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Korea’s Financial Regulatory Reforms Responding to the Global Financial Crisis of 2008: Assessments and Future Prospects

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Since the 2008 global financial crisis (GFC), we have seen many reforms, as each country has endeavored to reform its financial regulatory system, including banking and financial regulation. The reforms attempted to respond to the crisis in line with the new global regulatory framework initiated by G-20s and international financial organizations. The Korean Government has also proposed new legislation and financial reforms, in response to the GFC, including reinforcement of protection for financial consumers and strengthening the corporate governance in financial institutions. This article seeks to review the regulatory reform measures, and to analyze whether such measures follow those global trends and reforms. Then, given that further reforms remain necessary to rectify other shortcomings revealed as a result of the GFC, it provides some recommendations for the future direction of reform to further enhance the competitiveness of the Korean financial industry.

**Keywords**

Global Financial Crisis, Financial Regulatory Reform, G-20, Financial Consumer Protection, Corporate Governance, Bank Levy

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1 The Group of Twenty (G-20) is “the premier forum for international cooperation on the most important issues of the global economic and financial agenda. The G20 brings together finance ministers and central bank governors from 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, the Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States of America plus the European Union, which is represented by the President of the European Council and by Head of the European Central Bank. The G20 was formally established in September 1999 when finance ministers and central bank governors of seven major industrial countries (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States) met in Washington, D.C. in the aftermath of the financial crisis of 1997-1998, which revealed the vulnerability of the international financial system in context of...
financial organizations, such as the Basel Committee on Banking Supervision ("BCBS")\(^2\) and the Financial Stability Board ("FSB").\(^3\) Notably, for instance, the United States of America ("US"), where the subprime mortgage crisis triggered the GFC, enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank")\(^4\) as the US responds to the GFC. The Dodd-Frank initiated a major new regulatory framework, addressing macro-prudential regulation issues of financial stability and systemic risks as well as promulgating detailed rules on issues such as mortgage lending and underwriting. This legislation also created a new agency, the Consumer Financial Protection Bureau ("CFPB"),\(^5\) within the Federal Reserve System, to strengthen protection in regard to financial consumers, reflecting a new global trend. In the process, the US reforms are believed to have substantially affected the regulatory responses of other countries.

Similarly, the Korean Government\(^6\) also introduced reforms to the financial regulatory framework by proposing new legislation and amendments, responding to the GFC. The GFC hit the Korean economy and financial system. Financial institutions, especially commercial banks, revealed capital and liquidity shortage problems. Those commercial banks with weak economic globalization . . .” (http://www.g20.org/docs/about/about_G20.html) (last visited on Jan. 30, 2013). For more details of the G-20, see http://www.g20.org/index.aspx.

\(^2\) "The [BCBS] provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches and techniques, with a view to promoting common understanding. At times, the Committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable.” The Committee's members come from 27 countries: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States (http://www.bis.org/bcbs/about.htm) (last visited on Jan. 30, 2013). For more detailed description of the BCBS, see http://www.bis.org/bcbs/index.htm.

\(^3\) "The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB was established in April 2009 as the successor to the Financial Stability Forum (FSF). The FSB was founded in 1999 by the G7 Finance Ministers and Central Bank Governors following recommendations by Hans Tietmeyer, President of the Deutsche Bundesbank.” (http://www.financialstabilityboard.org/about/overview.htm & http://www.financialstabilityboard.org/about/history.htm) (last visited on Jan. 30, 2013). For more details of FSB, see http://www.financialstabilityboard.org/index.htm.


\(^5\) The Dodd-Frank Act § 1011.

\(^6\) The “Korean Government” in this article mainly refers to the Financial Services Commission, which has functions of financial industry and regulatory policies and so powers of proposing legislation in this regard, and rarely to the Ministry of Strategy and Finance with respect to international financial policy.
capital were supported by the Bank Recapitalization Fund imminently launched in March 2009 and mainly contributed from the central bank, which purchased hybrid securities and subordinated bonds issued by commercial banks. The volume of non-performing loans or assets of financial institutions and distressed assets of non-financial firms undergoing corporate restructuring sharply increased. The Corporate Restructuring Fund, administered and operated by the Korea Asset Management Corporation, a government-invested corporation, was launched in May 2009, in order to purchase distressed bonds and assets of the companies in danger of insolvency and firms under corporate structural improvement.

With respect to capital inflow in the foreign exchange market, the GFC revealed that Korea was greatly vulnerable to changes in the world economy and sharp capital movements. Further, the financial information sharing scheme among financial regulation-related institutions did not operate efficiently, which had hindered effective actions to contain the spread of the GFC. Moreover, a large number of financial consumers such as depositors or individual investors incurred huge monetary losses or damages from their deposits with insolvent mutual saving banks or their investments in financial investment products such as mutual funds due to their bad portfolio performances amid the GFC.

Thus, the regulatory reforms have been sought to rectify such revealed problems. The focus has been, inter alia, on reinforcing financial consumer protection, improving corporate governance of financial institutions, implementation of “Basel III” (which are recently strengthened capital adequacy rules of banks after the GFC), introducing a ‘bank levy’ system (referred to as the “macro-prudential stability levy” system in Korea), and enhancement of financial information sharing scheme among financial regulation-related agencies. Despite these various measures, many experts still believe that further reforms remain necessary in order to both address the problems revealed during the GFC and to enhance further the competitiveness and efficiency of the Korean financial industry.

This article intends to examine the Korean regulatory reform measures taken in response to the GFC and to explore some recommendations for a desirable future financial regulatory policy and framework. The article is composed of four parts. Following the introduction, Part II will explore those regulatory measures, along with analysis of global and international trends as the background. Based on the analysis of those measures, Part III will seek to propose more desirable future regulatory reforms and tasks, focusing on the six subjects, most importantly including a proposal to reform the financial regulatory authority organization of Korea. The last part offers some concluding remarks.

II. Post-GFC Financial Reform Measures in Korea

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9 For more discussion of Basel III, see II.1.A. below.
Financial regulatory reforms have been made or are being implemented in Korea with respect to implementation of Basel III, reinforcement of financial consumer protection, improvements in corporate governance scheme of financial institutions, launching of a macro-prudential stability levy system, and establishment of financial information sharing scheme through a MOU among the relevant regulatory agencies or institutions, respectively. This part will seek to investigate the developments and performances in those five subjects in depth.

1. Scheduled Implementation of Basel III

A. Why and How Basel III was Born?

One of the most drastic global regulatory reform measures following the GFC was to strengthen the capital adequacy regulations of banks. High quality capital is believed to buttress the good operations of banks. The GFC revealed that Basel I\textsuperscript{10} and Basel II\textsuperscript{11} were not sufficient for banks’ sustainable operations during a period of such systemic risks. The importance of strengthened capital requirements was recognized at successive G-20 meetings, where the BCBS was instructed to study and work to strengthen the capital adequacy rules with respect to quantity and high quality of capital, capital buffers, leverage ratios, and liquidity regulations. Through the discussions on several meetings of the G-20, including the London Summit on April 2, 2009, the Pittsburgh Summit on September 25, 2009, and the Toronto Summit on June 26, 2010, respectively, the Seoul Summit on November 11, 2010 finally confirmed that the strengthened bank capital and new liquidity framework, including capital buffers, leverage ratios, and liquidity ratios, should be adopted as the regulatory reform agenda.\textsuperscript{12}

Under the delegation of the G-20 summits, the BCBS submitted its reports about revised capital adequacy rules to the Seoul Summit in October 2010.\textsuperscript{13} Based on those reports, in December 2010, Basel III was finally announced as “Basel III: A global regulatory framework for more resilient banks and banking systems” (further revised in June 2011)\textsuperscript{14} and “Basel III: International framework for liquidity risk assessment, standards, and

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\textsuperscript{14} A revised version of June 2011 is available at \url{http://www.bis.org/publ/bcbs189.pdf} (last visited on Jan. 25, 2013).
monitoring.” Basel III aims “to improve the banking sector’s ability to absorb shocks arising from financial and economic stress, whatever the source, to improve risk management and governance, and to strengthen banks’ transparency and disclosures.”

