

GREEN/20/27

March 25, 2020

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

We thank staff for the comprehensive paper, and Mr. Heo, Mr. Shin, and Mr. Yoo for their insightful Buff statement.

The paper was prepared several weeks ago, and therefore unavoidably does not reflect global economic developments since then relating to COVID-19. Staff point out that that Korea is exposed to global financial market developments, and that both the Asian and the global financial crises led to the emergence of liquidity risk. We welcome staff's assessment that the adverse FSAP macro-financial scenario is severe enough to encapsulate the implied fallout on economic activity from COVID-19 and hope that this continues to hold in light of the further deterioration of global economic conditions since the paper was prepared. We also thank Mr. Heo, Mr. Shin, and Mr. Yoo for their helpful summary of the authorities' response to COVID-19.

Developments since last FSAP and systemic risk analysis

Korea's financial system has expanded significantly, up by 40 percentage points of GDP since the 2013 FSAP. This has been complemented by appropriate regulatory and supervisory measures which have largely held risks in check. The banking sector appears prudentially strong, and we welcome the overall finding that the banking system is resilient under an adverse macro-financial scenario in the stress tests.

Having said this, emerging risks including lower growth, an adverse demographic shift and potentially disruptive financial technologies. Korea's open economy is susceptible to adverse external shocks. Household debt is among the highest for OECD countries, with 16% of total household debt registered 'at-risk' and around 13% at immediate solvency risk. Old-age poverty in Korea is the highest among OECD countries, and a negative impact would transmit through several financial stability channels.

We welcome staff's reflection on the implementation of several prior recommendations in some areas but would have welcomed a more concrete section upfront giving a general sense of the

traction of the 2013 recommendations. This would help us better understand how the authorities will respond to the 2020 recommendations.

Fintech and other emerging risks

We welcome the focus on fintech, an important emerging issue in Korea's financial sector. This coverage is in line with the emerging conclusions of the FSAP Review. We agree that fintech developments warrant a comprehensive approach to avoid unintended spillovers, but note that fintech could make the financial system more efficient, effective and resilient if used appropriately. The challenge is to balance risks and opportunities. The report seems to focus more on the costs of fintech.

We feel that that another important emerging risk – green finance and climate stress testing – could have been covered in greater detail. The report does acknowledge that there is increased awareness and interest in climate risk in Korea. This includes Korea being a large supplier of ESG foreign currency bonds, and the authorities' interest in joining the Network for Greening the Financial System. We would, however, have welcomed a more comprehensive analysis of the impact of transition to a greener economy, including a climate stress test.

Systemic oversight and crisis management

We welcome Korea's well-developed macroprudential framework, based on previous experience with financial crises, but also agree that there are some areas which merit further development, in particular an expansion of the toolkit to mitigate household sector risks. We also agree with staff that more can be done to develop a coherent macroprudential strategy and to ensure better communications around macroprudential policy decisions.

Microprudential oversight appears to be in good shape. The authorities have addressed most recommendations from the previous FSAP. We agree with staff that, given that the plans of large Korean financial institutions to continue overseas expansion, cross-border supervisory activities would benefit from enhanced cooperation. We welcome progress made since the last FSAP on crisis management, and note the areas for further work flagged by staff, including the introduction of statutory bail-in powers and ensuring that resolution can be triggered sufficiently early. Finally, given the significant international footprint of Korean banks and the presence of foreign banks in Korea, we agree with staff that more attention should be given to how the failure of a cross-border firm would be managed.