

DINNER ADDRESS

Kwon Okyu

Deputy Prime Minister
Ministry of Finance and Economy

Opening Remarks

Respected Chairman Yoon Jeung-Hyun of the Financial Supervisory Commission, distinguished guests from home and abroad, ladies and gentlemen,

It is my great pleasure to say a few words at the welcome dinner of this important international gathering.

I would like to thank all participants, especially the foreign participants, who took time to come to the conference and my country all the way from your respective homes, despite your very busy schedule.

I hope that this conference on "Macroprudential Supervision: Challenges for Financial Supervisors," jointly organized by IMF and FSC/FSS, will create a significant momentum for Korea's financial supervisory system to upgrade to the next level.

Recent Economic Trends

Now, let me take you to a short journey to the present Korean economy.

The Korean economy this year has displayed the "higher in the first half and lower in the second" growth pattern as initially forecasted in the beginning of the year. Until the third quarter of this year, the GDP growth recorded 5.3%. We project that if the economy can expand 4% and over in the fourth quarter, our economy can grow 5% for the whole year.

In the case of financial markets, the Korean stock market index KOSPI and the foreign exchange market fluctuated at the North Korea's nuclear test announcement. However, the market fluctuation was short-lived. The financial market quickly returned to normal. As you may know, North Korea just last week announced its intention to return to the six-party talk. Given this, Korea's financial market is expected to stand on a more stable footing.

Albeit this, when taking into account the change in the surroundings, the Korean economy is not without risk. There are several downside risks to the global economy, I am afraid. The moderating U.S. economy is giving rise to uncertainties in the global economy, although the recent developments are suggesting a possible soft landing. Uncertainties still remain in connection with foreign exchange, the North Korean nuclear issue and oil prices.

We at the Korean government are closely monitoring the change in the surroundings and analyzing the impact on real economic indicators. If so deemed, we will prepare necessary measures to integrate into next year's economic policy framework. We believe that this process will help us ensure the Korean economy to expand in line with growth potential next year and the years to come.

Current Status of Korea's Financial Industry

As the Korean economy has matured, so has our financial industry. It has grown steadily over the years. Our financial markets were hard hit by the Asian financial crisis. However, the financial markets took it well and took up prompt restructuring and proactive streamlining of various institutions. This helped our financial system to recover its stability.

Insolvent financial institutions were exited, merged or acquired, leading to near completion of financial restructuring. As a consequence, profitability and asset quality of financial institutions have improved to a great extent.

Also, the share in GDP of the financial industry has risen from the 5-6% range in the 90s to 7-8% range since 2000. Its contribution to the

national economy is on a steady rise. This, however, is not sufficient to boost international competitiveness of our financial industry. It calls for more proactive endeavors.

To date, our financial institutions are still small compared to those in advanced economies. Our financial industry is yet to boast productivity and competitiveness as high as that of advanced economies.

Financial Hub Initiative Strategy

Just as I say this, you may be questioning: "What have you done then to level up your financial industry?"

Certainly, we have done our best and most toward a more advanced financial industry. Central to this endeavor lies the Northeast Asian Financial Hub Strategy of the Participatory Government. It was designed and is in implementation, with a view to promoting competitiveness of the financial industry and building it up as a key growth engine.

We are pursuing the advancement of the financial system to expedite financial innovation and competition. Concrete plans for this goal include the zero-base comprehensive financial regulatory reform and legislation of the "Financial Investment Services and Capital Market Act".

Another important agenda on our financial priority list is advancement of the foreign exchange market. To this end, early in the year we shifted the previous capital transactions permit system to a report system. In the same vein, full implementation of the foreign exchange liberalization plan, originally scheduled to be completed by 2011, has been brought forward to 2009.

As part of this drive, we are entrenching necessary supporting institutions and a legal base to facilitate the financial hub initiative. For instance, Korea Investment Corporation (KIC) was launched in 2005 and "fn HUB Korea" was set up early this year. We are also pushing for enactment of the "Financial Hub Promotion Act".

