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# **The Global Financial Crisis and Lessons Learned**

**- Korea's Key Success Factors -**



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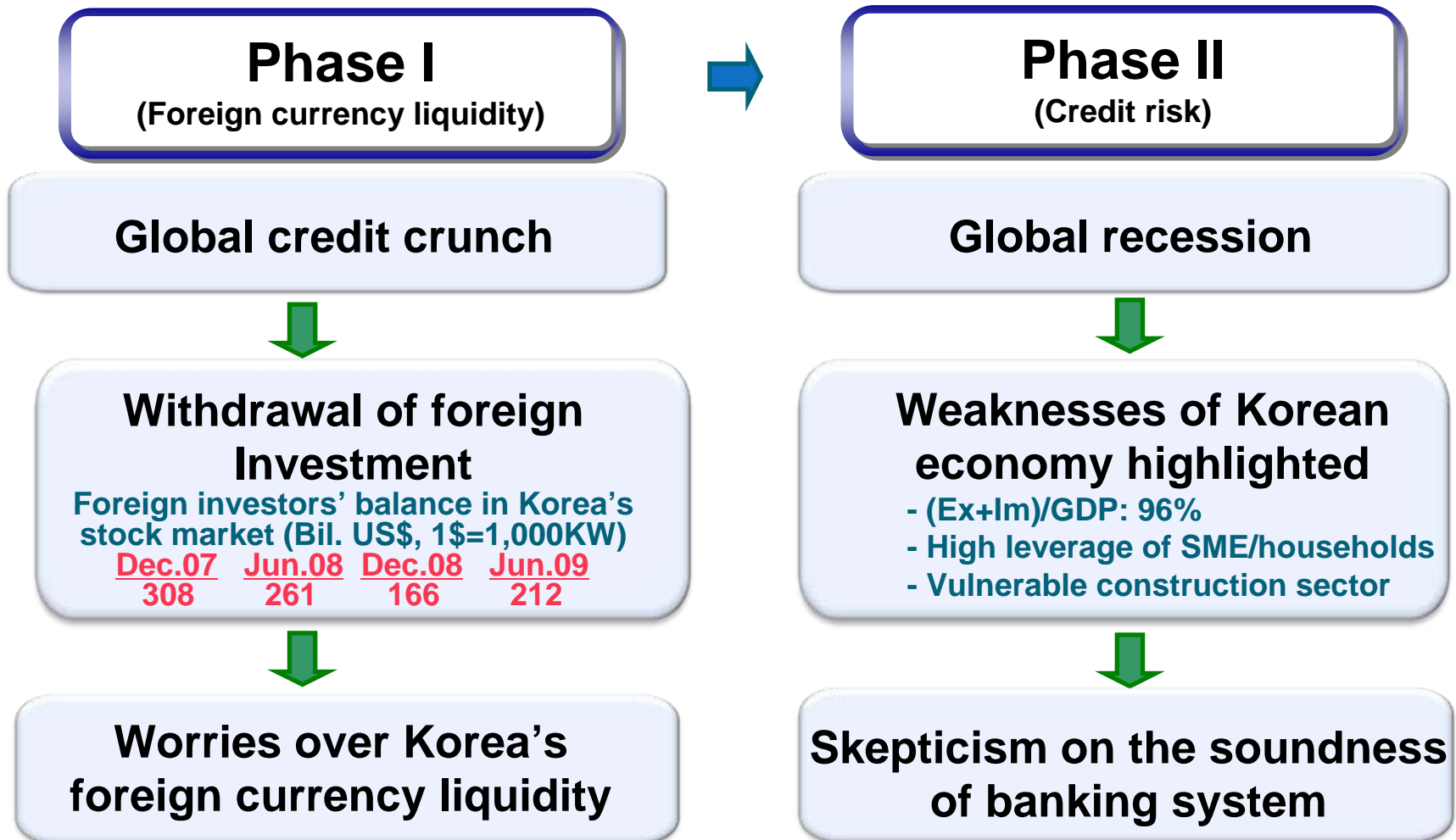


