I. Introduction

There is no uniform definition on what regulation is. Generally, regulation is recognized as intervention of government in activities of individuals or corporations in order to achieve certain purpose. However, it requires premise that the regulation agrees with social phenomena and its level is optimized. Unfortunately, such optimization is not prepared often in some regulations. For examples, regulation is divorced from society and technologic changes, and excessive regulation beyond public interest is imposed. Also, unclear and arbitrary judgment could be allowed to regulation officials.

Today, the field that regulation is most keenly discussed is economy. Considering that size of interest can be measured relatively accurate in the economic field, method and degree of regulation is evaluated very sensitively in this industry. Especially, financial industry very sensitively responds to regulation and abolition since it can compute interests and risks in figures according to regulation setup. The regulation system in the financial field has been changing moment to moment as affected by economic development policies, development and functional expansion of financial industry, changes of national demand, foreign exchange crisis, financial hub strategy in the northeast asia of the government, global financial crises, etc.

Meanwhile, as proved in the last global financial crisis, bank industry can be referred as bastion to keep the entire financial market circulated and stable as a center of financial market. For this reason, comparatively strict regulation is imposed in banks and the regulation came to have relatively strong justification. In this paper, general regulation systems and new changes in the entire financial industry and specific regulation system of the bank industry are studied.

II. Concept and Scope of Financial Regulation
1. Concept of Financial Regulation

Regulation means that a government intervenes in activities of individuals and corporations for specific purposes. Such activities in financial section are called financial regulation. Some people with other opinion on legal definition of regulation make definition of the regulation as "an authority intervenes in economic procedures and regulates, induces, builds or bans activities of economic agents". However, it premises a broad sense of financial regulation, so it appears difficult to include attracting or building activities in a narrow sense in the concept of regulation altogether. Therefore, financial regulation can be referred as "an authority puts limit in certain activities and enforce compliance in order to maintain market order in trade between financial institutes, producer of financial products, and financial customers". 

2. Principle and Method of Financial Regulation

(1) Principle of Financial Regulation

Principle of financial regulation can be found in Act on the establishment of financial services commission Art. 2, which defines that Financial Services Commission(FSC) and Financial Supervisory Service(FSS) should make effort to keep fairness and to secure transparency in conducting related business and not to hinder autonomy of financial institutes. Therefore, regulation principles of competent regulatory authorities can be accepted as principle of financial regulation. That is to say, the principle of financial regulation is based on fairness, transparency and autonomy.

(2) Method of Financial Regulation

In financial regulations, there are inspection or examination and monitoring(off-site examination) methods, entry and product selling regulation to prevent risk in advance, and PCA(Prompt Corrective Action) in order from the weakest in terms of direct intervention level. In risk removing methods to get rid of realized risks, there are corrective order, permission or approval or charter, cancelation or suspension, restoration order and so on. Regulatory methods are prepared as a follow-up method

for illegal incident. Such methods are by ‘Cheobun’ (處分), legal action of authority based on public law.

III. Change of Financial Regulation System in Korea

Changes of financial regulation systems in Korea have been accelerated mainly by foreign exchange crisis, global financial crisis and FTA (Free Trade Agreement between Korea and Unites States of America, KORUS). Especially ‘market regulation establishment’ and ‘competition strengthening’ suggested by IMF bail-out program are evaluated to be important motivation in reinforcing sound regulation in korean financial law system and improving unnecessary entry regulation and ‘Iron Wall’ in each section.

