

**LAPSE OF
TIME**

SM/20/65
Supplement 1

March 24, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Korea—Financial System Stability Assessment—Draft Press Release**

Board Action: Executive Directors' **consideration** on a lapse of time basis.

Deadline to Request Board meeting: **Wednesday, March 25, 2020
12:00 (noon)**

Publication: Yes*

Questions: Mr. Das, MCM (ext. 36330)

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the press release will be published.**



IMF Executive Board Concludes Financial System Stability Assessment with the Republic of Korea

FOR RELEASE

WASHINGTON, DC – April 20, 2020 the Executive Board of the International Monetary Fund (IMF) concluded the Financial System Stability Assessment¹ with the Republic of Korea on March 27, 2020 without a meeting.²

The FSSA was prepared by a staff team of the IMF for the Executive Board's consideration on Friday, March 27. The staff report reflects discussions with the Korean authorities in September and December 2019 and is based on the information available as of end June 2019. It focuses on Korea's near and medium-term financial stability challenges and policy priorities and was prepared before COVID-19 became a global pandemic and resulted in unprecedented strains in global trade, commodity and financial markets. It, therefore, does not reflect the implications of these developments and related policy priorities. Staff is closely monitoring the situation and will continue to work on assessing its impact and the related policy response in Korea and globally.

According to the FSSA, operating within a trade dependent open economy, Korea's financial system is among the most developed and internationally connected in Asia. The state keeps a tight control and operates a rules-based oversight system. The overall financial system appears resilient for the present, but with growing vulnerabilities. Stress tests suggest that banks and insurers, in aggregate, can weather severe macro financial shocks (encapsulating the potential near term COVID-19 implied fallout on economic activity and the financial sector), although some banks would make use of capital conservation buffers. Growth related uncertainties in view of the global macroeconomic conditions, COVID-19 crisis, and elevated household debt remain key risks to financial stability.

The Korean authorities have continued their efforts at upgrading the prudential, legal, and supervisory framework for the financial sector, and keeping up with international standards and practices in other G20 jurisdictions. The authorities have been steeling the system with micro and macroprudential measures (MPMs) against vulnerabilities, strengthening the crisis management framework, and upgrading the prudential and legal framework.

Looking ahead, and to help preserve positive financial stability conditions in Korea, the FSSA has suggested that a more forward-looking monitoring and systemic risk identification mechanism must become a sine qua non for Korea's financial stability and oversight framework. The reliability of various stress tests could be augmented with advanced methods, system-wide monitoring, and testing the overall leverage related to residential properties, households' resilience to adverse shocks, and sovereign contingent liabilities. Stronger focus is required on systemic risks emanating from securities market activities that can amplify

¹ The Financial Sector Assessment Program (FSAP), established in 1999, is a comprehensive and in-depth assessment of a country's financial sector. FSAPs provide input for Article IV consultations and thus enhance Fund surveillance. FSAPs are mandatory for the 29 jurisdictions with systemically important financial sectors and otherwise conducted upon request from member countries. The key findings of an FSAP are summarized in a Financial System Stability Assessment (FSSA).

² The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

contagion, including sudden redemption and liquidity pressures in the funds and asset management industry. Financial conglomerates and others connected directly or indirectly with the Korean financial system need to come under the purview of systemic monitoring. Onshore financial markets, including the foreign exchange (FX) market, must deepen to expand options for managing currency and capital flow risks. A review would be beneficial of housing market financing structures and implicit subsidies, pension funds market, and the overall role of state-owned banks in the financial system.