GREEN/20/25

March 24, 2020

Green Statement from Mr. Rosen, Ms. Pollard, and Ms. Senich on the Republic of Korea—Financial System Stability Assessment (SM/20/65)

We thank staff for this comprehensive and timely assessment of Korea's financial system stability and Mr. Heo, Mr. Shin, and Mr. Yoo for their helpful statement. We are comforted to hear that the overall assessment is that in aggregate Korea's banks and insurers can weather severe macro financial shocks, and commend the Korean authorities for their robust efforts on this front in recent weeks. It is unfortunate that due to COVID-19 we are likely to be in a situation where the macro financial shocks are real rather than hypothetical tests, but we welcome news that the country has weathered the crisis well, which bodes well for the Korean economy. We agree with much of the report's assessment, and will highlight several areas where we would like further information.

We strongly agree with the recommendation for Korea to support the development of pension and contractual savings products. However, we believe the report could have clarified why staff make this recommendation. We consider it possible that the lack of pension schemes has led to a build-up of risky savings products across the financial sector. For example, equity-linked securities include auto-callable structured notes, which as of late 2019 was a $93.2 billion market in Korea, or the size of markets for structured notes in the U.S. and Europe combined. The use of life insurance as a wealth management product in Korea poses similar risks, as Korean securities firms and life insurance companies require dollars to meet margin calls and to roll over FX swaps, and are becoming increasingly liquidity-constrained. *Could a build-up of alternative, higher-risk savings vehicles be linked to the underdevelopment of traditional savings products? Would IMF staff recommend any specific policy measures to address this?*

We read with interest the discussion on the macroprudential framework, in particular the explanation in paragraph 39 and footnote 13 on the leverage limit on net derivative positions and the macroprudential stability level. We note that staff classify these measures as CFM/MPPs, but there is not a clear statement on whether they are in line with the institutional view. The authorities indicate that they believe the measures have been effective in extending the maturity of external debt and reducing maturity mismatches and at the time of the 2013 FSAP review, staff stated the measures were geared towards maintaining financial stability. *Do staff continue to view these measures as effective in maintaining financial stability?*

Korea's macroprudential framework is such that the Bank of Korea has a dual mandate for price stability and financial stability, but does not have direct control over macroprudential policy tools. The BOK's Monetary Policy Committee has at times focused on macroprudential risks emanating from the real estate sector, while at other time focusing on price stability. There appears to be a lack of consistency in how it weighs one mandate over the other when it makes policy decisions. We would have appreciated more recommendations for how these tensions could be resolved, beyond the recommendation for better inter-agency coordination.

We appreciated the section on Fintech Vulnerabilities, but note that there seems to be missing an explanation about jurisdictional or cross-border risks. We are concerned that the introduction of parallel initiatives "to clarify and relax the legal frameworks for electronic financial transactions…" could also introduce vulnerabilities from an AML/CFT perspective and could potentially cause concern among international financial institutions operating in Korea or with Korean financial institutions. *Could staff provide clarity on whether Korean financial institutions are joining with fintech payment service providers, including international entities?* If this is to include international entities, there should be an accounting for jurisdictional and cross-border risks. The international AML/CFT standards and jurisdictions' effective implementation of the standards, including with respect to Fintech solutions, should not be weakened. Doing so may have unintended negative consequences for financial inclusion as well as financial transparency and integrity. Specifically, countries should comply with all AML/CFT obligations and international standards, especially when endeavoring to introduce new products and innovation into the market.