# Part I

## **How Did Korea Cope with the Global Financial Crisis ?**

# 1. What happened to the Korean economy?

## Effect of the global financial crisis on the Korean economy



## 2. Key success factors (1)

### Success factor 1: Strong economic fundamentals

	Asian Financial Crisis 1997 - 1998	Global Financial Crisis 2008 - 2009
<b>Causes</b>	Internal weakness	External factors
<b>Foreign Exchange</b>	Foreign Currency Reserves US\$ 8.9bn ST External Debt / FX Reserves 717% Total External Debt / FX Reserves 1,957%	US\$ 270.0bn <sup>1</sup> 55.6% <sup>1</sup> 148.9% <sup>1</sup>
<b>Banks</b>	Bank NPL Ratio 6.0% BIS Ratio 7.0%	1.24% <sup>1</sup> 14.36% <sup>1</sup>
<b>Companies</b>	Debt Ratio 424.6% Interest Coverage Ratio 115.0%	100.8% <sup>1</sup> 377.7% <sup>1</sup>

<sup>1</sup> as of December 2009

## 2. Key success factors (2)

Success factor 2: Preemptive, comprehensive, and large-scale policy response

Korean government knew what to do at the time of the crisis

### Market situation

### Measures required

**NPL**  
(Banks/Companies) ↑

**NPL disposition**

**Capital**  
(Banks/Companies) ↓

**Re-capitalization**

**Liquidity crunch &  
Market volatility**  
(Partly due to market sentiment  
& herd behavior)

**Liquidity supply &  
dialogue with market**

C  
R  
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S  
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Strong political  
leadership for inter-  
agency cooperation

## 2. Key success factors (2): Summary of Korea's policy response

### Phase I Responses

#### FX Market Stabilization

- Payment guarantee of foreign currency borrowings by domestic banks: \$100 bn
- Currency swap lines with U.S., Japan, and China: \$30 bn each / \$90 bn in total
- \$55 bn foreign liquidity provisions by the BOK and the government



### Phase II Responses

#### Fiscal Stimulus Package

- Won liquidity provision: 23.3 tn won (23.3 bn dollars <sup>1</sup>)
- Total Stimulus package: 3.6% of GDP in 2009

#### Enhancing Bank Soundness

- Launching of Bank Recapitalization Fund (USD 20 bn)
- Purchase of bank impaired assets through Restructuring Fund by KAMCO (USD 40 bn)

#### Corporate Sector Liquidity Provisions

- Extension of SME loans and guarantees due 2009
- Creation of Bond Market Stabilization Fund (USD 10 bn)

#### Corporate Restructuring

- Creditor bank-led restructuring
- Market-based restructuring

#### Social Safety Net

- Financial support through Microcredit (Miso Foundation)
  - Planning to supply 2tn won (USD 2bn) for the next 10 years
- Credit repair for low-income households through debt restructuring and refinancing at lower rates
  - Planning to supply 10tn won(USD 10bn) in the next 5 years through guarantees of small loans