Our such efforts are now bearing fruit. Our financial markets including the stock and foreign exchange markets are expanding. And there is a heightening demand by foreign financial institutions regarding making inroads to the Korean market.

Now, more financial experts and professionals at home and abroad are aware of Korea's financial hub policy and hold positive views on the feasibility of the initiative.

In order to build up the financial hub foundation further down the road, we will continue to effectively promote the financial system reform, including the financial regulations and the foreign exchange regime.

Added to this, we trust that the Korea-US FTA (KORUS FTA) will serve as momentum for further development of our financial industry.

We will move ahead with strategic opening. By this, I mean that we will not be shy of introducing advanced financial techniques and products as much as we can. And yet we will take full account of their impact on our domestic market and consumer protection.

Change in Role of Financial Supervision

An essential precondition for development of the financial industry is a built of an efficient and advanced financial supervisory system.

In the case of Korea, shortly after the Asian financial crisis we established the Financial Supervisory Service (FSS) in 1999, an overarching financial supervisory body, merging all related supervisory authorities. Since its inception, the financial supervisory body has introduced prompt and systemic supervision and inspection and adopted the 'Prompt Corrective Action'. The new system has prevented financial institutions from insolvency and efficiently propelled financial restructuring. In so doing, the financial supervisory body played a backbone role in Korea successfully overcoming the crisis.

Our efforts to create an effective supervisory mechanism have continued and deepened. In 2004, we drew up a reshuffle plan of the financial supervisory system to clearly demarcate the jurisdiction of

each supervisory organization.

The financial market has stabilized since the financial crisis. We have expedited our efforts toward a leap forward to a financial hub. In this process, a number of noticeable changes are taking place in the financial system. It seems to me and many of us, though, that the current financial system is somehow limited in meeting the new challenges in the rapidly changing financial market. In my assessment, we are at a critical juncture whereby a turning point is required for financial supervision to meet the new demands.

The key function of our financial supervision shaped in the process of overcoming the financial crisis rested on the regulation-oriented "directive authority". Under this regime, what was most valued was how to regulate to attain the prudence goal set in advance.

But the times have changed, calling for change in the system. If we are to remain competitive, we need to take action to shift to an "advisory authority". It highlights the market-friendly and preventive supervisory approach to financial institutions. The supervisory authority advises and consults financial institutions for them to complement the inadequate and the incomplete in their prudent management system.

I understand that this is the case in advanced economies. In the U.K. and the U.S., for instance, financial supervision focuses on identifying risks to prudent management and solving these problems through dialogue and consultation, rather than regulating. And they also take full advantage of regular inspection. As for on-site inspection, they abide by the principle of "upon required, of the required, and by required professionals", so as to lessen the burden of the inspected organizations.

We should benchmark best practices in advanced economies and create more advanced financial supervision to meet the needs of the advanced financial market and industry. In this regard, I believe that it is essential to examine the feasibility of establishing a more effective cooperation system among supervision related organizations. A symbiotic cooperation framework for supervision related organizations should be built to ensure that functions of each of them with diverse perspectives can work effectively in a complementary manner.

In doing so, we will make prudential supervision of the financial market more efficient and encourage the market to provide more diversified services to financial institutions.

A deep pool of educated financial human capital is crucial in developing the financial industry. As the financial market matures, the need for more financial professionals is increasing. In line with this, the financial supervisory authority requires more expert knowledge. Given this, it is clear that the financial supervisory authority will have to put even more efforts to foster high quality supervisory personnel with expertise.

Having said that, I would also like to request advanced foreign financial supervisory authorities, including the IMF, to extend your full cooperation and support in transferring your advanced knowledge and know-hows.

Closing Remarks

Ladies and gentlemen,

As I mentioned earlier, the Korean government is making continuous efforts to upgrade and internationalize the financial market and to entrench an advanced financial supervisory system.

Again, I request all financial experts and professionals for your active participation and cooperation toward the successful outcome of all our efforts. My request also goes to financial experts and professionals of foreign financial institutions. Your brisk investment and friendly advice with kind attention and affection to the Korean financial industry will be most appreciated.

On this hopeful note, I thank you for your participation in the conference.