The biggest momentum of changes between the foreign exchange crisis in 1998 and the recent global financial crisis was establishment of financial investment services and capital market Act (hereafter 'capital market Act'). Now, the financial regulation system is facing new trend of international agreement in regulation through re-regulation trend since the global financial crisis and FTA.2)

1. Substructure Section

On December 31st in 1997, current Financial Services Commission was established based on Act on the establishment of financial supervisory commission and agency.(now Act on the establishment of financial services commission). Before the establishment of Financial Services Commission, 4 institutions – the Bank Supervisory Service, Securities Supervisory Service, Insurance Supervisory Service and Credit Management Fund– had practiced supervisory authority in each field. Purpose of establishing the integral authority was to come up with lack of close cooperation among the supervisory authorities and financial integration in the integrated supervisory level. The integral authority was in pending due to interest conflicts among the supervisory authorities at that time and finally launched by the 'conditionality' imposed on IMF Stand-by Loan Agreement. However, issues about relationship between Financial Services Commission and Financial Supervisory Service, and scope and position of the Financial Supervisory Service are still controversial. In 2008, Act on

2) The change and history is based on Kim, Du-Ul(ed.), Economy and Laws for 60 years, Haenam, 2011 and http://www.fss.or.kr/fss/kr/promo/history/history06.jsp
the establishment of financial supervisory commission and agency is revised to Act on the establishment of financial services commission. Gist of the act was to unify financial supervisory authority which the Ministry of Finance and Economy (now Ministry of Strategy and Finance) used to have into Financial Services Commission.3)

One of core axes in sub-structure is deposit insurance system. In 1995, depositor protection Act was introduced for the first time. In 1997 December, integral deposit insurance system including not only banks but also securities, insurances, etc. was launched through legal reform. Also, additional function to clear up insolvent financial institutes by Korea Deposit Insurance Corporation was supplemented at that time. Due to foreign exchange crisis, other systems not in the list of protection objects such as foreign currency deposit, CD, etc. were included in the protection list as special cases. However, as moral hazards that counts on depositor protection system of financial institutes facing insufficiency became greater, limit of insurance decreased to W\20 million and again increased to the current level, W\50 million in October 2000.

However, with regard to depositor protection system, there have been some cases not complying with purpose of the Act. First, it is difficult for banks to go bankruptcy in reality. Consequently the purpose to compensate depositors up to certain level when insolvent banks went bankruptcy was disregarded. For example, at the event of foreign exchange crisis, Gangwon Bank went bad but it was takeover by Joheung Bank without declaration of bankruptcy. Secondly, political activities preserve over W\50 million. The range of protection in case of Busan Saving Bank scandal invaded original purpose of depositor protection system, encouraged by political motivations of congressmen in the area.

Other than this, Act on the structural improvement of the financial industry is important in the procedure of structural improvement such as insolvent financial institute clearance and takeover. When financial status is considered substandard, this Act becomes legal base to take management improvement measure to the concerned institute in order to prevent malfunction or insolvency of the institute in advance. This Act, established in 1997 in the midst of foreign exchange crisis, was the most important legal foundation in financial restructuring.

3) This revision is reflected on the IMF Financial System Stability Assessment(FSSA) of Korea(2004). One of main findings of the FSSA was that the FSC lacks regulatory authority to determine the scope of permissible banking activities., Byung-Tae Kim, Legal Review of the IMF’s Financial System Stability Assessment’ for the Korean Bank Supervision and Regulation, Journal of Korean Commerical Law Association, Vol. 23 Nr. 3, pp. 625-626, 640
### Changes of Substructure Legislation according to foreign exchange crisis

<table>
<thead>
<tr>
<th>Law Title</th>
<th>Contents</th>
<th>Revision Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Act on the establishment of financial supervisory commission and agency</td>
<td>Establish Financial Supervisory Commission and Financial Supervisory Service, as an integral supervisory entity</td>
<td>1997.12</td>
</tr>
<tr>
<td>Depositor Protection Act</td>
<td>Combine deposit insurance agency of each section into Korea Deposit Insurance Corporation Grant an authority to clear up insolvent financial institutes to the Korea Deposit Insurance Corporation</td>
<td>1997.12</td>
</tr>
<tr>
<td>Act on Establishment of an Institution Exclusively Developed to the Efficient Resolution of non-performing loans (NPLs) of Financial Institutions and Distressed Companies</td>
<td>Establish Korea Asset Management Corporation, as a professional organization to handle with insolvent asset of financial institutes * Sungup corporation(former KAMCO) was established by Act on Effective resolution of financial institution NPLs and establishment of KAMCO in 1962 Establish non-performing loan disposal fund</td>
<td>1997.11</td>
</tr>
<tr>
<td>Act on the Structural Improvement of the Financial Industry</td>
<td>Exercise measures obligatorily when cases are fit in the condition of prompt corrective action Strengthening prompt corrective action: capital increase/decrease, business suspension/liquidation, clearance of holding asset, submission of action plan</td>
<td>1997.12</td>
</tr>
</tbody>
</table>