<sup>1</sup> KRW 1000 = USD 1

## 2. Key success factors (2) : Well-organized resolution scheme

### Improve asset soundness of Financial Institutions (FIs)

**Restructuring Fund  
(KAMCO)**

NPL Acquisition

### Preemptive recapitalization measures

**Bank Recapitalization  
Fund**

Recapitalization

**Financial Stabilization  
Fund (KoFC)**  
to be used for all FIs

Recapitalization &  
Equity, Loan, Guarantee

Pre-PCA stage

Post-PCA stage

### Resolution of Insolvent FIs

**Deposit Insurance Fund (KDIC)**  
in cooperation with KAMCO



## 2. Key success factors (2)

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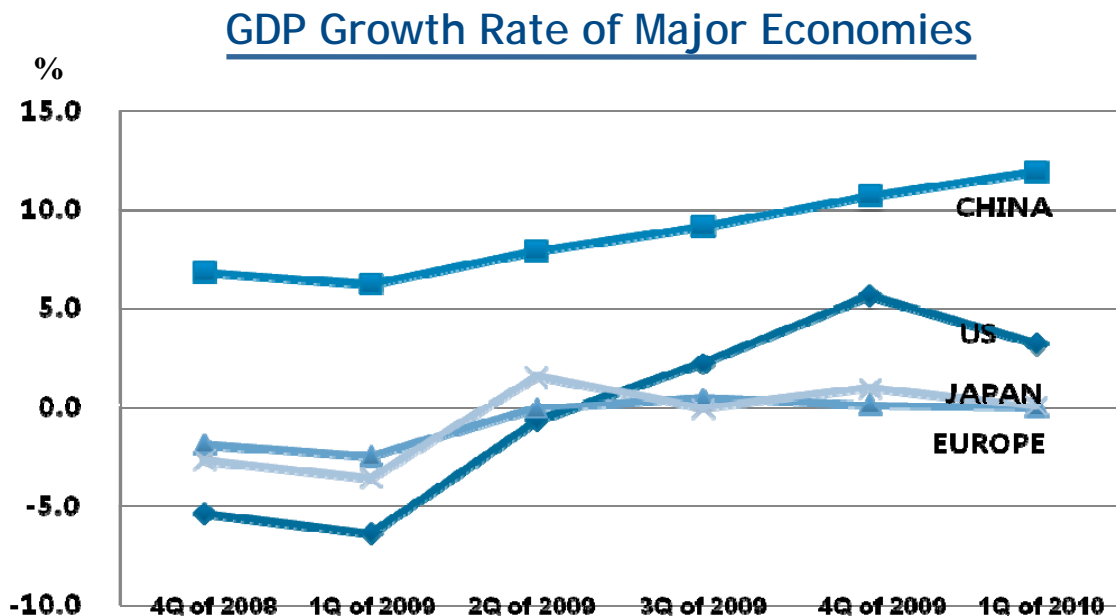
### Institutional arrangements after 1997 Asian crisis

- Regulatory frameworks in line with global standards
  - Forward-looking criteria (FLC)
  - Prompt corrective action (PCA)
  - Mark-to-market
  - Disclosure & transparency
  
- Disposition of NPL
  - Korea Asset Mgt Company (KAMCO) and secondary NPL market

## 2. Key success factors (3)

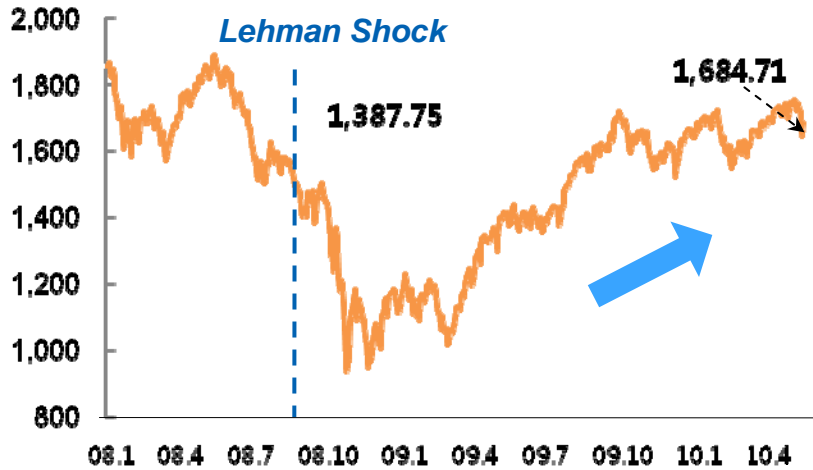
### Success factor 3 : Resilience of the global economy

- Global economy recovering faster than expected
- IMF revising 2010 global economic growth outlook :  
3.1% (Oct.'09) -> 4.2% (Apr.'10)

