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# **Policy Responses to Global Financial Crisis and Korea's Experience**

**September 3, 2010**

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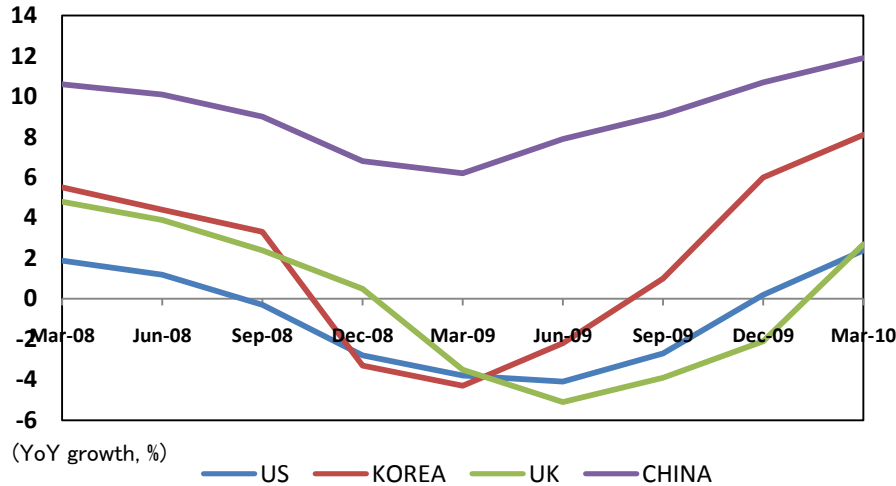


# Part I

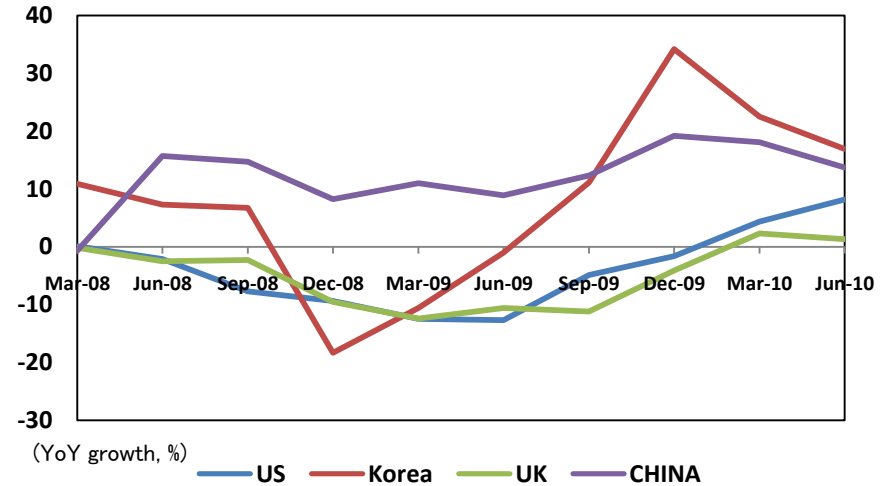
## **Korean Economy and Financial Market**