Basel III is comprised of the following building blocks:

(i) higher quality of capital, with a focus on common equity, and higher levels of capital to ensure banks can better absorb the types of losses like those associated with this past crisis;
(ii) better coverage of risk, especially for capital market activities;
(iii) an internationally harmonised leverage ratio to constrain excessive risk taking and to serve as a backstop to the risk-based capital measure, with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration;
(iv) capital buffers, which should be built up in good times so that they can be drawn down in periods of stress;
(v) minimum global liquidity standards to improve banks' resilience to acute short term stress and to improve longer term funding; and
(vi) stronger standards for supervision, public disclosures and risk management.

According to the new framework of Basel III, the minimum common equity requirements is raised from 2% to 4.5%, and a capital conservation buffer comprising common equity of 2.5% of risk-weighted assets is newly imposed, bringing the total common equity standard to 7%.

In addition, according to the liquidity coverage ratio requirement, which is the newly introduced standard, banks are required to have sufficient high quality liquid assets to withstand a 30-day stressed funding scenario, to be specified by the regulators in each member country. Basel III began to be implemented starting from January 1, 2013 and will be fully phased in by January 1, 2019.

B. Korea’s Plan for Implementation of Basel III

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15 This document is available at [http://www.bis.org/publ/bcbs188.pdf](http://www.bis.org/publ/bcbs188.pdf) (last visited on Jan. 25, 2013). This was further revised as “Basel III: The Liquidity coverage ratio and liquidity risk monitoring tools” in January 2013. This document is available at [http://www.bis.org/publ/bcbs238.pdf](http://www.bis.org/publ/bcbs238.pdf) (last visited on Jan. 25, 2013).

16 Basel Committee on Banking Supervision, supra note 13, at 1.


19 Id.; see Basel Committee on Banking Supervision, supra note 13, at 6.

20 Id. at 16 (Annex 1: Phase-in arrangements).
Since Korea became a member of the BCBS in March 2009, it is now required to comply with Basel III. Before then, the Korean Government had voluntarily followed Basel I and Basel II even as a non-member. Korea wanted to be in full compliance with international standards set by the BCBS, specifically the capital regulations, in order to enhance its “national validity and international credibility.” Therefore, the Korean financial regulatory authorities have been preparing for the implementation of Basel III since early 2011, and have already completed their preparatory works for implementing Basel III. On September 27, 2012, the Financial Services Commission (“FSC”), a financial regulatory policy-making authority, announced the plan to implement Basel III, originally to take effect from January 2013. This implementation has, however, been postponed because of the need to conform to the global timeline for domestic implementation by member countries. Finally, the FSC announced in May 2013 that Basel III would be implemented starting from December 1, 2013.

The proposed Basel III rules of Korea reflect the international standards of the BCBS’s Basel III. They include, inter alia, the following: (i) a minimum capital requirement for banks will be divided from the current 8% of total capital into three criteria: 4.5% of common equity, 6% of Tier I capital, and 8% of total capital; and (ii) a newly introduced capital buffer requirement will be imposed on banks to reserve an extra capital buffer of 2.5% in addition to

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21 According to the charter of the BCBS, a member country “is committed to implement and apply BCBS standards in their domestic jurisdictions . . .” Sec. 5(e), available at http://www.bis.org/bcbs/charter.pdf (last visited on July 11, 2013). The BCBS standards “are incorporated into local legal frameworks through each jurisdiction’s rule-making process.” Sec. 12. So, these standards are called as “soft laws.”


the minimum capital requirement. With respect to the capital buffer requirement, it is not mandatory, but if banks fail to meet the requirement, restrictions on dividend payments or share repurchases would be imposed by the regulators. Further, regulations on liquidity and leverage ratios are expected to be introduced as early as 2015.

2. Reinforcement of the Financial Consumer Protection Scheme

A. Why did the Issue of Financial Consumer Protection Become So Important Globally?

One of the conspicuous outcomes of the GFC was a new trend across the globe of reinforcing financial consumer protection. This mainly results from the heavy losses incurred in financial products or deposits with bankrupt financial institutions by individual investors or depositors in most countries. It became evident that financial institutions did not comply with ‘conduct of business’ rules in selling financial products, such as the ‘suitability principle’ and the rules for duty of fully explaining financial products, particularly, financial derivative products.

This issue was examined by the G-20 meetings and discussed as one item of the reform agendas; for instance, the G-20 Seoul Summit dealt with the subject of enhancing consumer protection. In line with this global movement, as the GFC spread out around the countries, each country also began to take regulatory reform actions to strengthen their scheme for the protection of financial consumers. Most notably, the US, through the enactment of the Dodd-Frank, created a new agency called the CFPB, a strong consumer financial protection watchdog, within the Federal Reserve System, to strengthen protection for financial consumers.

B. Background and Developments of Reinforcing Financial Consumer Protection in Korea

Korea was no exception to this global trend. In particular, during the GFC, more than 500 small and medium-sized exporting companies incurred huge losses from over-the-counter (OTC) financial derivative transactions, or ‘knock-in and knock-out’ currency option

28 Id.
29 Id.
30 The ‘suitability principle’ refers to the financial institutions’ duty not to recommend investors to make investments if the investment is deemed not suitable for investors in light of investment purpose, status of property, investment experiences and others. See Financial Investment Services and Capital Market Act of Korea, art. 46(3).
32 The Dodd-Frank Act § 1011.
contracts, mainly used for hedging currency-related risks, with commercial banks. These derivative contracts, popularly called “KIKO,” “ramp up downward exchange rate exposure, but offer a better strike price, the latter of which is more favorable to such [exporting] companies.” However, with sharp depreciation of the Korean Won against U.S. Dollars in late 2008 amid the GFC, such exporting companies had obligations, according to the terms of such contracts, to pay a huge amount of money to the counterparties upon the exercise of the banks’ call options. Firms asserted that commercial banks as sellers of derivative products breached business conduct rules, such as the suitability principle and duty of explanation, which are asserted to be required in banks’ selling financial derivatives (including these ‘KIKO’ products). More than 100 cases have been brought to the courts. Significant legal issues relating to the breaches of the suitability principle and duty to explain have been in the spotlight. Some courts, holding that commercial banks as sellers did not breach business conduct rules in selling the KIKO products to those companies, ruled that commercial banks were not liable for the damages incurred by such exporting firms. This episode, however, ignited a new wave of pressure to strengthen financial consumer protection in Korea. This important event, known popularly as the “KIKO Incident,” significantly affected the shift of the Korean Government’s financial regulatory policy toward enhancing financial consumer protection.

Furthermore, a large number of individual investors, who had incurred huge monetary losses from their investments in mutual funds or other financial investment products, complained to the financial regulatory authorities, arguing that financial institutions breached their business conduct regulations in selling their financial products. Those consumers then brought many dispute cases to the conciliation system, which is an alternative dispute resolution (“ADR”) scheme operated by the Financial Supervisory Service (“FSS”), a financial regulation implementation non-governmental agency in charge of examining the safety and soundness of financial institutions. This event, together with the “KIKO Incident,” also escalated the calls for reinforcing financial consumer protection and so significantly influenced the financial regulators’ shift of its financial policy.