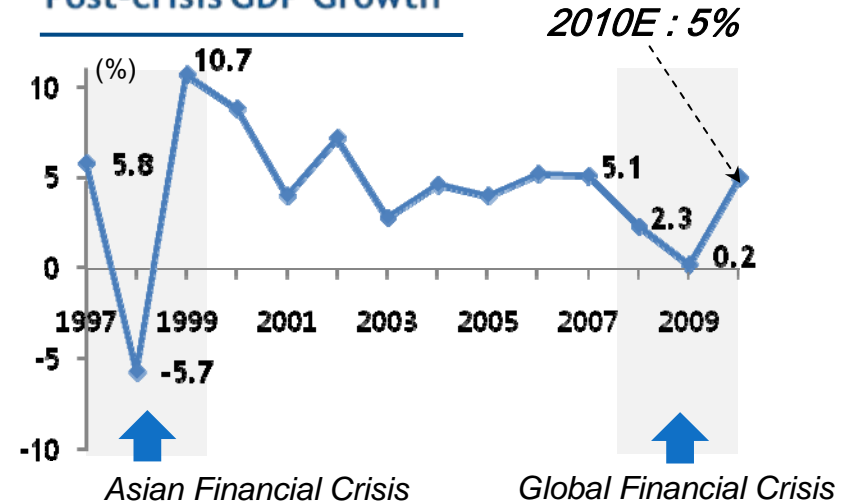


# Resilience of Korean economy

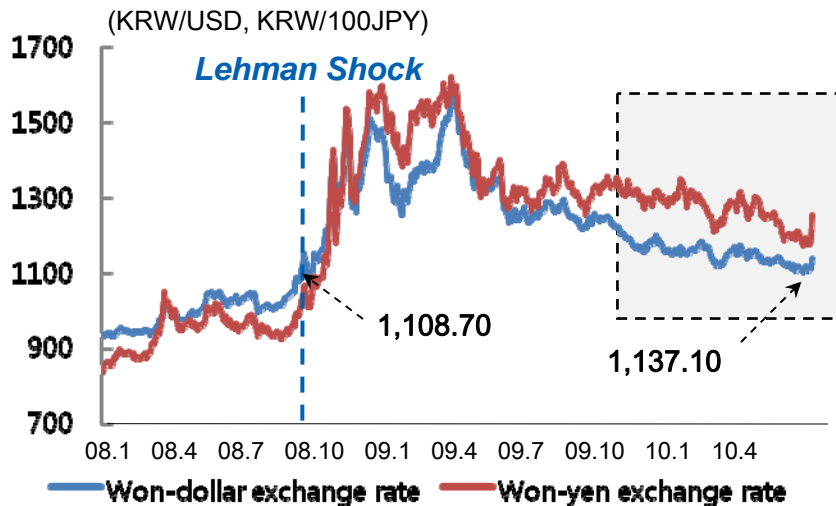
## Stock Index Movement (KOSPI)



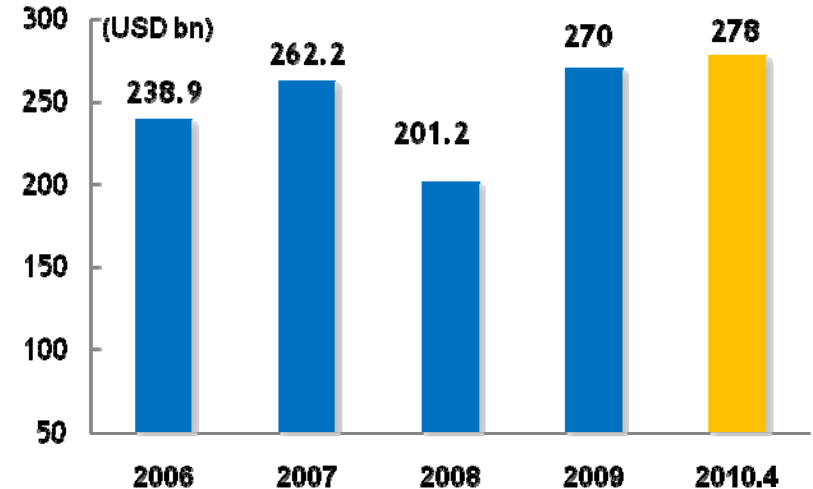
## Post-crisis GDP Growth



## Foreign Exchange Rate



## Foreign Exchange Reserves



# Concluding remarks

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- Given the complexity and interconnectedness of the global economy, crisis may come at anytime & in various forms
- Prudent macro-management such as stable current account balances and strong fiscal condition is critical
- Institutional arrangements such as inter-agency cooperation with strong leadership and preemptive policy actions as demonstrated by Korea can be effective
- At international level, Korea has called for “Global Financial Safety Net” to ease temporary liquidity shortage, particularly for non-reserve currency economies