# Real Economy

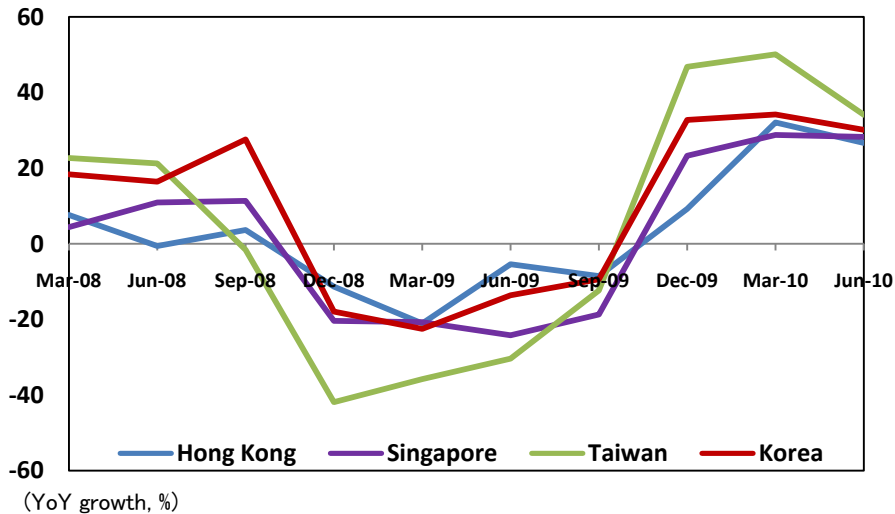
## Real GDP Growth



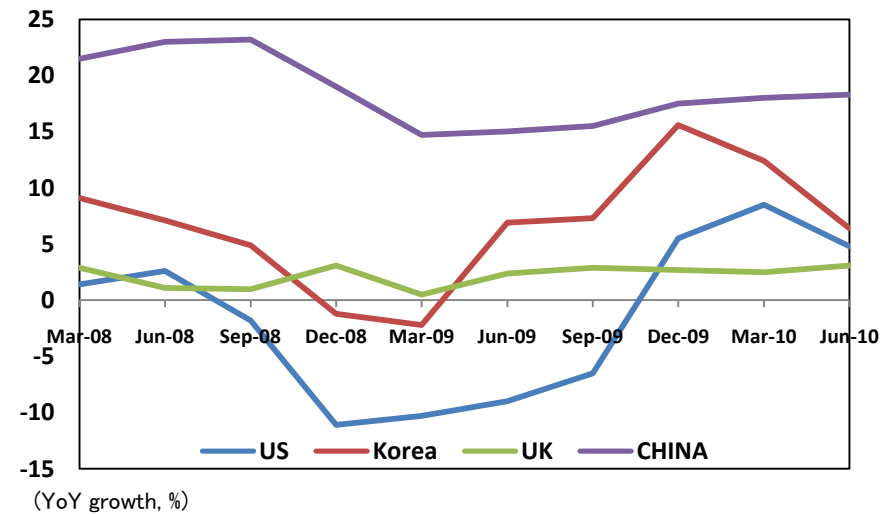
## Industry Outputs



## Exports

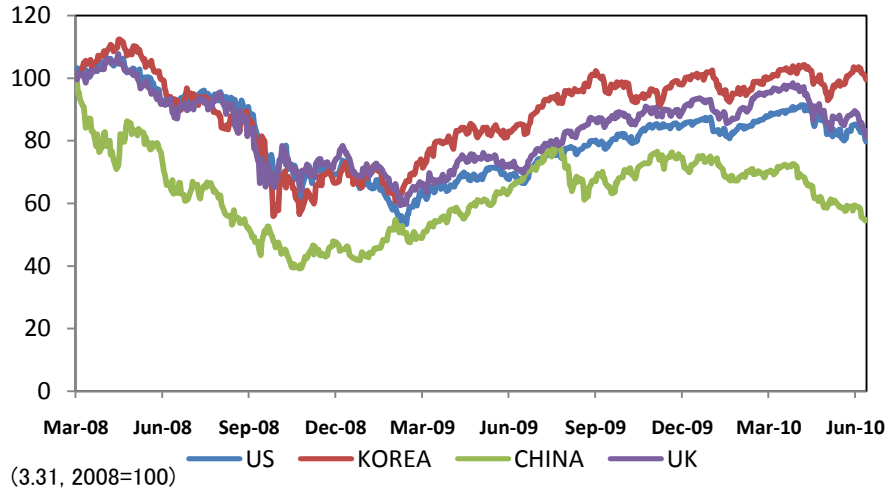


## Retail Sales

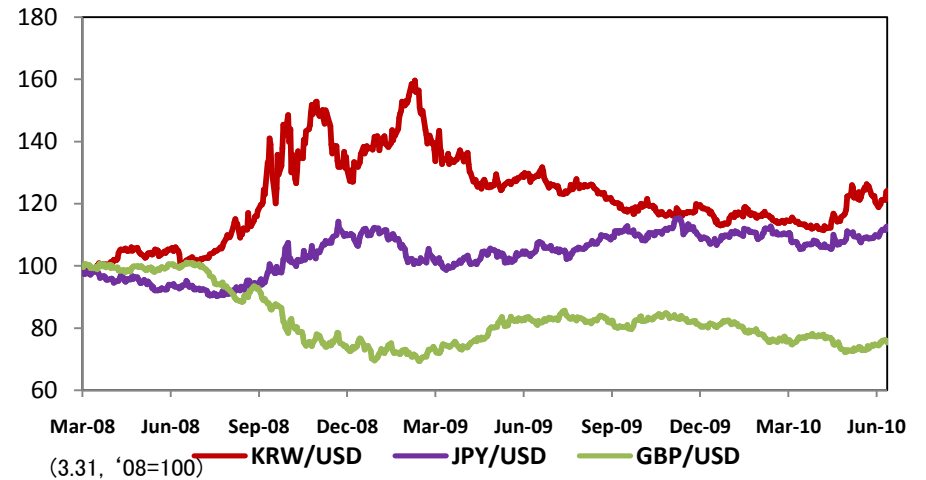


# Financial Market

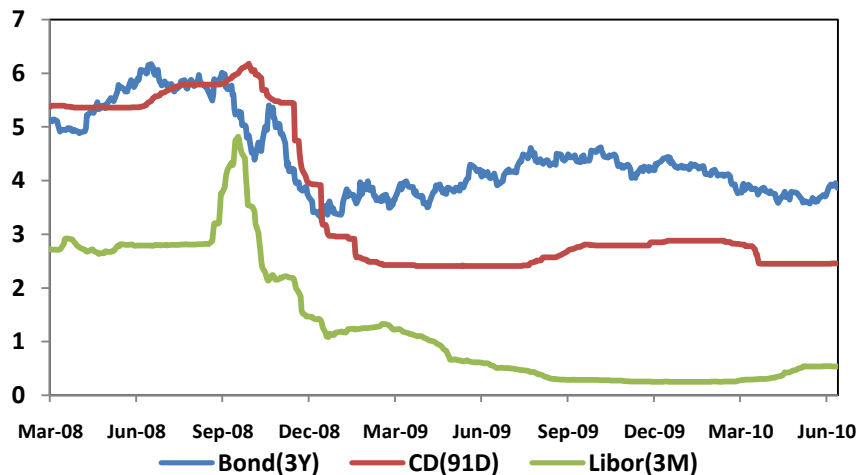
## Stock Price Movements



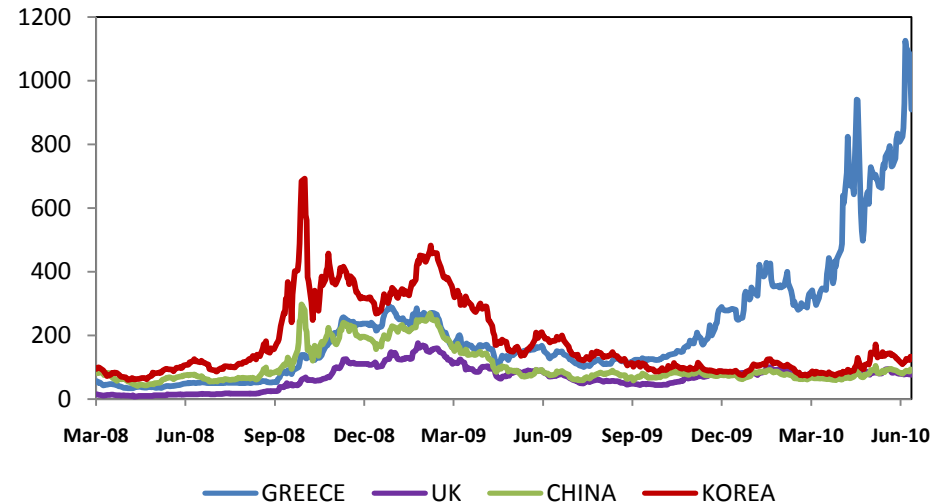
## Exchange Rate Changes



## Money Market Rates



## CDS premium 5 year



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# Part II

## Policy Framework

# I. Economic Fundamentals

Asian Financial Crisis  
in 1997 - 1998

Global Financial Crisis  
in 2008 - 2009

Causes

Foreign  
Exchange

Banks

Corporate

Government

Internal weakness

External factors

Foreign Currency Reserves	US\$ 8.9bn	US\$ 270.0bn <sup>1</sup>
ST External Debt / FX Reserves	717%	55.6% <sup>1</sup>
Total External Debt / FX Reserves	1,957%	148.9% <sup>1</sup>