2. Bank

Since established in 1950, the banking Act has been revised along with economic development plan and banking industry development but significant changes started since the time of foreign exchange crisis. The ratio of investment to other industries of bank was raised from 10% to 15% for each section by revising the banking Act in 1998 so as to support restructuring of businesses. At the same time, loan and

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payment guarantees were dealt concentrated on risks as a part of structure renovation program (a part of bail-out program) that IMF suggested.

At the time of revision in 2000, regulations related to permission or approval and supervision of bank were directly defined in the Act to agree with principle, 'Rule of Law'. Besides, they endeavored to improve ownership and management regulation of banks and to establish autonomous management foundation. With revision in 2002, securities of bank that one person can hold was expanded from 4% to 10%. However, when Financial Services Commission permits, over 10% of securities became possible and in this case, Financial Services Commission assessed eligibility. To prevent bank from being dominated by industrial capital, over 4% of shares owned by non-financial enterprises was banned. Even in this case, up to 10% was possible when Financial Services Commission permitted. As establishment of financial holding company became available in October 2000 by setting up the Act on financial holding companies, banks started establishing holding companies that have affiliated securities or insurance companies.

As attention on securities and investment companies came back to bank industry after the global financial crisis initiated in the U.S., interest in activating bank industry had been getting greater. That is to say, the concept that banking industry plays a core role in financial industry expanded and general regulation renovation started to strengthen competitiveness of bank industry. This regulation contains ease on scope of banking works and strengthening regulation for financial soundness at the same time. Major contents are as followings. When establishing local subsidiary overseas, requirement to have previous agreement with Financial Services Commission was changed to follow-up report. Also, in order to strengthen checking function of director board, ratio of external directors was lifted to over 50% of total number of directors and necessary rules to operate director board was established and announced. In terms of incidental business of bank, previous reporting system was maintained for the case it was necessary so that it could expanded the scope of works significantly. By accepting criticism that banks get double regulation, comparing to IB on capital market Act overlapped parts were changed to reporting system as well.

3. Securities and Investment
What regulated securities and investment market before capital market Act established in 2009 were mainly securities and exchanges Act and other Acts such as secured bond trust Act, capital market promotion Act and securities investment company Act supplemented. Along with the establishment of capital market Act, they are combined and operated synthetically. In 1998, the biggest issue of the securities and exchanges Act was support of company restructuring. However, there were M&A by black-knight as well. For protection of right to control of company the Act was amended to increase the ratio that listed companies can have their own stock. It functioned as an white-knight.

In 2005, enactment of capital market Act started being pushed ahead. Considering new trend of unifying stock, futures and asset management, regulatory arbitrage according to divided regulation system by each section and incomplete investor protection system, the new system was encouraged to enact. Characteristics of capital market Act are that it changes from positive system to negative system in regulating mechanism, divides investors into private customer and market counterparty(professional investor), and allows multi-business by each section of capital market. At the time of amendment in 2009, supervision strengthening policy about financial derivatives transaction on over the counter were added.