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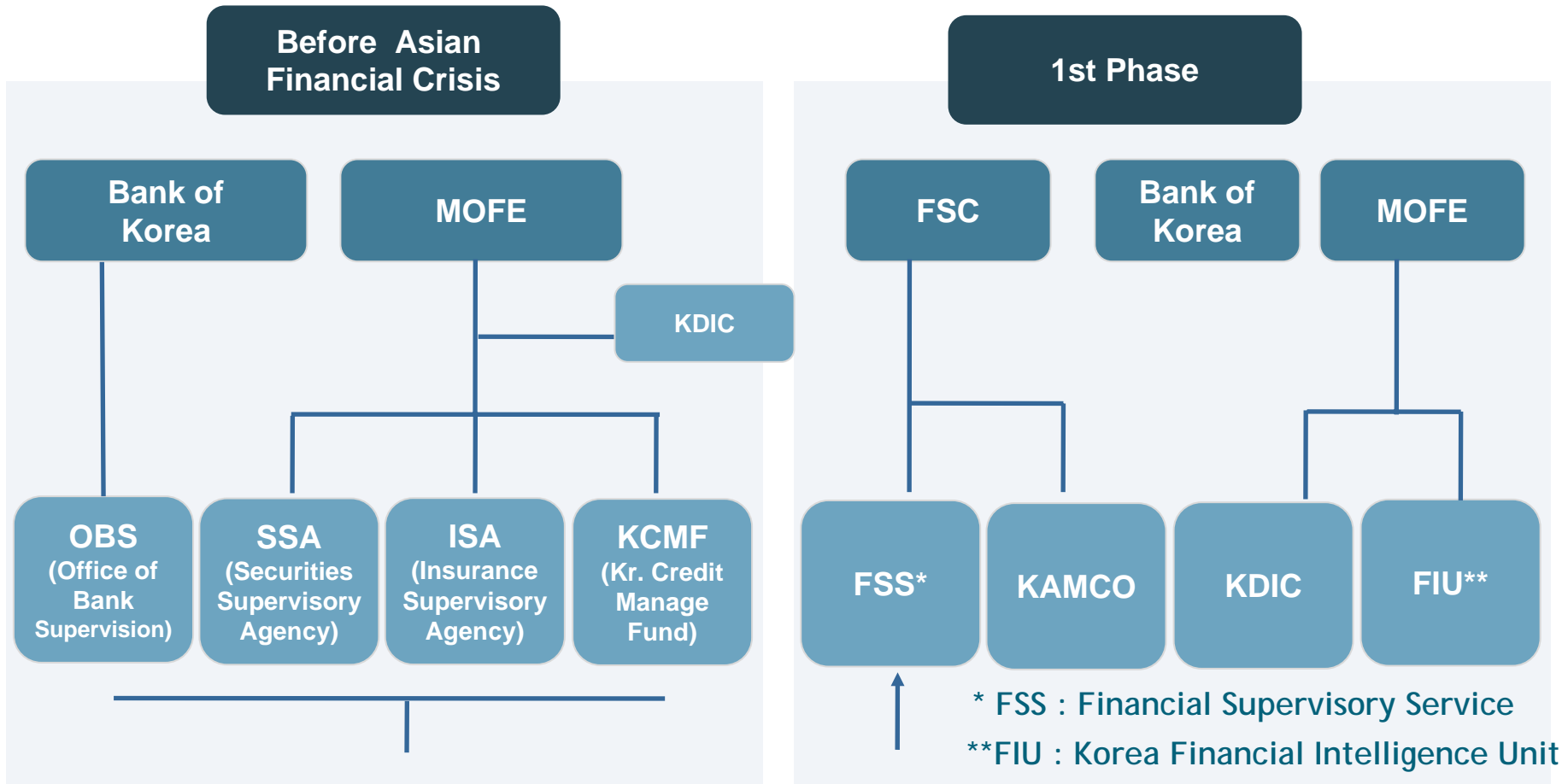


## Part II

# **Korea's Regulatory Reform and Implications on Recent Discussions**

# 1. Korea's regulatory reform

<1<sup>st</sup> Phase 1998.4 ~ 2008.3>



- Consolidated oversight on diversified financial sectors & risk factors
- Coordination & Sharing of best practices vs. Span of control