Bank NPL Ratio	6.0%	1.24% <sup>1</sup>
BIS Ratio	7.0%	14.36% <sup>1</sup>

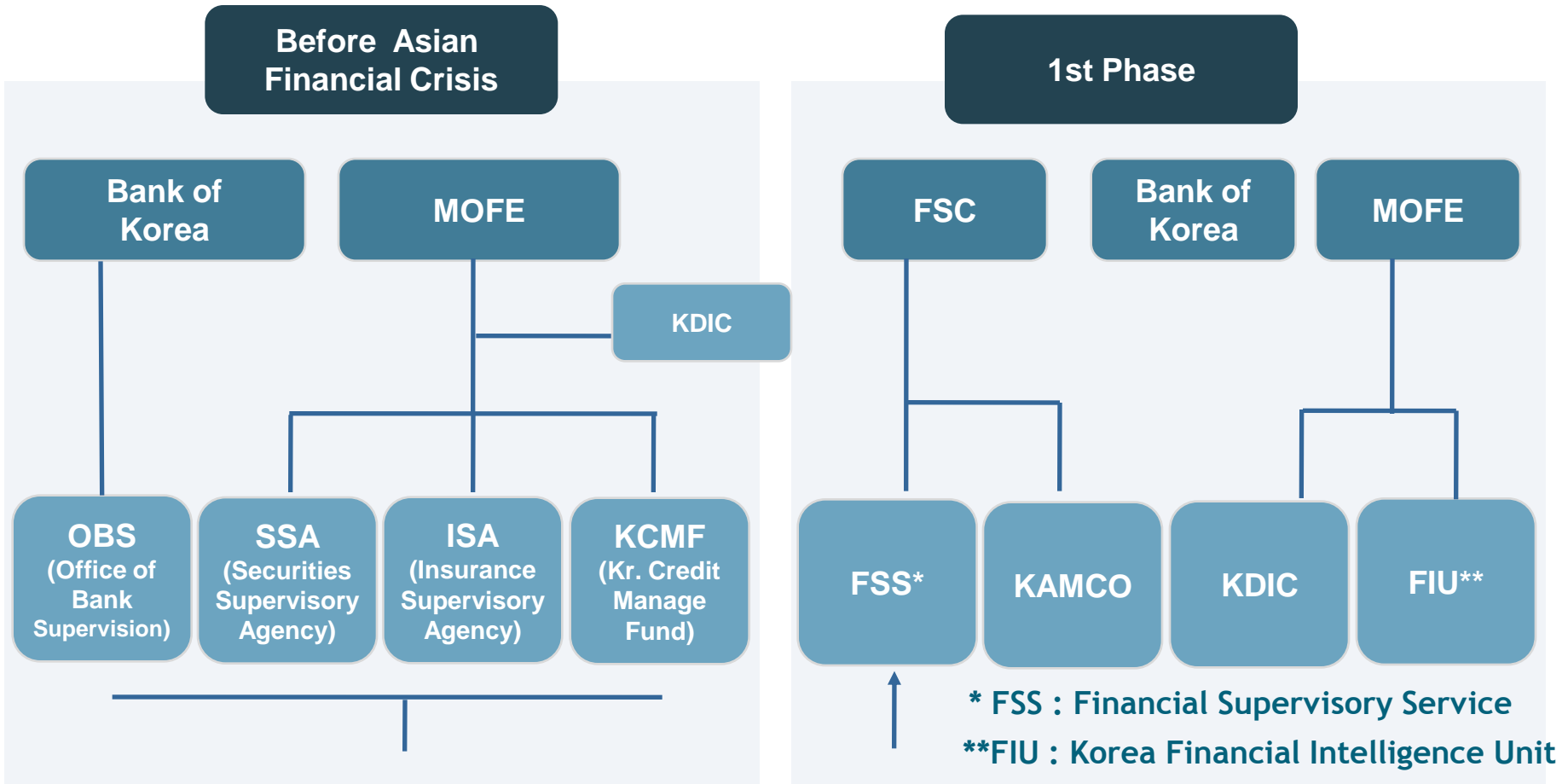
Corporate Debt/Equity Ratio	424.6%	100.8% <sup>1</sup>
Corporate Interest Coverage Ratio	115.0%	377.7% <sup>1</sup>

'09 <sup>1</sup>	USA	UK	JAPAN	GREECE	KOREA
Fiscal Debt/GDP	△ 12.5%	△ 11.6	△ 10.3%	△ 12.7%	△ 2.8%
Public Debt/GDP	83.2%	68.2%	217.5%	1126%	34.9%

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

# II. Regulatory Framework(1)

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

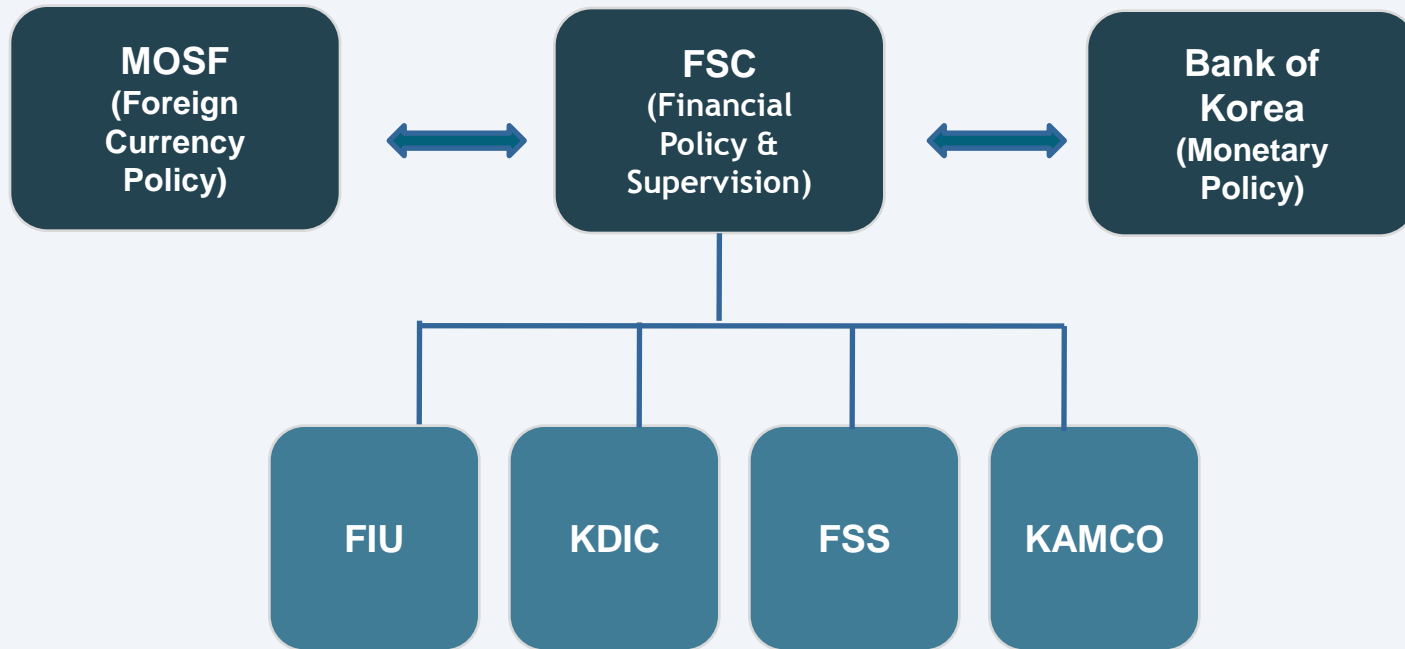


- Consolidated oversight on diversified financial sectors & risk factors
- Coordination & Sharing of best practices vs. Span of control



## II. Regulatory Framework(2)

<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

## II. Regulatory Framework(3)

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### Korea's Lessons on Regulatory Framework