33 SANGCHEE LEE & YOUNG DO KIM, KIKO SANGPUM EU IEHAE [MYTHS AND TRUTHS ABOUT KOKO FORWARD CONTRACT] 110 (English abstract) (Korea Institute of Finance, June 2009), available at http://www.kif.re.kr/KMFileDir/128888946015703384-%ec%b8%88%ec%a1%b006%eb%b3%b4%ec%95%88%eb%b6%84.pdf (last visited on Jan. 25, 2013). For more detailed discussions on “KIKO” products and their structures, see id.

34 See Financial Investment Services and Capital Market Act, art. 46(3).

35 See id. art. 47(1) (“A financial investment business entity shall, whenever it makes an investment recommendation to an ordinary investor, explain the details of the financial investment instrument, the risks contingent upon the investment, and other matters specified by Presidential Decree with such sufficiency as to allow the ordinary investor to understand them.”).

36 For a description of functions and powers of the FSS, see Financial Services Commission Establishment Act, arts. 18, 37. And for details of the conciliation system operated by the FSS, see id. arts. 51-57.
C. Proposed “Financial Consumer Protection Bill”

Finally, responding to this new trend, in November 2011, the Korean regulatory authorities announced the introduction of a new law known as the “Financial Consumer Protection Bill” (“FCPB”). This proposed Bill contains many relevant provisions for reinforcing financial consumer protection, including an explanation duty and a suitability principle.

Although the FCPB has not yet been enacted, it is worth paying attention to this Bill because it includes diverse clauses relating to the conduct of business rules imposed on regulated financial institutions for the purpose of enhancing financial consumer protection. Such provisions include, inter alia, a “know-your-customer” rule, a suitability rule, an explanation duty in selling financial instruments, a strict liability of financial product sellers, and regulations of advertising financial products.37 Most of those rules and regulations are currently being implemented under the Financial Investment Services and Capital Market Act (“FISCMA”), 38 which took effect in February 2009 and applies generally to financial investment business companies such as securities firms and asset management firms, as well as other financial institutions, such as banks and insurance companies, but only if they are involved in the business of financial investment including activities of selling financial derivative products. However, it is worthwhile to note that those rules and regulations under the FCPB extend to other financial institutions, including banks, insurance companies, mutual savings banks, and credit finance companies, when they are engaged in their own business or activities such as banks’ lending to individual consumers or insurance firms’ selling insurance products to consumers. In light of these measures, it is clear that the Korean regulatory authorities are becoming more focused on the financial policy of reinforcing financial consumer protection. This is also illustrated by the recent overhaul of the organization of the FSS with respect to dealing with financial dispute settlement, consumer complaints and financial education matters, as discussed in detail below.

D. FSS’s Creation of the “Financial Consumer Protection Bureau”

In order to reinforce the protection of financial consumers, the FSS reshuffled its organizational structure. On May 15, 2012, the FSS created the new “Financial Consumer Protection Bureau,” a semi-autonomous division within the FSS, by integrating consumer protection functions previously implemented by various departments and offices.39 Simultaneously, the FSS enlarged the number of staff handling consumer protection and financial dispute conciliation matters. The newly created Bureau “is primarily charged with providing useful, consumer-friendly information on financial products and services, helping consumers better exercise their legal rights in their dealings with financial firms, and

38 Financial Investment Services and Capital Market Act, arts. 46–53.
improving investor education.” Further, the new Bureau is empowered with assuming the tasks of consumer protection by issuing “consumer alerts on financial fraud,” investigating consumer complaints, and providing a wide variety of consumer education services, although lacking the disciplinary powers. In order to perform its broadened mission, the Bureau’s consumer protection organizations have been expanded to comprise three departments and one office: the Consumer Protection Department, the Dispute Settlement Department, the Financial Education Department, and the Complaints Examination Office. However, since this new Bureau is established within the FSS and is not completely separated from the FSS, which is more focusing on prudential regulation matters rather than financial consumer protection matters, there is a growing concern that independence in terms of its operation and budget would be so weak that the scheme for strengthening the protection of financial consumers might not work sufficiently and efficiently.

3. Improvement of Corporate Governance in Financial Institutions

A. Background and Developments of Improvement of Corporate Governance Globally

The GFC highlighted the importance of corporate governance systems in financial institutions. The management of financial institutions, including directors and officers, who had received excessive bonuses and compensation, were heavily blamed for the failures of financial institutions. In addition, it was thought that failures of financial institutions were partly due to bad corporate governance and, in particular, poor performance by the board of directors, which had failed to discharge their responsibilities under the risk management and internal control systems, and had pursued shot-term profits, but instead, had received excessive compensation.

Against this backdrop, the task of improving corporate governance in financial institutions was actively discussed at the global level. The G-20 summits dealt with this issue. The G-20 London Summit proposed reforming compensation practices of financial institutions as one of eight elements of its reform agendas. The G-20 Pittsburgh Summit also discussed this issue as part of the reform agendas. In line with this approach, the Organization for Economic Cooperation and Development (“OECD”) also showed interests by publishing relevant reports such as the “Corporate Governance Lessons from the Financial Crisis” in February 2009 and the “Corporate Governance and the Financial Crisis: Key Findings and Main Messages” in June 2009, respectively. Those reports asserted that corporate governance in

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40 Id.
41 Id.
financial institutions should be improved, citing the bad operation of a board of directors, which involved problems such as the pursuit of short-term oriented profits, payments of excessive bonuses or compensation, and a failure of risk management. In addition, the BCBS announced the revised “Principles for Enhancing Corporate Governance” in October 2010, mainly aiming to reinforce the corporate governance of banks, which were particularly to blame for their insolvency.

Korea followed this global trend. As described below, the Korean Government took legislative and regulatory actions to improve corporate governance in financial institutions, including banks.

B. History of Reforms of Corporate Governance of Financial Institutions Prior to the GFC in Korea

Drastic reform of corporate governance of financial institutions in Korea was implemented after the Asian financial crisis in late 1997, which had been the first economic and financial crisis in Korean economic history and was due to a short-term shortage of foreign exchange reserves. The Government’s austerity monetary and fiscal policy thereafter directly hit the financial markets and industry. Thus, many financial institutions, including banks, which had a large volume of non-performing loans and assets, as well as troubled non-financial firms, especially large-sized conglomerate companies, went into bankruptcy. This, in turn, led to the restructuring of the financial industry and the whole economy. It was asserted that the poor operation of financial institutions was in part due to bad corporate governance. The International Monetary Fund (“IMF”), which provided emergency financial assistance to Korea, strongly urged the Korean Government to undertake reforms to improve the corporate governance of financial institutions, including improving the operations of the board of directors. As a result, the Korean Government began to implement the reform measures to overhaul the corporate governance system in financial institutions. Priority was given to reform the operation of the board of directors, where ‘standing directors’ who were also executive officers dominated the board and, in particular, a chief executive officer (“CEO”) as a representative director held a powerful position. It was believed that this ‘old’ system hindered good corporate governance.

