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Green Statement from Mr. Bevilaqua and Mr. Fuentes on the Republic of Korea—Financial System Stability Assessment (SM/20/65)

We thank staff for the well-written report. We also thank Messrs. Heo, Shin, and Yoo for their statement, including the useful update on the COVID-19 developments in Korea. The Korean financial system remains stable, resilient and technology driven, operating within a highly open economy. The financial sector has been growing steadily since the last FSAP in 2014, with banks adequately capitalized and improved asset quality under a rules-based regulatory and supervisory regime, largely in line with international standards. Stress tests suggest that banks and insurance companies can withstand a severe macro-financial shock. Yet, the rise in COVID-19 virus cases will imply a significant shock to the global economy and, particularly, to economic activity in Korea with significant spillovers to the financial sector. Nevertheless, the country possesses a well-established financial safety net and valuable experience gained from managing past crisis that will assist authorities in accommodating this shock while safeguarding financial stability.

Household debt remains a major vulnerability to financial stability. While housing prices and household lending growth has moderated with the deceleration in economic activity, household debt remains very high, notwithstanding the tightening of housing market regulations and household lending standards. Furthermore, the debt-servicing burden of households remains high as debt growth has outpaced that of income and financial assets, and the loan delinquency rate has been rising since 2018, especially among nonbank loans. Over the medium term, risks emanate from both the interest rate structure of a significant share of outstanding loans, and the vulnerability of households' balance sheets to fluctuations in housing prices. Against this background, Korean authorities have been diligent in implementing macroprudential measures to moderate housing price appreciation and reduce the risk of sharp house price corrections. All in all, we agree with staff and authorities on the merits of strengthening the current framework by establishing macroprudential oversight as the primary objective of the Macroeconomic and Finance Meeting (MEFM).

Improving the supervision of financial conglomerates is paramount to avoid a risk buildup. We welcome FSC efforts to revise the guidelines on the supervision of financial conglomerates to enhance capital adequacy assessments, disclosure rules, and internal controls requirements. Yet, the absence of a legal mandate regarding the operations of financial conglomerates without a clear holding structure, allows these groups to continue operating outside the supervisory jurisdiction of the FSC. In this regard, we associate ourselves with staff recommendation of developing a prudential framework to systematically manage group-wide risks of "non-holding financial groups" under an integrated FSC/FSS supervision. This framework should feature enough flexibility to capture group organizations' risks exhaustively and strengthen regulation of non-bank activities.