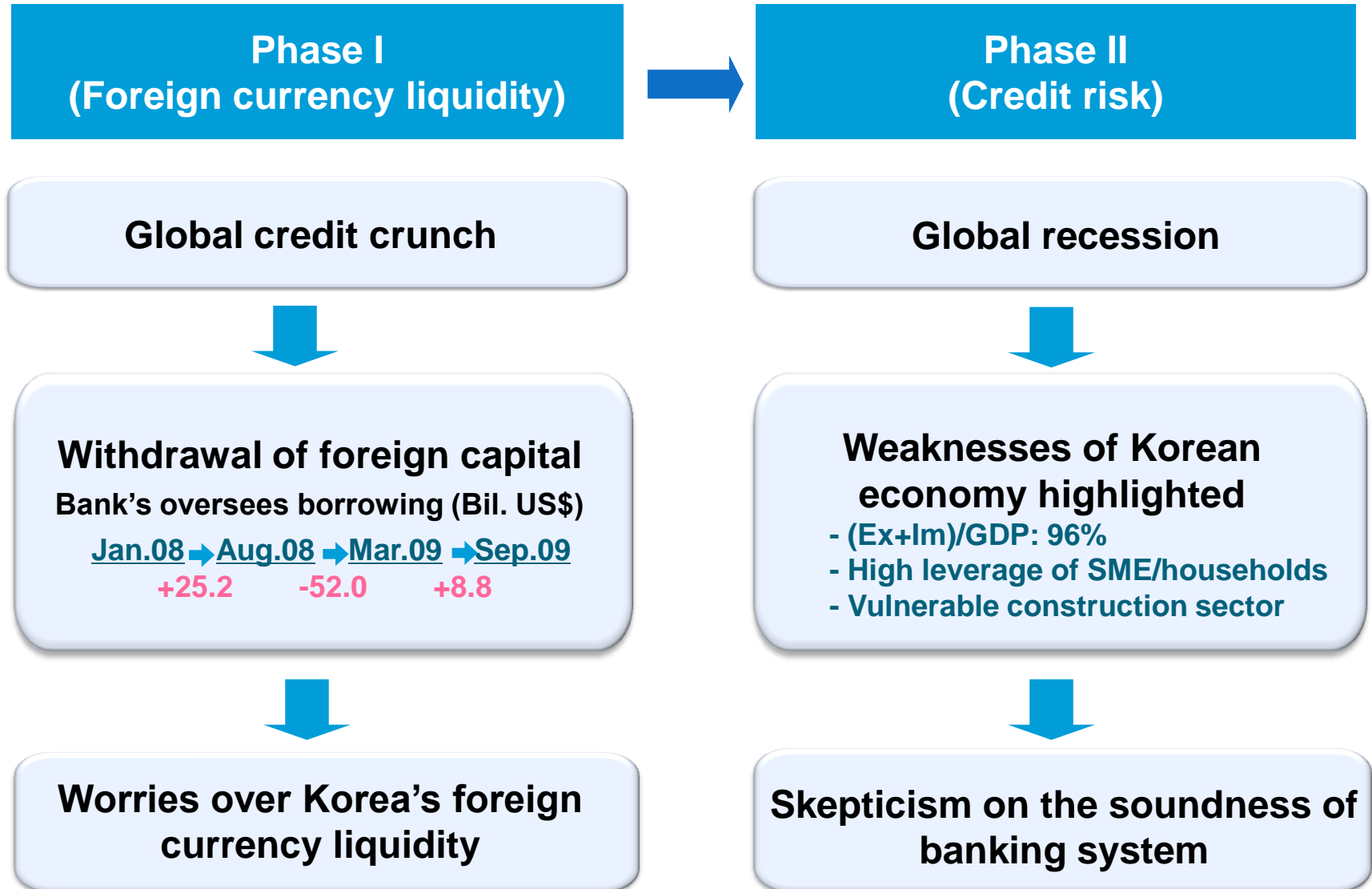
**Coordination & information  
sharing is critical**  
**Integrated supervisor as well  
as others failed**

**Specific regulatory reform is  
more important than  
institutional changes**  
**ex) capital/liquidity, macro-  
prudential regulations**

**No one-size-fits-all regulatory framework**

**➔ Must consider each country's unique circumstances**

# III. Effects of Global Crisis on Korean Economy



# IV. Policy Response

## Phase I

### 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

### 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 (20 tn won)
- Purchase of bank impaired assets through Restructuring Fund by KAMCO (40 tn won)
- Financial Stabilization Fund
- Resolution of insolvent Fis through KDIC

### Corporate Sector Liquidity Provisions

- Extension of SME loans and guarantees / Fast Track Program
- Creation of Bond Market Stabilization Fund (10 tn won)

### Corporate Restructuring

- Creditor bank-led restructuring
- Market-based restructuring

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

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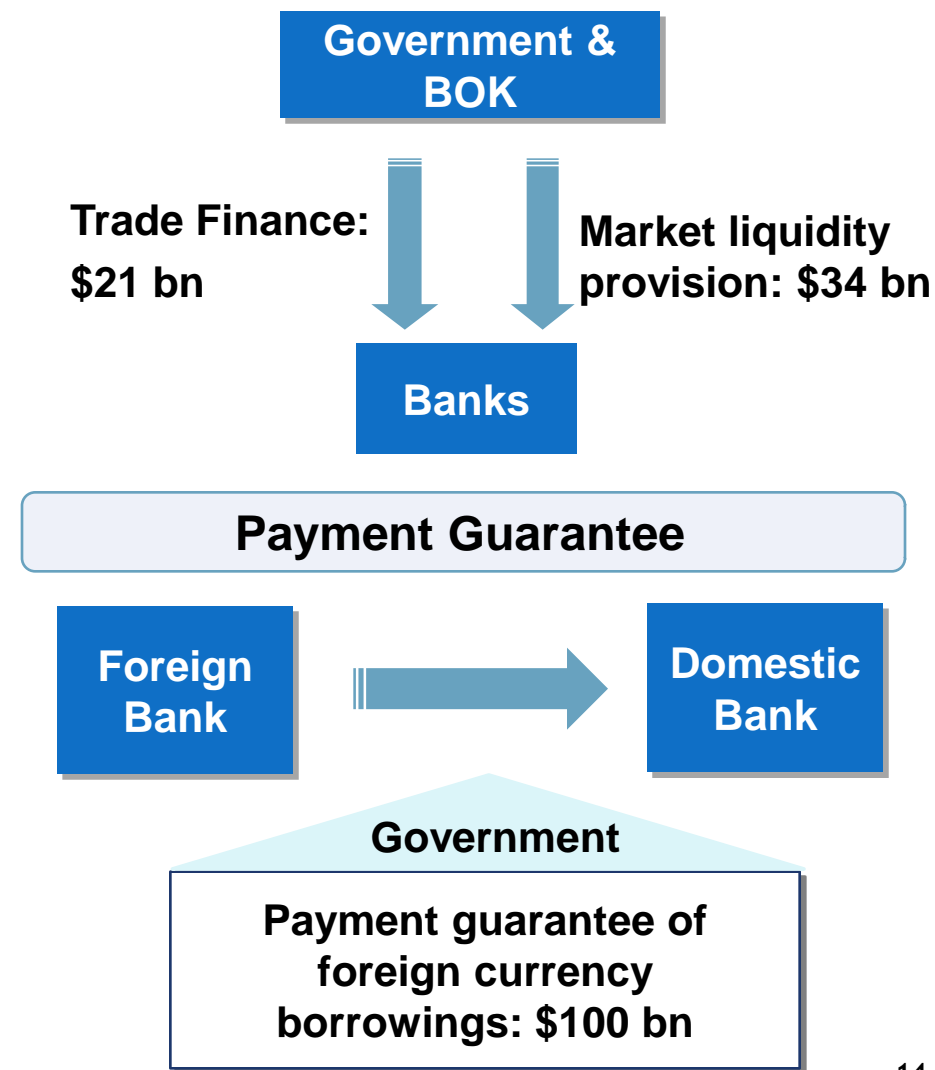
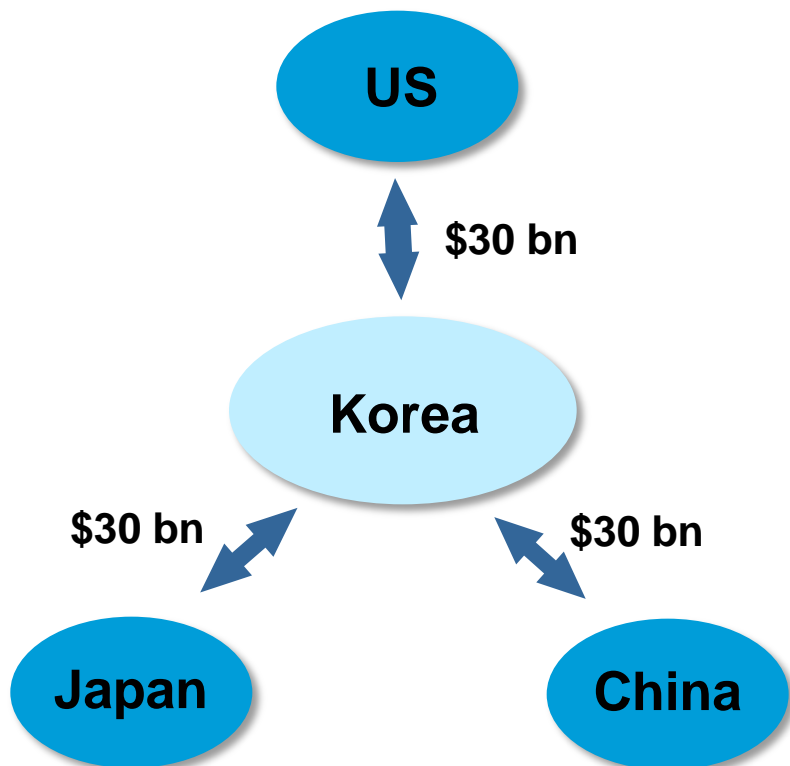
# Part III