Thus, by amending the Bank Act in April 2000 and subsequently other relevant laws, such as the Financial Holding Company Act in October 2000, a ‘new’ system of ‘outside directors,’ called independent directors, was introduced, the main role of whom is to contain the management of financial institutions. Under this system, major financial institutions, such as banks, securities firms and insurance companies, were required to have at least half of the board members comprised of outside directors. Outside directors, among others, should be

44 Id.
46 See e.g., Bank Act before the amendment of Nov. 18, 2012, art. 22(2).
neither related persons to major shareholders nor employees or officers of their affiliated institutions or companies.47

Another reform of corporate governance took place in the internal audit system. For the purpose of reinforcing the audit procedure and scheme of financial institutions, instead of an auditor, an audit committee, consisting of members no less than two-thirds of which are outside directors, was required to be set up in such financial institutions.48 Furthermore, major financial institutions were legally required to set up an internal control system and appoint at least one compliance officer, who is responsible for monitoring whether the internal control procedures and standards are observed by employees and officers.49

However, it has been consistently pointed out that despite the introduction of such a ‘revolutionary’ corporate governance system, the new system has not been working well in practice.50 For instance, since a CEO or president of financial institutions is still strongly influencing the process of selecting outside directors, such selected outside directors are so swayed by such a boss that their original role of check and balance against the management is not being sufficiently performed, and their strong independence is lacking.51 There have also been criticisms that outside directors are wielding too much influence on the process of selection, reappointment, compensation and evaluation of their peers, which led to the “clubby board” problem.52

C. First Step: Reinforcing Corporate Governance of Banks

Recognizing that such a new corporate governance system, introduced after the 1997 financial crisis, was not working as well as intended, and additionally affected by the global trends of reinforcing corporate governance, the Korean Government sought to reform the corporate governance scheme in financial institutions. A task force was set up in early 200953 and then recommended some improvements to the financial regulatory authority. The first and immediate reaction took place in the area of banks, which are believed to be critical financial institutions in this matter.

The Bank Act, the basic and general law regulating banks’ business or activities, was revised in May 2010. The revisions strengthened the rules on corporate governance of banks. The amended Bank Act, which took into effect in November 2010, focused primarily on

47 See e.g., id. art. 22(7).
48 See e.g., Bank Act, art. 23-2(2).
49 See e.g., Bank Act, art. 23-3(2).
52 Id.
53 Id.
improving the outside director system and the audit committee scheme. With regard to the outside director system, the number of outside directors in the board of directors of banks has been increased from no less than 50% to the majority, in order to further secure their original role of checking and balancing the management and strengthening their independence. To block the influence of major bank shareholders, these shareholders as well as their related or affiliated persons are not eligible to be outsider directors.

Concerning the audit committee system, in order to enhance its specialization, the revised Bank Act required banks to select at least one specialist in the area of audit or finance. For the purpose of securing the audit committee’s independence from major shareholders, the large shareholders holding more than 3% voting shares are prohibited from exercising their voting rights for the portion exceeding 3% in selecting outside directors in the audit committee member at the shareholders meeting.

Moreover, a new requirement of setting up a bank’s internal rules or best practices on corporate governance and disclosing the details thereof on its website, including the constitution of the board of directors, qualifications of the directors, and a compensation scheme of directors and officers, was imposed on banks, for the purpose of enhancing the transparency and credibility of the banks’ corporate governance, since corporate governance of banks is believed to have significant impacts on the interests of stakeholders and customers.

D. Second Step: The Government’s Proposal of the Unified “Financial Institution Corporate Governance Bill”

Furthermore, in order to consolidate the current rules and regulations on the corporate governance of financial institutions dispersed in separate pieces of legislation, and to further enhance the transparency and accountability of financial institutions, the FSC as a financial industry policy-decision agency announced the proposal of the new integrated “Financial Institution Corporate Governance Bill” (“FICGB”) in December 2011. The FICGB applies to major financial institutions, including securities firms, insurance companies, mutual savings companies, credit specializing finance companies, as well as financial holding companies and banks. Although it is still being discussed in the National Assembly and has not yet been

54 Bank Act, art. 22(2).
55 Id., art. 22(7), item 2.
56 Id., art. 22-2(2), item 2; Enforcement Decree of the Bank Act, art. 17(1).
57 Bank Act, art. 23-2(5).
58 Id., art. 22-4(1).
60 Financial Institution Corporate Governance Bill, art. 2, item 1.
enacted, this Bill contains many significant provisions that aim to enhance the corporate governance in financial institutions.

The FICGB is adopting substantial regulations, some of which have been already imposed on banks as described above. These include the constitutional requirement for the majority of the board of directors being outside directors,\(^{61}\) the requirement that the audit committee have at least one specialist in the area of audit or finance,\(^{62}\) the prohibition against voting by major shareholders when selecting audit committee members,\(^{63}\) and the adoption of internal corporate governance rules and disclosure thereof.\(^{64}\) Further, the FICGB is adding stricter regulations. Major measures include the following. First, a chairman of the outside director candidate recommendation committee, an ad-hoc committee, should be appointed from the outside directors, instead of standing directors; this would help block any influence from a CEO as a standing representative director.\(^{65}\) Second, a compensation committee for addressing matters of compensation for directors and the management should be established;\(^{66}\) this requirement is designed to promote transparency and accountability in the process of setting compensation. Third, a risk management committee as well as internal risk management rules must be set up, and a chief risk officer in charge of this matter must be also appointed;\(^{67}\) these requirements would greatly promote the risk management standards and skills. Fourth, major executive officers such as those in charge of strategy and financing must be appointed by a resolution of the board of directors\(^ {68}\) rather than the appointment by a CEO under the existing rules, so as to ensure their more strong independence from a CEO’s influence. Fifth, ‘positive’ qualification requirements for the outside directors were added to the current ‘disqualification’ requirements, providing that outside directors should be experts possessing specialization and experiences in the fields of finance, economy, management, law or accounting,\(^ {69}\) this, in turn, would give them greater independence and specialization and so enable them to play the role of keeping the management, particularly, a CEO, in check.

In conclusion, the FICGB contains diversified measures seeking to upgrade the corporate governance system in financial institutions by introducing new requirements and schemes, and in particular, strengthening the roles of outside directors. Nevertheless, there still remain more issues that need to be improved or rectified; these will be discussed in detail in III.3.

\(^{61}\) Id. art. 12(2).
\(^{62}\) Id. art. 18(1).
\(^{63}\) Id. art. 18(7).
\(^{64}\) Id. art. 13.
\(^{65}\) Id. art. 15(3).
\(^{66}\) Id. arts. 17(1), 21.
\(^{67}\) Id. arts. 17(1), 20, 26, 27.
\(^{68}\) Id. art. 8(1).
\(^{69}\) Id. art. 6(3).
4. Introduction of a “Macro-prudential Stability Levy” System

A. Background

After the GFC, the issue of each nation’s introduction of a “bank levy” system, often called a “financial stability contribution” system, was also one of the controversial agendas of the G-20 summits. Its main purpose is to procure a necessary ex-ante fund contributed by the financial institutions themselves, not by government, “to repair the financial system or to fund resolution.” Some countries, such as the US, the United Kingdom, Germany and France, supported this approach, whereas other countries, such as Canada, Australia, Japan, Brazil and China, preferred other approaches. Thus, the G-20 Toronto Summit on June 26 and 27, 2010 only agreed to adopt the basic principles, according to which a range of approaches would follow:

(i) protect taxpayers;
(ii) reduce risks from the financial system;
(iii) protect the flow of credit in good times and bad times;
(iv) take into account individual countries’ circumstances and options; and
(v) help promote a level playing field.