# 1. Korea's regulatory reform

## Background on regulatory reform of 1998

### The 1997 Asian crisis revealed weakness of fractured supervisory system

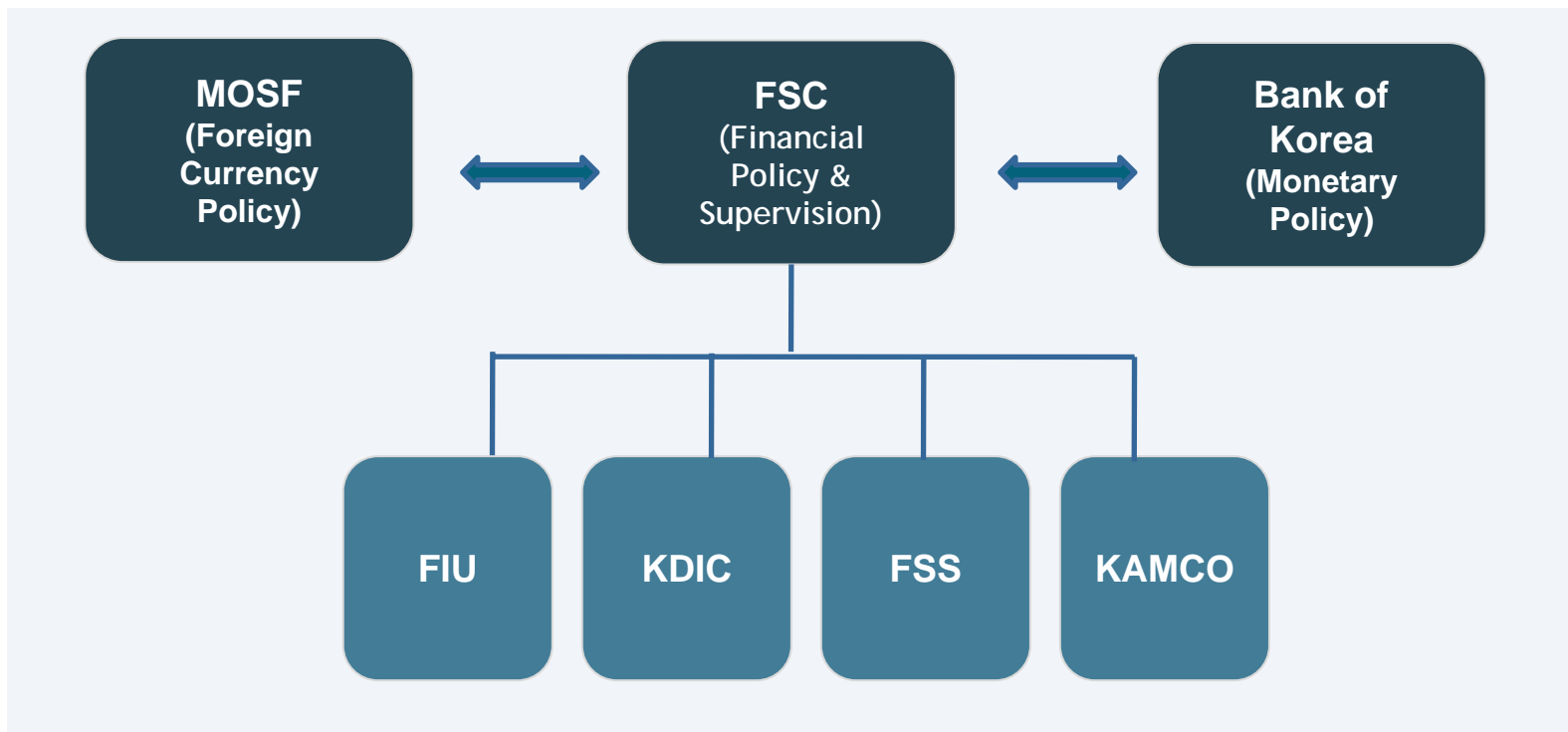
- Information sharing among supervisory authorities (e.g. banking, securities, insurance & nonbanking) was limited
- No single authority oversaw risk comprehensively in the complex and interconnected market
- Regulation was sector-specific, no comprehensive oversight