## Policy Tools

# Phase I : FX Market Stabilization

Currency Swap Lines : \$90 bn

Foreign Liquidity Provision : \$55 bn



# Phase II : Enhancing Bank's Soundness

**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

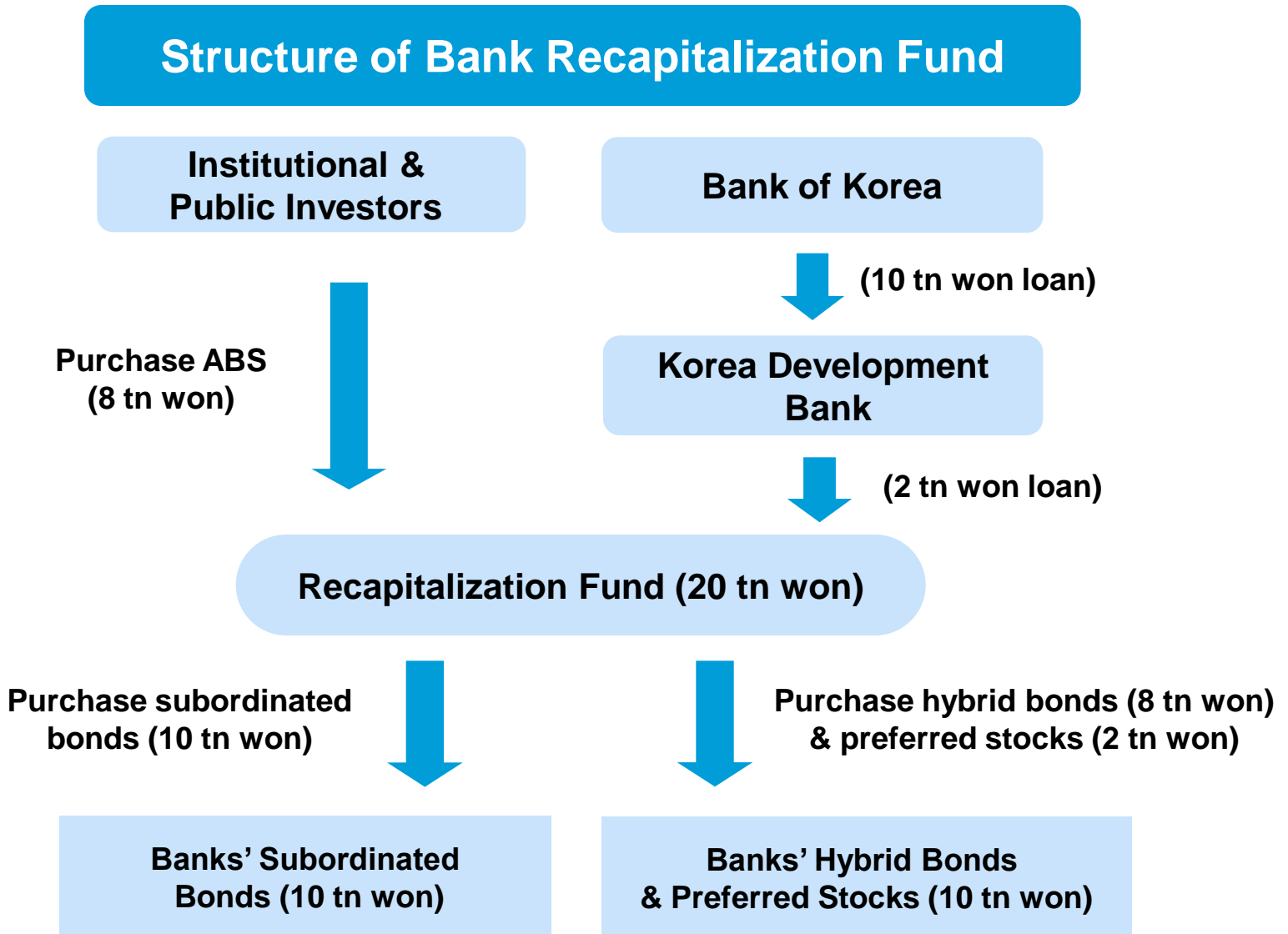
**Pre-PCA stage**

**Post-PCA stage**

**Resolution of Insolvent FIs**

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

# Phase II : Bank Recapitalization Fund



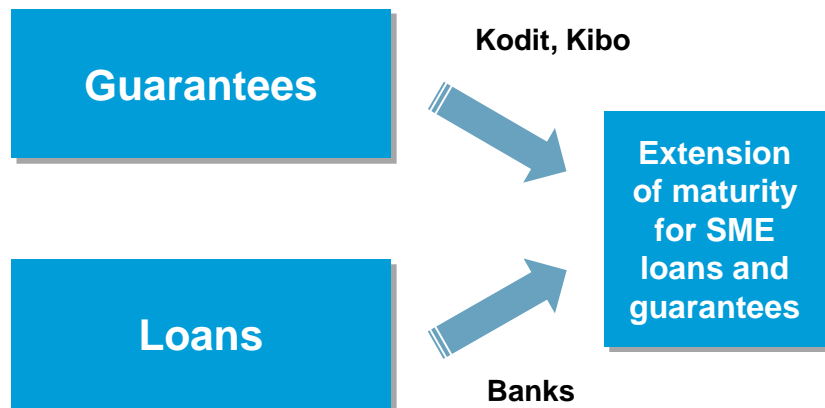
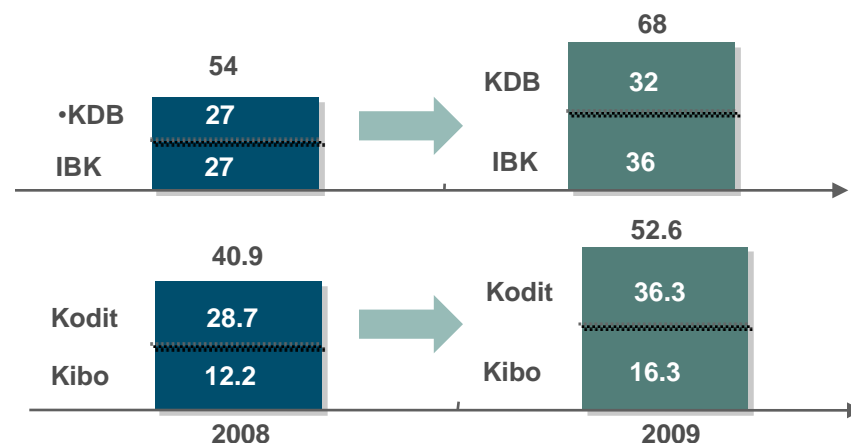