4. Insurance

Insurance business Act to regulate the insurance section was enacted in 1962. It went through big change in 1977 to harden social security function of insurance, to improve capability as capital supplier and to protect insurance holders. At the time of amendment in 1980, system improvement was implemented from the viewpoint of insurance carrier so as to enable capital of insurance carriers more faithful and consequently to improve public-interest of insurance. However, as a decision was made in 1986 to open domestic insurance market, general regulation system of insurance business was re-setup. Especially, in case of paid-in capital, life insurance was re-adjusted from ₩200 million to ₩10 billion and indemnity insurance from ₩300 million to ₩30 billion. Qualification for shareholders of insurance companies was regulated, mediation committee was established in order to protect insurance holders and Korea Insurance Corporation was reorganized to Insurance Supervisory Service. Later, installation and relocation of insurance companies were changed to
reporting system when revising the Act in 1995 due to Uruguay Round and insurance agencies were changed from approval system to registration system. In 2003, the insurance business Act was completely revised to come up with generalization of insurance and rapid development of domestic insurance market. Major contents of this revision were to ease entry regulation to insurance industry, autonomy of asset management method as a principle, etc. In 2010, obligation to explain products became stricter to prevent incomplete sales, subsequently strengthening insurance customer protection measures.

5. Foreign Exchange

Increase of foreign exchange demand along with the initiation of economic development plan in 1960s encouraged enactment of foreign exchange control Act. This law has been frequently revised according to domestic and overseas economic status. In 1970s, the main issue of revision was to reinforce foreign exchange control of the 'Oil Shock'. In 1980s when seoul asian game and olympics were held in Korea, related regulations such as foreign exchange payment to other countries and overseas investment regulation were substantially eased followed by increased trades, etc. In 1992, there was another extensive regulation ease that transferred the foreign exchange regulation from positive system to negative system. However these excessive open policy was criticized as a cause of foreign exchange crisis in 1998. In current korean foreign exchange regulation, ordinary trades are completely liberal and other many trades including overseas deposit, trust, guarantee, direct investment and derivatives trades are available only by reporting to Ministry of Strategy and Finance, Bank of Korea or Bank who has permission for foreign exchange transaction as a principle.

IV. History and Status of Banking Regulation

1. Entry and Liquidation Regulation

One of typical financial regulation methods is entry regulation. In financial industry, even liquidation is regulated through approval to protect depositors or investors. The banking Act contains requirements for approval from Art. 8 through Art. 10. Art. 9 shows that the requirement of initial capital for nationwide bank is ₩100 billion. Art.
8 regulates personnel requirement which mentions probity and public-interest of organizer or the managements, and for these undefined concept leaves a room to decise in case at authorities discretion. Therefore, in arguing about approval refusal, it becomes core of administrative adjudication and administrative litigation that whether there was abuse of discretionary power in the procedure of approval or not. Title of ‘bank’ can be used only when physical and personnel requirements are satisfied. Regarding use of the name ‘bank’, the government has allowed mutual savings and finance companies to use the name of ‘saving bank’ since 2002 based on mutual saving banks Act. However, as shown in the series of recent saving bank scandals, people believed the name of bank with trust toward bank and lots of them cannot avoid loss. As a result, criticism was arisen toward the government to allow saving banks to use the name ‘bank.’

capital market Act, Art. 12 regulates approval for financial investment business as well. This article mentions requirements of approval, but has uncertain concept that business plan should be proper and sound. Therefore, judgment of authority within the jurisdiction on cases is very important element. Essential nature of the approval is to enable to have effect of public law as the government certifies activities. However, in case of approval to establishment of financial institute, achievement and implement of financial policy’s purposes are more emphasized than supplement of public legal effect. It is closer to concept of charter. Therefore, it is hard to consider approval to bank and financial investment as simple approval.\(^5\)

There is regulation on liquidation as well. Except for some cases beyond the range that financial institutes can cover, they can liquidate businesses with liquidation approval after completing required measures to protect depositors and investors.

2. Ownership Regulation

Changes in ownership regulation started from the privatization of national banks in 1980s. This regulation was introduced to prevent banks from becoming a ‘piggy bank’ of industrial capital, and to ban interest conflicts by major shareholders and illegal profits through moral hazards according to result of interest conflicts during the procedure of privatization. Such banking–industry separation method can be found in financial service modernization Act of 1999 in the U.S. as well.