B. Implementation of the Levy System

From among those approaches, the Korean Government decided to choose a bank levy system. The Korean bank levy system mainly aims to promote the stability of a financial system rather than to fund the resolution of insolvent financial institutions, and it focuses more on maintaining the stability of the ‘foreign exchange’ market. It is therefore named the “Macro-prudential Stability Levy System.”

In December 2010, the Korean Government announced the plan to introduce this levy system, with charges on the daily average balance of the non-deposit foreign currency liabilities of banks, not all financial institutions. The Government recognized that “Korea was highly vulnerable to changes in the global economy and sudden capital movements,” an example of which was the “sudden capital outflow following excessive capital inflow during

72 SUNGWOOK PARK & YOUNG DO KIM, supra note 70, at 12, 13.
boom periods” in the midst of those two financial crises in 1997 and 2008, respectively.\textsuperscript{75} The need for curbing massive capital inflow into the Korean foreign exchange markets in the form of “carry trade” was also another motivation for adopting this levy system.\textsuperscript{76}

This levy system has been implemented since August 2011, by revising the Foreign Exchange Transaction Act (“FETA”) and the Enforcement Decree thereof, which are the relevant law and regulations.\textsuperscript{77}

\textbf{C. Operation of the Levy System}

Pursuant to the FETA, a levy is imposed on the non-deposit foreign currency liabilities of banks, including commercial banks, specialized banks, and branches of foreign banks.\textsuperscript{78} A levy of up to 0.5 percent is imposed on the daily average balance of those liabilities according to their maturity; 0.2 percent for those liabilities with less than one year maturity, 0.1 percent for those between one and three years, 0.05 percent for those with three to five years, and 0.02 percent for those with more than five years.\textsuperscript{79} In case of an emergency, particularly where there appears to be harm to the financial markets and the national economy due to the increasing volatility of international financial markets or a sudden surge of foreign capital inflows into Korea, an extra levy of up to 1.0 percent is imposed for up to six months on the increased amount of the balance during that period.\textsuperscript{80} The extra levy is calculated on the difference between the daily average balance during the period when the extra levy is being imposed and the daily average balance during the three-month period immediately preceding the day of imposition regarding the extra levy.\textsuperscript{81} Further, taking into account that retail funding is more stable than wholesale funding, such as foreign borrowings and bond issuances, and in order to provide incentives to those banks holding retail foreign currency deposits, the retail deposits have been deducted, effective from December 2012, from such daily balances of the non-deposit foreign currency liabilities.\textsuperscript{82} The deduction is only up to

\begin{itemize}
    \item \textsuperscript{75} Id.
    \item \textsuperscript{76} Id.
    \item \textsuperscript{77} Financial Services Commission Press Release, \textit{Macro-prudential Stability Levy to be Imposed from August} (July 29, 2011), \textit{available at} http://english.mosf.go.kr/ (last visited on Jan. 21, 2013).
    \item \textsuperscript{78} FETA, art. 11-2; Enforcement Decree of the FETA, art. 21-2. The levy applies to a total of 56 financial institutions, including 13 commercial banks, 37 foreign bank branches, 5 specialized banks (Industrial Bank of Korea, Korea EximBank, Korea Development Bank, Bank of National Agricultural Cooperative Federation, and National Federation of Fisheries Cooperatives), and Korea Finance Corporation. See Financial Services Commission Press Release, \textit{supra} note 74.
    \item \textsuperscript{79} FETA, art. 11-2(2); Enforcement Decree of the FETA, art. 21-3.
    \item \textsuperscript{80} FETA, art. 11-2(3).
    \item \textsuperscript{81} Enforcement Decree of the FETA, art. 21-5.
    \item \textsuperscript{82} Enforcement Decree of the FETA, art. 21-4(2).
\end{itemize}
30 percent of the daily balance of the non-deposit foreign currency debts liable to the bank levy.83 The levy amount will be used for providing foreign currency liquidity to troubled financial institutions during future financial crises, in order to cope with external shocks.84 The introduction of this levy system in Korea is consistent with the global trend. It will surely contribute to promoting the macro-prudential stability of the financial system and markets in Korea since it will help reduce volatility in capital movements and curb excessive capital flows in the foreign exchange markets to which Korea is so vulnerable.

5. Enhancement of the Financial Information Sharing Scheme among Financial Regulation-Related Agencies

A. Inefficient Operation of Financial Information Sharing System

Improvements were also made in the area of financial information sharing among financial regulation-related institutions, such as the finance ministry, the central bank, the financial regulators and the deposit-taking insurer in Korea. There had been strong criticism that the poor financial information sharing system had hindered effective actions to contain the spread of the GFC in Korea.85 In particular, under such a failed scheme, the central bank lacked bank supervisory powers, of which the BOK had been deprived since 1998 right after the 1997 financial crisis, and this deficiency was believed to have negatively affected the central bank’s function as a lender of last resort. To be an effective lender of last resort requires sufficient and reliable information about financial institutions. In the absence of bank examination powers, the BOK had difficulty in accessing financial information.

B. Enhancing with a MOU Scheme

A new scheme for promoting the information sharing system was implemented by revising the then-existing memorandum of understanding (“MOU”). On September 15, 2009, the revised “Memorandum of Understanding on Financial Information Sharing” was signed among the BOK, the FSC, the FSS, the Ministry of Strategy and Finance (“MOSF”), and the Korea Deposit Insurance Corporation (“KDIC”), amending the previous MOU that had been entered into among the BOK, the FSS, and the KDIC on January 20, 2005.86

The inclusion of the government ministries, the MOSF and the FSC, as parties to the MOU, is believed to further strengthen the cooperation and information sharing scheme

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83 Id.
84 Financial Services Commission Press Release, supra note 74.
85 Dong Won Ko and Tae Seok Roh, Kumyung Anjung Eul Yihan Yekeum Boheom Gigu Yi Yeokhwal E Kwanhan Yeongu [Improvements for the Role of the Korea Deposit Insurance Corporation in Relation to Financial Stability in Korea], 11 KUMYUNG ANJUNG YEONGU [FINANCIAL STABILITY STUDIES] No. 1, 99, 132 (2010).
among such agencies. Further, the revised MOU “clarified when and what information should be shared, put in place a feedback system and reinforce[d] coordinating function of the [Financial Information Sharing] Council,” 87 thus enhancing the information sharing scheme.

Under the amended MOU, the scope of information to be shared among the BOK, the KDIC and the FSS has been greatly expanded. For instance, the number of information sharing cases between the BOK and the KDIC during 2009 sharply increased to 34 from 9 cases a year earlier as 25 more external reports and foreign exchange reports were shared.88 Further, the KDIC’s availability of the FSS’s business reports increased to 96.3% as the FSS’s business reports related to the financial investment business sector were added to a list of information sharing.89

Nevertheless, we may still find some drawbacks to the reinforced MOU scheme, in particular because the MOU lacks legal binding force. In other words, the MOU would not be enforceable unless the parties voluntarily cooperate in sharing information. This implies the need for some improvements, as discussed in detail below in III.6.

III. Prospects and Recommendations for the Future Direction of Financial Reforms in Korea

Are the regulatory reform measures taken by the Korean Government after the GFC sufficient? This author strongly believes that they are not. More systemic reforms need to be undertaken in order to tackle some problems that appeared during the GFC in the area of financial policy and regulations and to further enhance the competitiveness and efficiency of the Korean financial industry. This part will explore some recommendations for future effective financial regulations and policies as well as to enhance the competitiveness of financial industry in Korea.