# Phase II : Liquidity Provision

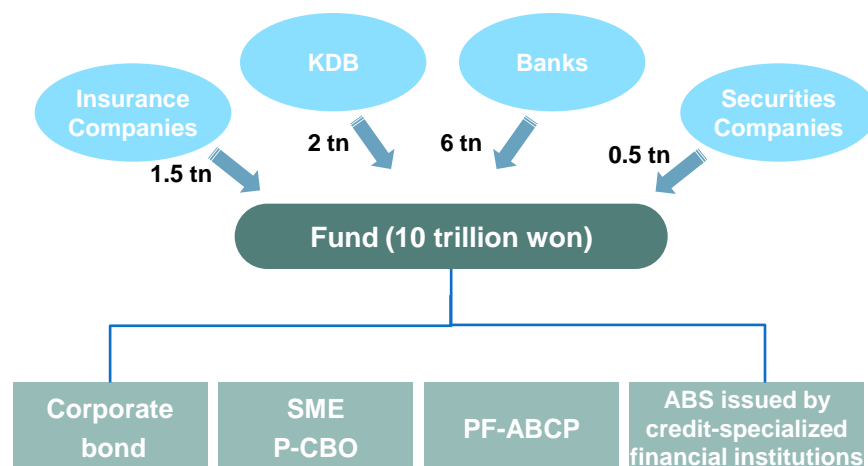
## Extension of SME loans and guarantees

- Maturity extension of guarantees provided by public guarantors till June 2010
- Maturity extension for SME loans falling due within June 2010
- Review standards and limits eased for new loan guarantees and required process expedited

## Policy Banks & National Guarantors (tn, won)



## Creation of Bond Market Stabilization Fund (10tn. won)



# Phase II : Corporate Restructuring Scheme

## Principles

#1

**Creditor financial institution-led restructuring**

#2

**Market-based restructuring**

- Encouraging private capital participation

#3

**Corporate restructuring support system**

- Setting up a restructuring fund & tax incentives

## Methods

**Sound Corp.**

- A** Normal: Support
- B** Temporary liquidity shortage: Support
- C** Signs of insolvency but viable: Workout
- D** Non-viable: Liquidation

**Weak Corp.**

Signs of Insolvency?

NO

YES

Viable ?