The banking Act Art. 15, para. 1 mentions cases that non-financial institution (NFI) become the biggest shareholders of a bank (except for local bank) or is appointed by executives according to presidential decree. In this way, the NFI participate in the banking business. When investor wants to have more than 4% of total number of issued stocks with voting right, it requires approval of Financial Services Commission. This is kind of realization of policy to protect right function of general economy and it puts limit on private profits through balance between private and public profits. Changes in such ownership regulation limit system are as followings.6)

### Changes in Ownership Regulation

<table>
<thead>
<tr>
<th>Time</th>
<th>Content</th>
<th>Background</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1980s</strong></td>
<td>o Temporary measure on financial institutes: limit the range of major shareholder decision below 10%</td>
<td>o Maintain soundness of ownership structure in the procedure of bank privatization</td>
</tr>
<tr>
<td></td>
<td>o Revised in Dec. 1982: one person can hold up to 8% in nationwide bank, not applied to local bank</td>
<td>o Many local banks are owned by local enterprises’ owners and it is considered.</td>
</tr>
<tr>
<td><strong>1990s - Before foreign exchange crisis</strong></td>
<td>o Expansion of one person’s limit: companies belonging to massive companies are included in the scope of one person.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>o Local bank holding limit : 15%</td>
<td>o Reflect Cheboel ownership structure in Monopoly Regulations and Fair Trade Act</td>
</tr>
<tr>
<td></td>
<td>o Introduction of exclusive financial company system: exclusive financial company up to 12%, non-exclusive company 4%</td>
<td>o Need to keep soundness of local banks</td>
</tr>
<tr>
<td></td>
<td></td>
<td>o Nurture financial business operator</td>
</tr>
<tr>
<td><strong>After Foreign Exchange Crisis (Revised in Jan. 1998)</strong></td>
<td>O Abolish financial business operator system</td>
<td>o Difficult to find purchaser of insolvent banks in domestic financial market due to bank restructuring</td>
</tr>
<tr>
<td></td>
<td>o holding limit of domestic citizens 4%, foreigner 10%</td>
<td>o Difficult to secure domestic investors due to domestic capital market collapse</td>
</tr>
<tr>
<td><strong>Revised in Apr. 2002</strong></td>
<td>o Ownership limit ease</td>
<td>o Overcome the crisis</td>
</tr>
</tbody>
</table>

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6) Kim, Yong-Jae, Banking Law and Regulation, Parkyoungsa, 2010, pp. 94–98
7) Financial investor is a person who invests some capital in the hopes of just gaining a return on this
3. Business Regulation

Banking business can be divided into original, incidental and concurrently running parts. Original business include marketable securities issue such as CD, Repo exchanges of Bonds, investment on government bond and currency stabilization bond of BOK, investment on other stocks and foreign exchanges transaction. incidental business are defined by the ‘Guideline for scope of incidental business in bank’ enacted based on Enforcement Decree of the banking Act Art. 18-2, para. 4. The most typical one is financial investment duty such as investment and marketable securities lending, CD trades and merchant banking like M&A intermediation. However, as a part of the incidental business is overlapped with trading in banking Act Art. 38, para. 1, there is gray area in the range of two sections. Also, since foreign exchanges transaction accompany with financial derivatives such as swap, division between original business and incidental business is not clear.⑧ banking Act Art. 38 specifies prohibited acts that banks cannot do.⑨

|       | o Enlarge to cope with entry of foreign banks  
o Need to do concurrently running financial business due to unification of financial works |
|-------|-------------------------------------------------------------------------------------------------|
| Jun. 2009 | o Non-financial business operator requirement ease: investment companies could enter into this field  
o Expand the stock holding limit with voting right of industrial capital to 9%  
Extra holding became available with permission of Financial Services Commission |
|       | o Enlarge banks and improve competitiveness  
o Cope with entry of foreign banks  
o Nurture financial investors⑦ |

money over time without doing control power

⑧ Kim, Yong-Jae, ibid, p. 193
⑨ Art. 38 (Prohibited Business) Banking Act * No financial institution shall engage in any of the following activities:
1. Investment in stocks or other securities (excluding state bonds and Bank of Korea currency stabilization bonds) with a period of redemption of not less than three years which exceeds the amount equivalent to the ratio as determined by Presidential Decree within the limit of 100/100 of its equity
4. Financial Soundness and Liquidity Regulation

