular meeting with foreign CEOs, and the FSS Financial Reform Monitoring Team. And I can tell you that what we hear from foreign firms does receive our attention and a fair hearing from us.

Let me also stress that we take the transparency and integrity of financial accounting very seriously. So we are significantly expanding our supervisory resources for accounting and audit inspections and improving the effectiveness of our oversight. And we are adopting tougher and stiffer enforcement actions than ever before against accounting and audit violations.

On a related matter, we see bold and aggressive restructuring of financially distressed companies as critical to the success of our business-friendly environment. This year, we will be closely watching the progress of restructuring of 5 cyclically vulnerable industries including shipping and shipbuilding. We are doing this to ensure we effectively identify and preempt distress in the corporate sector.

Now, if I may, I would like to speak to you about what makes Korea stand out in terms of its global competitiveness.

Let me first say that Korea is an attractive investment destination.

Korea's average sovereign rating is AA (double A), which is similar to France's average rating, and higher than Japan's A+ and China's AA-. Because of the low price-earnings ratio of Korean stocks—about 9.8 compared with 18.6 for U.S. stocks and 20.7 for Indian stocks—Korean share prices represent great buying opportunities for foreign investors. And I would especially underscore this point to ECCK members that may be thinking of investing in Korea.

Second, Korea is not only an attractive investment destination. It also boasts a deep talent pool capable of driving the 4th Industrial Revolution. Korea is one of the few countries in the world that already possesses deep knowledge and technology base that the 4th Industrial Revolution demands. Our technology talent pool is truly world-class and is more than deep enough to meet the demands of the 4th Industrial Revolution. The Korean government is doing its part by announcing plans to foster specialized talent pools for future industries that the 4th Industrial Revolution will create. In short, if you are having difficulty finding the right talent, I say you need not look any further because you will find it here in Korea.

Lastly, I want to say a few words about free trade.

Although the threat of protectionism has loomed large lately, I think free trade will persist and overcome it, especially for Korea. Because Korea's openness to the global economy, many suspect that domestic demand will not be sufficient to reverse the low-growth trend. Korea has signed FTAs with 54 countries beginning with Chile in 2004. And the combined output of these countries makes up some 77% of the world's GDP. Among the world's top ten trading countries, Korea also happens to be the only country that has so far signed FTAs with the United States, China, and the EU.

So, although the prospect of protectionism taking hold in global trade is certainly not welcome, I think you will continue to see Korea on the side of free global trade.

Ladies and gentlemen,

I suspect that many of you are familiar with the so-called "catfish effect." It comes from the real-life observation that, when sardines are caught alive and brought to the port, they survive longer in the presence of catfish that naturally prey on them.

So it may be said then that, if we are caught in a low-growth, protectionist tank, we can break from it and gain new grounds by facing up to the challenges brought about by a watershed change like the 4th Industrial Revolution. In particular, when more European businesses and financial firms come to Korea, they will spark new competition and ultimately make the Korean economy more competitive and better off.

I am sure you have heard of the saying that "A ship in harbor is safe but that is not what ships are built for." Although the waves of uncertainty are likely to get rough, I am sure we can pull through on the strength of the relationships Europe and Korea have built together over the years.

Let me conclude my talk today by reiterating our commitment to the policy of "win-win" for both European and Korean financial firms and businesses. I very much appreciate your time today. I wish everyone at the ECCK great success with all of its endeavors in Korea.

Thank you.

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