YES

NO

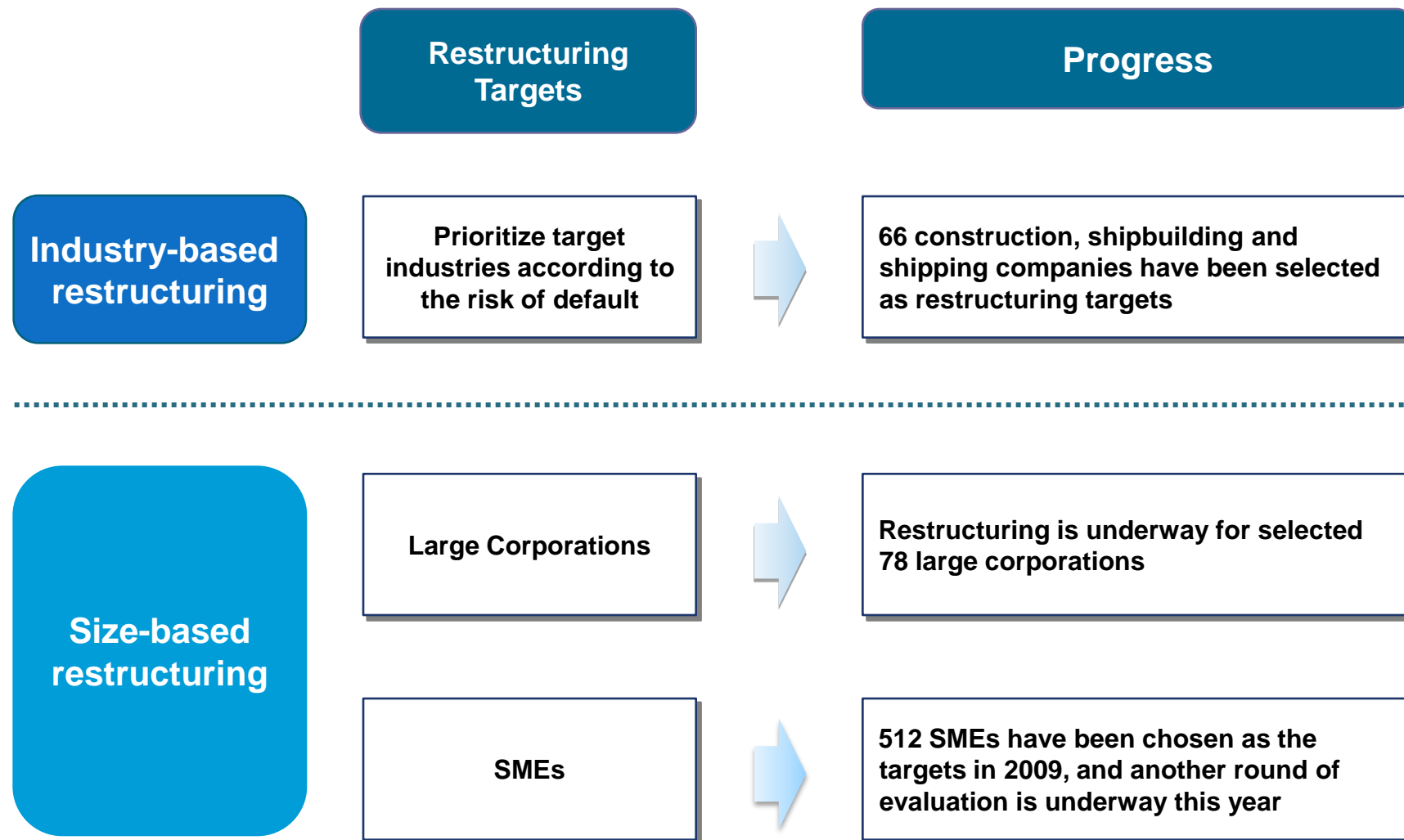
A

B

C

D

# Phase II : Corporate Restructuring Implementation



Jan.2009 - Present

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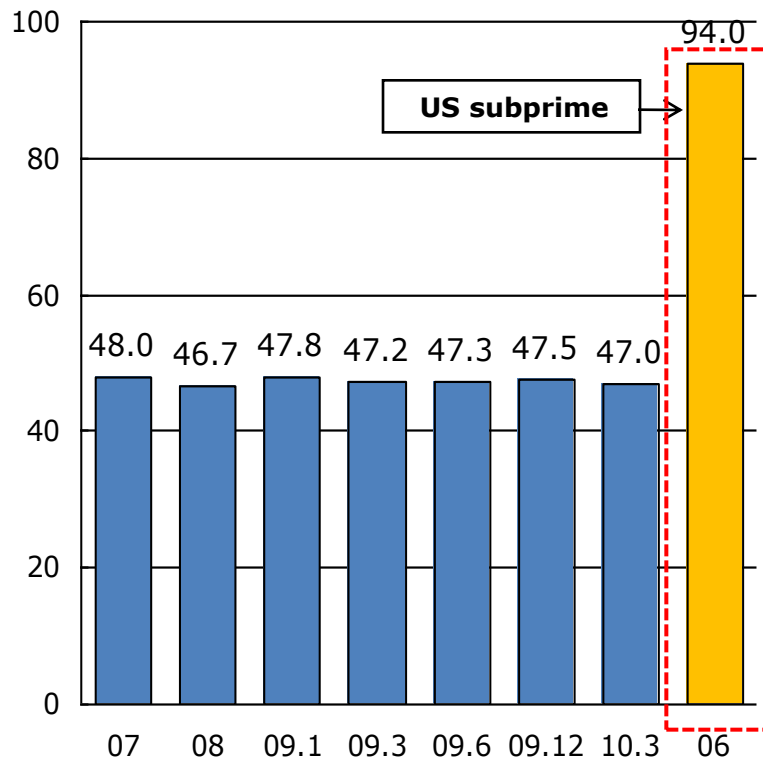


# Part IV

## Measures to Enhance Resilience of Korean Financial System

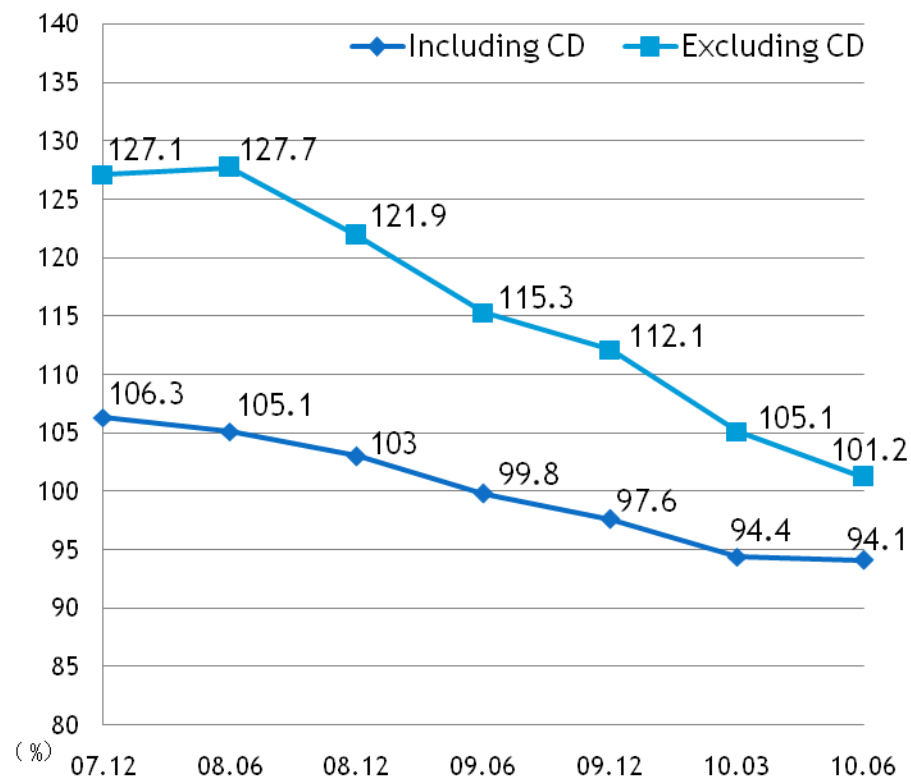
# Macro-prudential Measures (1)

## Mortgage Loan-to-Value Ratio



- Stronger risk management on household lending
  - DTI (Debt-to-income) was introduced in Aug. 2005

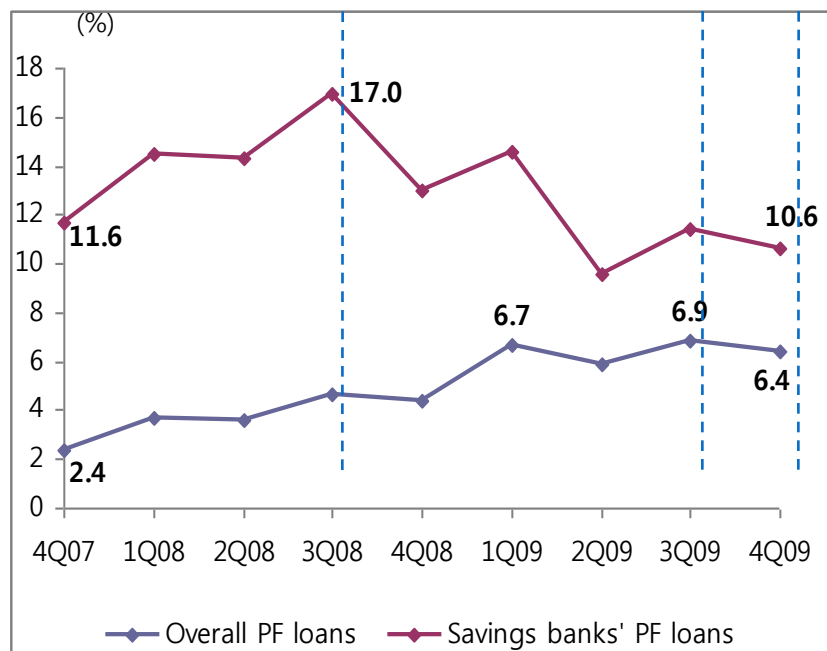
## Declining Loan to Deposit Ratio



- Loan to deposit ratio was introduced to curb excessive bank asset growth in Aug. 2010 (under 100%, by 2014)

# Macro-prudential Measures (2)

## PF loan delinquency ratio



- **Slow recovery in the construction sector raise concerns on financial distress**

- Major concern : PF loan delinquency, especially by saving banks

**Improve soundness & risk management of savings bank**

### Tightened prudential regulations

- **Ceiling on PF loan**
  - 30% ('10) => 25% ('11) => 20% ('13)
- **Improvement on capital adequacy criteria**
- **Introduction of liquidity ratio**
- **Introduction of dynamic fit & proper test**

### Strengthened examination

- **Differentiated examination depending on risk profile**
- **Stress test & intense monitoring**
- **Shorten full-scale examination cycle**
  - from 2-3 years to 1 year

### Improvement on deposit insurance

- **Raised deposit insurance premium for savings bank**
  - 0.30% => 0.35% ('09) => 0.40 ('11)

# Measures to Enhance Financial Resilience

## Phase III

### FX soundness improvement

- Step 1 ('09.11) : Foreign currency liquidity ratio, Foreign currency liquidity risk management standards, Minimum holdings of safe FX assets
- Step 2 ('10.6) : Regulation of FX position, Enhanced management of FIs' FX management

### Normalization of market measures

- Termination of payment guarantee measures on foreign debt ('09.12)
- Normalization of SME loans and guarantees('10.7)
- Termination of SME Fast Track Program('10.12)

### Financial Safety Net

- Financial support through Microcredit (Miso Foundation) : Planning to support 2tn won (USD 2bn) for the next 10 years
- Introduction of Sunshine loan('10.7) : Low-interest rate loans totaling 10 tn won for low-income & low-credit people during next 5 years.