1. Reshuffling the Financial Supervisory Organization Scheme

A. Why Is an Overhaul Needed?

One of the most controversial and crucial issues with regard to financial regulation and policy in Korea is the reform of the financial regulatory authority scheme. Without a robust financial supervisory system, it is almost impossible to develop and upgrade the financial industry and markets. The current system was set up in early 2008 under the Financial Services Commission Establishment Act. It was initiated by the then ‘president transition committee’ when the new administration of President Lee Myung Bak was launched.90 The transition

87 Id. at 63.
88 Id.
89 Id.
90 Dong Won Ko, Hyunhaeng Geumyung Gwamdok Gigu Cheju Eu Munjejeom Kwa Gaepyun Banghyang
committee was mandated to reschedule the government organizations, including the financial regulators. The committee proposed the creation of a new agency, the FSC, as a governmental body, consolidating the function of ‘financial industry policy’ conducted by the then Ministry of Finance and Economy and the function of ‘financial regulation policy’ performed by the then Financial Supervisory Commission (changed into the FSC in February 2008), a governmental agency. Further, the chairmanship of the Financial Supervisory Commission was segregated from the governorship of the FSS, a non-governmental financial regulatory execution body. This means that it was a system of dual financial regulators. The proposal was passed in the National Assembly in February 2008. Many scholars and civic groups have, however, strongly criticized this proposal, arguing that the new scheme would not operate efficiently and would give rise to many problems.91

Their concerns were indeed realized when several mutual saving banks went bankrupt in early 2011.92 Strong criticism was raised against the financial regulators—both the FSC and the FSS—the assertion being that they failed to supervise those saving banks properly. Immediately after this event, President Lee strongly urged the Government to reform the regulatory organization, and in May 2012, the Prime Minister’s Office launched a task force consisting of scholars and relevant government officials to consider the proposal of reshuffling the financial regulator scheme.93 However, the task force did not touch on the issue of overhauling the organization scheme; rather it only proposed some improvements in respect to their operations. The belief was that this issue was closely related to an overall government overhaul scheme expected with the launch of the new Government in February 2013 after the presidential election in December 2012.94 Amid such developments, during the latter part of 2012, more than ten seminars or symposia were held discussing this imminent and important issue. The objective of these gatherings was to search for a more desirable model for the regulatory organization.

What are the problems? This author believes that five serious problems exist. The first and foremost is that the FSC itself executes both financial industry policy and financial regulation policy,95 so that there is no adequate check and balance between the two functions.96 Second, because the FSC is a governmental agency, a tendency for the government to exercise a

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91 Id. at 472.
93 Dong Won Ko, supra note 90, at 442.
94 Id.
95 See Financial Services Commission Establishment Act, art. 17.
96 The financial industry policy is usually oriented into deregulation policy, whereas the financial regulation policy is mainly targeted into strong supervision on financial institutions. Thus, if two policies are performed by one entity, then the check and balance between them would fail.
strong influence upon and interference with the financial markets and industry always exists, leading in turn to inefficiency of the financial industry. This problem has been continuously criticized vehemently by reputable scholars as a ‘peculiar’ phenomenon in Korean financial history.97 Third, as mentioned above, the FSC and the FSS, being separate entities, do not sufficiently cooperate with each other and even fight over the same or similar issues. This also appears to create substantial burdens on the financial markets and industry, generating severe inefficiency. Fourth, because the function of financial regulatory policy is conducted by the FSC, a governmental entity, it lacks the independence, neutrality, and specialization of financial regulation. Such features are regarded as important standards for effective supervision and regulation, as suggested by international financial organizations, such as the BCBS,98 the International Organization of Securities Commissions,99 and the International Association of Insurance Supervisors.100 Fifth, because the function of ‘international’ financial policy, or the policy regarding foreign exchange and reserve management and control, is conducted by the MOSF, while on the other hand domestic financial policy is performed by the FSC, cooperation and information exchange between the two agencies does not work well.

B. How Should the Future Scheme Be Designed?

(1) Separation between Financial Industry Policy and Financial Regulation Policy Functions
The first solution is obvious; it is to split the functions of financial industry policy and financial regulation policy. These are currently conducted by one entity, the FSC. Comparatively, it is unusual that one entity performs two such roles at the same time. Japan is perhaps the exception.101 Korea so often tends to model its system after Japan. Financial

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97 Dong Won Ko, supra note 90, at 454.
industry policy, which inclines inherently toward deregulation, needs to be controlled and checked by financial regulation policy, and the latter tends to be more cautious. In the case where one institution performs both functions, regulatory policy would likely be inclined to be subordinated to financial industry policy, which would often lead to a lack of adequate checks and balances.

The solution is simple: the FSC’s financial industry policy should be returned to the MOSF, which already has powers over foreign and international financial policy. This would naturally lead to the consolidation of domestic and international financial policies. And separately, the FSC’s financial regulation policy function should be transferred to the FSS, the current financial regulation enforcement agency, enabling the FSS to become a unified financial regulatory authority. This reform will eventually lead to the dissolution of the FSC.

(2) Performance of the Financial Regulation Policy Function by a Non-Governmental Agency

Integrating the financial regulation policy decision-making agency and the financial regulation execution policy entity is another important, yet controversial and interesting issue in reforming financial regulatory organizations. The Government always takes the position that financial regulation policy should be conducted by a government agency, because performance of financial regulation policy by a non-governmental entity would be likely to violate Article 66(4) of the Korean Constitution, which provides that “[e]xecutive power shall be vested in the Executive Branch headed by the President.” However, most scholars believe that the term “executive power” extends to a non-governmental entity as well as central government departments and provincial government departments as long as the legislation delegates such power to a non-governmental institution. Further, the operations of financial regulation policy by a non-governmental entity would be more efficient. A non-governmental entity would ensure independence, specialization and accountability because it is remote from the influence or interference from the Government and even political groups. Therefore, if the function of financial regulation policy would be transferred to the FSS, as discussed above, then the consolidation of two functions would be easily implemented, and the FSS will be the sole financial regulatory agency in the capacity of a non-governmental institution.

2. Remaining Issues for the Promotion of Financial Consumer Protection

A. Need for an Independent Financial Dispute Settlement Agency

The Korean Government’s policy toward reinforcing financial consumer protection is on the right track. For instance, seeking to enact a new law, the FCPB, which contains various provisions regarding business conduct rules, is regarded as desirable. Much more attention, however, should be paid to the other side of consumer protection, providing consumers with

efficient and affordable remedies for damages incurred by unfair or illegal activities of financial institutions. Of course, consumers may seek legal remedies through the court. This, however, involves high costs and takes even longer for resolution. Instead, an ADR system, such as conciliation or mediation, may be preferable because the ADR is substantially less expensive than litigating in the courts, and less time consuming. Therefore, the ADR system, particularly the conciliation system, is now becoming popular in Korea, and the FSS is operating this conciliation system in the area of financial disputes.103 One of advantages of the conciliation system operated by the FSS is that, pursuant to the relevant law, the Financial Services Commission Establishment Act, if both disputing parties accept the resolution proposed by the FSS as a conciliator, then the resolution would be legally binding without further opportunity for recourse to the court.104

The current system, however, needs to be improved because it has some drawbacks. First, because the regulator also operates the conciliation system, it lacks ‘fairness.’ Regulated financial institutions are highly likely to be burdened by a fear of possible ‘retaliation’ from the regulator if they do not accept the resolution proposed by the FSS. Secondly, since the function of financial dispute settlement is regarded as a ‘trivial’ or unimportant part within the FSS, as compared with the functions of prudential regulations and business conduct regulations, the FSS’s departments in charge of these matters are not favored by employees. As a result, it is difficult to retain exceptional personnel or staff as well as legal experts, who are qualified to analyze legal issues of the concerned dispute cases. Yet most financial disputes involve complicated legal issues.