### Political compromise between Ministry of Finance and Economy (MOFE) and Bank of Korea

- BOK wanted more independence from the government (MOFE)
- The government did not allow an independent BOK having supervisory power
- The result of political compromise between the government & BOK  
=> Greater independence to BOK but bank supervisory power transferred to a consolidated body (FSS: Financial Supervisory Service)

# 1. Korea's regulatory reform

<2<sup>nd</sup> Phase 2008.3 ~ Present>



- FSC & BOK exchange supervisory information on regular basis (MOU)
- Joint inspection (FSS & BOK)
- Coordinating body led by the vice head of MOSF, FSC, FSS and BOK



# 1. Korea's regulatory reform

## Background on the regulatory reform of 2008

### Balance of power & strengthened consolidation

- The new government decided to consolidate the Budget Office with MOFE but was wary of power concentration to MOFE
- The Financial Policy Bureau of MOFE was separated from MOFE and was consolidated with FSC
- The new FSC is the single government entity with financial policy and supervisory policy-making authority
- FSS, specializing in inspection, is a non-government special purpose agency that supports FSC

## 2. Lessons from Korea's experience

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- Countries with integrated supervisor fell victim to global financial crisis => no one-size-fits-all supervision
- Other things being equal, however, integrated supervisor has advantage in collecting market information and executing supervisory actions in more concerted and orderly manner. Macroprudential supervision becomes easier.
- Best practices across sectors could be internally shared, raising overall standards or level of supervision
- Korea's current supervisory system is likely to undergo reform in the next government
  - Separation of international and domestic finance
  - Conflict between FSC (government agency with 160 staff) and FSS (non-government entity with 1,700 staff)

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# Part III

## **G20 and the Role of Korea**

# 1. Why G20 is more effective than G7

## Need for new global governance

- G7 has proven ineffective in resolving major global issues
  - Due to growing influence of EU, relationship between the U.S. and EU has shifted, making it more difficult to reach consensus
  - Growing influence of emerging markets (e.g. BRICs) reduced the role of G7 in global economy

## Better balanced representation of G20

Region	Country
<b>G7</b>	U.S., Japan, England, France, Germany, Canada, Italy
<b>Asia</b>	Korea, China, India, Indonesia, Saudi-Arabia
<b>Latin America</b>	Argentina, Brazil, Mexico
<b>Europe</b>	Russia, Turkey, EU Presidency, Australia
<b>Africa</b>	South Africa

## 2. Korea brings emerging market perspectives

### Example 1 ) Proposal for “Global Financial Safety Net”

**Original Sin**

- Currency mismatch
- Maturity mismatch

**Foreign Currency Reserves**

- Sudden reversal of capital flow
- Volatility in FX market

**Global Financial Safety Net**

- Reduce need for foreign currency reserves
- Increase effective global aggregated demand
- FCL (Flexible Credit Line), MSL (Multi-country Swap Line)

### Example 2 ) Proposal for FX transaction-related accounting standards

- Reduce FX transaction-related gains or losses during FX rate volatility

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Thank You!

**Kim Joo Hyun**  
**Secretary General**  
**Financial Services Commission**  
**KOREA**

# <Appendix 1> G-20 Financial regulatory reform

## G20/FSB Regulatory Reform Agenda

### Prudential Regulation

- Strengthen capital (minimum capital, quality and consistency), leverage and liquidity requirements
- Counter-cyclicality: capital buffer & expected loss model for provisioning

### Systemic Risk

- Identify systemically important financial institutions (SIFIs) and reduce moral hazard posed by SIFIs
- Early Warning Exercise

### Regulatory Scope

- Hedge fund registration
- CCP clearing of OTC derivatives; CRA regulation/supervision

### Risk Mgt & Compensation

- Improved internal risk management system
- Risk-based compensation system, stronger disclosure & monitoring

### Accounting

- Single set of high quality global accounting standards

### Non-Cooperative Jurisdictions

- Measures to deal with tax havens, money laundering & terrorist financing
- Peer review for NCJs

# <Appendix 2> Interconnectedness of major issues