## Phase IV

### Governance of FI

- Enactment of FI's Governance Act
- Establish a governance structure to encourage sound risk management of FIs
- Align regulations that are different while serving the same purpose

### Financial Consumer Protection

- Enactment of Financial Consumer Protection Act
- Adoption of functional regulation : "same function-same regulation"
- Enhancement of effectiveness in consumer protection

### Risk Based Deposit Insurance

- Adoption of risk based deposit insurance premium system ('14)
- differentiate insurance premiums depending on the risk level of each financial institutions

# Phase III : FX soundness

**Strengthen FX soundness  
of financial institutions**



**Reduce volatilities of  
capital flows**

## FX liquidity ratio

- Ratio fine-tuned to reflect differentiated weights given to different classes of assets according to recoverability

## Min. holding of safe FX assets

- To cope with outflows of capital in crisis
- Initially set minimum requirement at approximately 2% of the total assets

## Longer-term Financing

- Increase mid to long term financing through revising criteria from '1 year or more' to 'more than 1 year'
- Increase min. requirement from current '80% or more' to '90% or more'

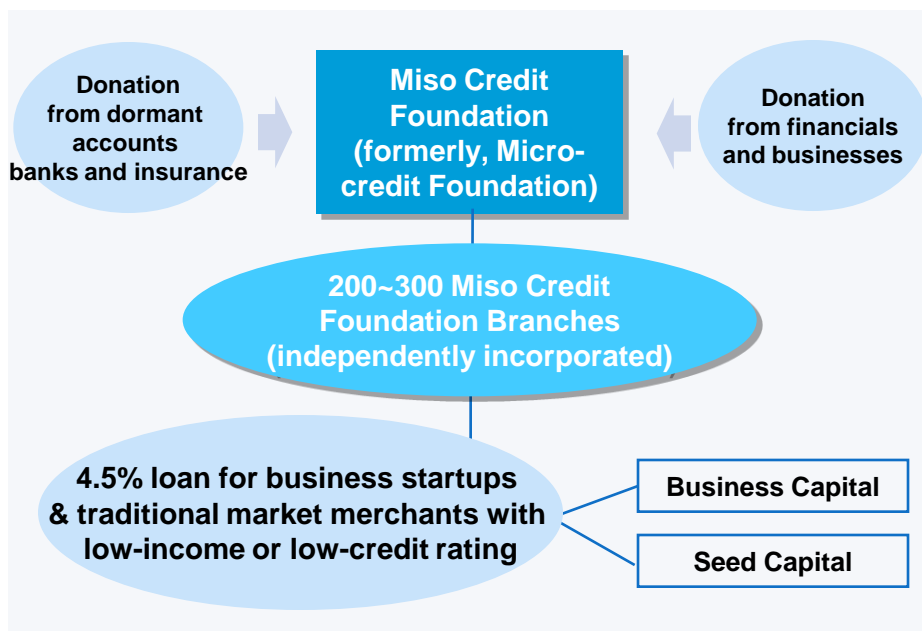
## Regulation on FX position

- Minimize foreign capital outflows in times of crisis by managing short-term foreign capital inflows from overseas
- Max. FX forward position limited to
  - 50% of equity capital for domestic banks
  - 250% for foreign bank branches



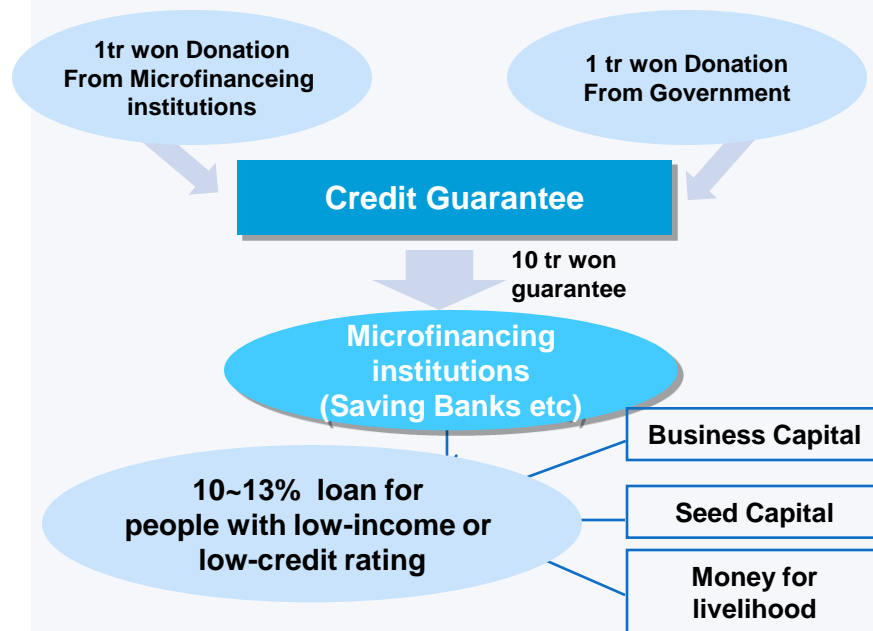
# Phase III : Social Safety Net

## Miso Credit Foundation



- Plan to raise and support 2 tn won over 10 years
- Expansion of the national network  
(No. of MCIs: 58 → 200~300)
- Engagement of voluntary workers  
(e.g. retired financiers, youths)

## Sunshine Loan



- Plan to raise and support 10 tn won over 5 years
- Sunshine loan will be partially(85%) guaranteed to prevent moral hazard of lenders
- Total of 45,962 loans worth 398.2 bil won were handled since the introduction (Aug. 24 )

# Phase IV : Governance & Consumer Protection

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## Governance Act

- **'Governance' emerged as a reason for global crisis**

## Consumer Protection Act

- **Need to protect financial consumers in times of crisis**
  - ex : KIKO

**Apply same regulation for same function  
irrespective of institutions**

- **Alignment with global standard**
  - Adoption of compensation principles
  - Independence and accountability of outside director
- **Build up countermeasures to prevent excessive risk-taking by FIs**

- **Achieve balance between prudential regulation & consumer protection**
- **Improve effectiveness of relief measures for consumers' damages**

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# Part V

## Lessons from Korea's Experience

# Lessons

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## Crisis repeats itself

- **Given the complexity and interconnectedness of the global economy, crisis may come at anytime & in various forms**
  - Asian crisis(1997), Subprime(2008), Europe(2010)
  - Crisis can be “Disguised Blessings” if dealt correctly

## Regulatory coordination is important

- **Inter-agency cooperation and information sharing is critical in crisis management**
  - Institutional framework established since the 1997 financial crisis helped to deal with the global financial crisis

## Preemptive measures are necessary

- **Preemptive & prompt response mechanisms should be in place to effectively respond to crisis**
  - Resolution regime should be set-up in advance to ensure “smooth failing” & reduce spill-overs

## Macro-prudential supervision

- **Macroprudential supervision is critical in ensuring stability of financial system as well as the real economy**
  - Need to develop macroprudential policy measures to contain procyclicality and herd behavior (e.g. LTV, DTI)

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**Thank You !**

**Dr. Jong-Goo Yi**  
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