One method to enhance the protection of financial consumers would be to set up a system where wronged consumers are sufficiently and fairly protected through impartial financial dispute settlement procedures. In that sense, we may agree that the conciliation system needs to be handled by an independent third party institution, rather than a regulator. Therefore, the financial dispute settlement function should be separated from the FSS, creating a new independent institution. By creating a new agency, specialization will be procured easily and naturally. The new agency would be able to focus on financial disputes that require legal expertise and would be able to recruit sufficient legal experts and staff accordingly.

Securing such fairness and specialization would help enhance the reliability of conciliation resolution so that consumers would prefer conciliation to the court. This would generally save on costs for financial dispute resolution. By way of comparison, the United Kingdom and Australia have established their respective ‘independent’ financial dispute settlement institutions, both called the “Financial Ombudsman Service,” to be operated independently, albeit supervised by the regulators, the Financial Conduct Authority and the Australian Securities and Investments Commission, respectively, for certain limited matters.105

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103 See Financial Services Commission Establishment Act, art. 51.

104 See id. art. 55.

105 Financial Services and Markets Act 2000, Sec. 225, Schedule 17, Sec. 3(3); see BLACKSTONE’S GUIDE TO THE FINANCIAL SERVICES AND MARKETS ACT 2000, 191 (Michael Blair ed., 2009). For a detailed
B. Is a ‘Twin-Peaks’ Model Desirable for Reinforcing Financial Consumer Protection?

In connection with the enhancement of financial consumers protection, another related key issue is about the introduction of a ‘twin-peaks’ model for regulators in Korea. Under this model, there are two regulators, namely a prudential supervision regulator and a business conduct regulator. A prudential regulator focuses primarily on ‘prudential’ regulations or safety and soundness regulations on the regulated financial institutions, while a business conduct regulator is mainly involved in regulating business conducts of financial institutions selling financial products and is in some cases also engaged in regulating capital and securities markets. This model is currently adopted by a few countries, such as Australia, the Netherlands, New Zealand, and very recently the United Kingdom. The twin-peaks model has definite advantages: each regulator is able to pursue specialization in the respective area by concentrating on their respective business. Whereas there might be some drawbacks, such as regulatory ‘underlap’ where the fields exist which neither regulator can cover, regulatory ‘overlap’ or duplication which creates additional regulatory burdens on regulated financial institutions, increases in the likelihood of non-

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106 For the concept and comprehensive descriptions of the twin-peaks model, see generally MICHAEL W. TAYLOR, TWIN PEAKS: A REGULATORY STRUCTURE FOR THE NEW CENTURY (1995).

107 HEIDI MANDANIS SCHOONER & MICHAEL W. TAYLOR, GOLBAL BANK REGULAITON: PRINCIPLESS AND POLICIES 267 (2010). There are four types of financial regulators: an institutional regulator, a functional regulator, an integrated regulator, and regulators under a twin-peaks model. Id. at 260-269.


cooperation between two regulators, and difficulties in sharing of financial information between two regulators.\textsuperscript{112}

Would the twin-peaks model be desirable for Korea? Taking into account the financial environment of Korea, this author believes that the model might actually result in more negative effects. In addition to the ‘underlap and overlap’ regulation phenomenon, two regulators are highly likely not to cooperate or share financial information well. Therefore, it is believed that the model would lead to inefficiency in the financial industry and regulatory system in Korea. In short, this article concludes that the twin-peaks model is not ideal for Korea at the moment.

3. Need for Additional Improvements in the Corporate Governance of Financial Institutions

The Korean Government is seeking to enact a new integrating law regarding corporate governance of financial institutions through strengthening the current governance system. Thus, it seems generally to be proceeding in the right way. As mentioned above, the proposed Bill, the FICGB, introduces various tools for securing the strong independence of outside directors, such as the requirement of comprising the board of directors with the majority of outside directors, and the requirement of appointing a chairman of an outside director candidate recommendation committee from outside directors.

Nevertheless, some important areas remain unaddressed, particularly in limiting the extensive powers of the CEO over the management and operation of financial institutions. Although outside directors are selected by the procedure of nomination of the outside director candidate recommendation committee, the committee, in the process of nomination, is in reality heavily influenced by the current CEO. The CEO could even be the chairman of the board of directors. The proposed Bill fails to address this point. In order to curb the influence of powerful CEOs, banning a CEO from the chairmanship of the board of directors should be considered, requiring instead an outside director to assume the chairmanship.\textsuperscript{113} Alternatively, if a CEO has the concurrent position of chairmanship in the board, one consideration could be to select a lead outside director who will preside over outside director meetings, which would play a role of containing the CEO. This alternative method is currently applied by banks and bank holding companies that follow the “Best Practices of Outside Directors of Banks and

\textsuperscript{112} Sources are the author’s interviews with Mr. Chris Gaskell, Head of International Relations of the Australian Prudential Regulation Authority, Mr. Jeremy Bray, Senior Economist of the Australian Securities and Investments Commission, and Mr. Cameron Paterson, Division Director of Risk Management Group of Macquarie Bank Limited, on November 26, 2012, respectively.

\textsuperscript{113} Comparatively, the United States is adopting the disclosure requirement, rather than the direct prohibition of concurrent position of chairmanship and a CEO. Under the Dodd-Frank Act of 2010, an issuing listed company is required to “disclose in the annual proxy sent to investors the reasons why (1) the issuer has chosen the same person to serve as chairman of the board of directors and chief executive officer (or in equivalent positions); or (2) different individuals to serve as chairman of the board of directors and chief executive officer (or in equivalent positions of the issuer).” The Dodd-Frank Act, §972.
Bank Holding Companies,” adopted (though not as binding law) by the Korea Federation of Banks, a self-regulatory organization for banks, and endorsed by all banks and bank holding companies.

Second, the procedure for selecting a CEO should be more transparent. Currently, a financial institution CEO can be appointed under the Articles of Association of the respective financial institutions as long as they comply with the procedure prescribed by the Commercial Code. In other words, unlike the selection of outside directors and without the procedure of nomination of a candidate committee, a CEO is appointed only by resolution of the board of directors or at shareholders meetings if this is prescribed by the Articles of Association of the concerned financial institutions. However, it should be noted that CEOs are very influential. Financial institutions have ‘public’ characteristics in their economic roles, as compared with non-financial companies, where ‘private’ characteristics are more dominant. Therefore, it is essential to establish a CEO candidate committee, which should consist of all outside directors, or at least a representative of consumer groups. By securing such a scheme, a more qualified CEO would be more likely appointed, and this would enhance the competitiveness of financial institutions.

Third, a system of operating a ‘pool’ of outside director candidates is required. Currently, outside directors are only selected through nomination by an outside director candidate committee, followed by appointment at shareholders meetings. In fact, this process is significantly influenced by the current CEO, who is exercising his enormous powers by often recommending his friends, colleagues, relatives or related persons as outside director candidates. The current system lacks transparency and fairness. Therefore, it is recommended that a ‘pooling system’ be adopted, in terms of which a special institution such as a self-regulatory organization, like the Korea Federation of Banks or the Korea Financial Investment Business Association, would develop and operate a pool of qualified candidates and recommend such qualified candidates to the financial institutions concerned if requested. Through such a scheme, candidates with the proper qualifications, expertise and experience would be able to be selected as outside directors so that it would help enhance their intended roles of containing the management, particularly the CEO.

