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Joint Green Statement from Mr. Alkhareif, Mr. Geadah, Mr. Sylla, Ms. Choueiri and Mr. Nguema Affane on the Republic of Korea—Financial System Stability Assessment (SM/20/65)

We thank staff for the comprehensive report and Mr. Heo, Mr. Shin, and Mr. Yoo for their insightful statement. We broadly share the thrust of the staff assessment and policy recommendations and we wish to make the following comments for emphasis.

We commend the Korean authorities for the progress made in enhancing the regulatory and supervisory framework in line with international standards. Likewise, improvement has been made in strengthening the crisis management and resolution frameworks. Korea's financial system is one of Asia's largest and developed financial systems and it is assessed to be resilient to potential large shocks according to stress tests. That said, as an open economy, with large exposure to global financial cycles, measures are recommended to address remaining weaknesses in the prudential, legal and supervisory framework, notably regarding the supervision of nonbank financial activities and state-owned financial institutions. In addition, high household debt, demographic shifts and the adverse growth impact of the COVID-19 pandemic are posing challenges to financial stability. The ongoing efforts to address these challenges and better identify and monitor systemic risks to financial stability go in the right direction and should be sustained. We support staff's call for a review of the communication strategy to improve the transparency, accountability, and predictability of policy decisions. We look forward to the findings of the recent onsite AML/CFT assessment in the next Article IV consultations.

We appreciate the assessment of the impact of the COVID-19 pandemic on Korea's financial sector. The authorities ought to be commended for their prompt and effective response to the pandemic. We take note of the FSAP's team assessment that the adverse FSAP macro-financial scenario is severe enough to include a COVID-19 implied fallout on economic activity. However, the pandemic has adversely affected global growth. Moreover, the Coronavirus crisis has resulted in severe market volatility and capital outflows and uncertainty around future impacts remains high. Therefore, it would be useful for future staff work to update its assessment of the potential impact of these developments on Korea's financial system, including the liquidity of the system, possible solvency concerns, capital outflows and bank credit. Also, it would be interesting to determine whether the vulnerabilities identified in the FSAP further came to the fore since the outbreak of the pandemic. We encourage the authorities to remain vigilant to ensure financial stability.

It would be recommended to strengthen the macroprudential policy strategy, as well as prudential oversight responsibility and coverage. We agree that the existing division of responsibility between financial regulators could be improved to strengthen prudential oversight. We support staff's recommendation to primarily task the Macroeconomic and Finance Meeting (MEFM) with the sole objective of safeguarding macroprudential oversight and financial stability, while the Financial Services Commission (FSC) is charged with microprudential supervision. Financial regulators should also work on expanding financial oversight to cover large financial conglomerates, which do not meet the narrow definition of a financial holding company. The authorities' consideration to review that definition as well as the ongoing development of a prudential framework for those financial conglomerates is welcome. In the same vein, the oversight of mutual savings banks and other depository institutions should also be reinforced, given the contingent liabilities risks posed by pursuing social and economic objectives. That said, gaps in the supervision of systemically important financial conglomerates, notably regarding their cross-borders and overseas operations, stress the need to further strengthen financial safety nets and crisis resolution frameworks.

High household exposures and household debt call for a strengthening of the macroprudential toolkit. The recent tightening of the prudential framework with notably the adoption of measures to limit debt-service ratio is commendable. Nevertheless, we see merit in staff's recommendation to introduce a sectoral countercyclical buffer (SCCyB) that would complement existing borrower-based macroprudential measures and aimed at reducing systemic risks stemming from banks' high household and real estate exposures.

The identification and monitoring of emerging systemic risks stemming from Fintech and nonbank financial intermediation need to be improved. Although Fintech can provide substantial benefits in terms of improving financial inclusion and efficiency, its financial stability implications should be carefully monitored. The adoption of appropriate regulations mandating financial information disclosures, notably regarding ownership structure and cross-country activities, and the strengthening of stress testing will be essential to identify and monitor risks. We also encourage the authorities to conduct the assessment of the impact of the open banking policy on the financial sector.

We agree that banking consolidation might be needed as competition from Fintech and nonbank financial intermediation is rowing considerably. We are pleased to note that banks are adapting their business models to this development. That said, we look forward to future staff's assessment on the likelihood of a banking consolidation in Korea.

With these remarks, we wish the Korean authorities continued success in their financial reform efforts.