4. Need for Macro-Prudential Supervision and Policy Framework
The GFC revealed that each nation lacked a macro-prudential regulation system, the main purpose of which is to prevent systemic risks in the financial system. The G-20 summits recognized this issue and chose this subject as one of its major plans: the G-20 London

\[114\] Best Practices, art. 16(2), (3).

\[115\] Commercial Code of Korea, art. 389.


\[117\] See e.g., Bank Act, art. 22(3).
Summit set this up as one of eight major reform agendas; and the G-20 Seoul Summit called on the FSB, the IMF and the Bank for International Settlements to do further work on a macro-prudential regulation policy framework, seeking to deal with systemic risks in the financial sector in a comprehensive manner. In line with this, the US, by enacting the Dodd-Frank, launched the “Financial Stability Oversight Council” ("FSOC"), which has statutory authority to identify and address systemic risks threatening financial stability.

In Korea, the Bank of Korea Act, the central bank law, was amended in September 2011 to provide a mandate of “financial stability” to the BOK. It is unclear, however, whether the BOK was wholly mandated for the power of macro-prudential regulation under the new provision of the task of financial stability, because there are no detailed and specific provisions in implementing this task. Therefore, in order to create a macro-prudential regulation framework, Korea needs to set up a new council modeled along the lines of the FSOC in the US. Such a body would be responsible for identifying and addressing emerging systemic risks throughout the financial system. The related institutions or agencies such as the MOSF, the BOK, the FSC, the FSS, and the KDIC, as well as independent civil members, should participate in the council. This council should also be supported by a secretariat for collecting financial data and conducting economic analysis with regard to systemic risks, like the US’s Office of Financial Research, housed within the Department of Treasury under the Dodd-Frank, and providing data and analyses regarding financial stability to the FSOC upon its request.

5. Setting Up a New Framework for Regulating Domestic Systemically Important Financial Institutions (“D-SIFIs”)

Amid the GFC, a number of large, global financial institutions, such as Lehman Brothers and AIG, went into insolvency, destabilizing the financial system domestically and globally, and
exposing taxpayers to the risk of loss.\textsuperscript{123} It shocked the financial system, and in turn harmed the real economy.\textsuperscript{124} The G-20 summits sought to address this problem: the G-20 Pittsburgh Summit set this issue as one of the agendas;\textsuperscript{125} and the G-20 Seoul Summit also identified this as one of the principles necessary for strengthening supervisions of systemically important financial institutions (“SIFIs”), reducing moral hazard problems and simultaneously addressing “too-big-to-fail” problems, which are believed to be the “root” causes of the GFC.\textsuperscript{126} Mandated by the G-20 summits to address global systemically important financial institutions (“G-SIFIs”), in November 2011, the FSB and the BCBS jointly announced a report of the \textit{“Global systemically important banks: assessment methodology and the additional loss absorbency requirement.”} The report set out the “measures . . . on the assessment methodology for global systemic importance, the magnitude of additional loss absorbency that [G-SIFIs] should have, and the arrangements by which they will be phased in.”\textsuperscript{127} Further, to address domestic systemically important financial institutions (“D-SIFIs”), the FSB and the BCBS jointly published a report in October 2012 entitled \textit{“A framework for dealing with domestic systemically important banks.”} This report complemented the G-SIFIs framework by “focusing on the impact that the distress or failure of banks (including by international banks) will have on the domestic economy.”\textsuperscript{128}

In Korea, a D-SIFIs framework needs to be set up, rather than a G-SIFI framework, because the G-SIFIs do not appear to have significant operations in Korea. It may be argued, however, that the D-SIFIs regime may not be needed at the moment in Korea because of the current strict regulation and supervision imposed on large banks and financial holding companies, and such new regulations might create a burden on the management of business, e.g., increasing funding costs. However, this author takes a different view. Whereas the current regulations focus primarily on a micro-prudential regulation framework, the new D-SIFIs framework aims to reduce systemic risks from the perspective of macro-prudential regulation. Therefore, this article advocates that the new D-SIFIs regime should be founded in Korea as soon as possible. Especially, this argument is important because other countries

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\item Basel Committee on Banking Supervision, \textit{Global systemically important banks: assessment methodology and the additional loss absorbency requirement} (Nov. 2011), at 1, available at \url{http://www.bis.org/publ/bcbs207.pdf} (last visited on Jan. 27, 2013).
\item \textit{Id.}
\item The Seoul Summit Document, supra note 119, at Para. 30.
\item Basel Committee on Banking Supervision, supra note 123, at 2.
\end{list}
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with major financial centers critical to Korea, such as the US, Switzerland, and Sweden have already began to implement this new regulatory scheme or plan to do so soon.

6. Need for Improvement of the Financial Information Sharing Scheme
Sharing or exchanging financial information among financial regulatory-related authorities is a crucial factor for maintaining robust financial stability. Without a well-operated information sharing scheme, each relevant authority is not able to deal with problems such as systemic risks in a proper and timely manner. As discussed above, in Korea, in response to the GFC, the new scheme of the MOU was set up among the financial regulation-related authorities. However, the current MOU system has its own limitations because it is not legally enforceable, unlike a contract or an agreement, which has binding legal force. Without voluntary compliance and cooperation from the participants, the MOU system may not be effective.

Thus, this author strongly asserts that it is necessary to create a new institution such as a “Central Financial Information Repository” (“CFIR”) as a legal entity, controlled and supervised by the financial regulators. The new system would work as follows: financial institutions would submit all information, data and documents, including periodical financial reports and other documents, to the CFIR, and the relevant regulatory institutions such as the MOSF, the FSC, the FSS, the BOK and the KDIC would retrieve all such documents without the need to demand documents directly from regulated financial institutions. Thus, the regulated financial institutions would not have the large burden of filing reports to the several regulators; and there would be no discord or conflicts among those related financial regulators on the accessibility to financial information.

IV. Conclusion

The GFC has great impacts on the Korean financial system as well as the financial regulatory regime. In the opinion of the author, in general, the Korean Government responded

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to the GFC well and has taken necessary regulatory measures in a prompt and timely manner with respect to the injection of public funds, reinforcing financial consumer protection, and improvements of corporate governance. These measures have been effective because the Government gained experience from the first financial crisis in late 1997 almost fifteen years ago and has learned the lessons from such experiences. In addition, it is noteworthy that such regulatory reform measures have been consistent with global trends initiated by G-20 summit meetings and the frameworks set up by international financial organizations such as the BCBS and the FSB.

However, further improvements and developments remain necessary for the future financial industry and system of Korea. The most important task is to reform the financial regulatory regime, currently still a comparatively unprecedented and ‘awkward’ scheme that continues to display many serious problems. Further, in order to protect financial consumers more efficiently, the ADR system currently operated by the FSS needs to be segregated from the FSS organization in order to more effectively redress financial consumers who have suffered damages or losses from unfair or illegal activities of financial institutions. In addition, improvements for corporate governance in financial institutions remain, particularly in restricting the enormous powers of the CEO, often the most influential person on the board of directors, including the process of selecting outside directors. Moreover, the framework for macro-prudential supervision needs to be set up by creating the “Financial Stability Oversight Council.” Furthermore, the D-SIFIs regime should be launched to rectify “too-big-to-fail” problems. Finally, the information sharing scheme under the MOU needs to be upgraded into a legal basis with a creation of the “Central Financial Information Repository.”