(1) Prudential Regulation

Prudential regulation with BIS equity capital standard can be found in banking Act Art. 2 Para. 1 Nr. 5 and enforcement decree, Art. 1–2. The BIS capital ratio was introduced at the end of 1995 in Korea and settled down as the most important regulation standard in bank industry to overcome the foreign exchange crisis. However, while operating back then system, Basel I, major problems were pointed out such as that risk weighted value of CP between blue-chip companies and non-blue-chip companies were equivalent, that risk level could be changed indirectly through ABS(Asset Backed Securities) and that credit crunch occurred in medium and small sized companies as banks reduced their risk weighted assets.

In order to improve such problems, Basel II was announced in 2004 and introduced to Korea in 2007. Gist of this system is to evaluate elements dividing into 3 parts: minimum equity capital regulation (Pillar I), supervision strengthening (Pillar II), market regulation strengthening (Pillar III). However, some possible problems were raised for this regulation as well, like unclear standard to decide the range of regulated capital in detail, uncertain basis of 8% of capital ratio and possibility that holding company would manipulate this ratio by securing capital of affiliates financial institution. Besides, the credit crunch caused by application of BIS ratio still remains as serious issue to discuss. 10)

(2) CAMELS and Prompt Corrective Action

capital. In such cases, the Financial Services Commission may, if necessary, otherwise determine, within the said limit on investment, the ceiling on investment in stocks and derivatives which are securities: 2. Ownership of real estate (excluding real estate acquired through the exercise of a security interest such as mortgage) other than real estate for business purposes: 3. Ownership of real estate used for business purposes in excess of an amount equivalent to the ratio as determined by Presidential Decree within the limit of 100/100 of equity capital: 4. Loans of funds to speculate in commodities or securities: 5. Loans in which stocks of the financial institution or stocks exceeding 20/100 of issued stocks of other stock companies are offered as security, whether direct or indirect (excluding loans for operators, etc. as prescribed by Presidential Decree who operate private investment projects for infrastructure): 6. Loans contingent on the purchase of stocks of the relevant financial institution, whether direct or indirect: 7. Loans for political funds, whether direct or indirect: 8. Loans to officers or employees of the relevant financial institution (excluding petty loans as determined by the Financial Services Commission)

10) Kim, Yong-Jae, ibid, pp. 74–75
banking supervision regulation, Art. 33 suggests standard to evaluate management soundness. The Art. 33, para. 3 Nr. 1 defines that local subsidiary of financial institute can make management evaluation about banks with elements of Capital adequacy, Asset quality, Management, earnings, Liquidity and Sensitivity to market risk. Result of management evaluation is divided into 5 levels and subject to prompt corrective action when they fall into 3, 4 or 5 level.

Prompt corrective action (PCA) refers to a measure that hardens stability of financial institutes by coming up with proper management improvement measures for possibly insolvent financial institutes and normalizing the management state of the concerned institute in early stage. Legal basis of this measure is in Act on the structural improvement of the financial Industry, Art. 10 and banking supervision regulation, Art. 34 and 36. Detailed contents of the prompt corrective action are supposed to be notified in advance to present liquidation standard for such sanction previously.

### Structure of Current Prompt Corrective Action

<table>
<thead>
<tr>
<th>Type of Measure</th>
<th>Condition</th>
<th>sanction</th>
<th>Binding Force</th>
</tr>
</thead>
</table>
| Management Improvement Warning | o Below 8% of BIS capital ratio  
o Below 3rd level of CAMELS | o No direct sanction  
o Control of new business entry, structure improvement warning, etc. | o Action of Financial Supervisory Commission Governor  
o No binding force  
o Practical binding power is controversial |
| Management Improvement Request | o Below 6% of BIS capital ratio  
o Below 4th level of CAMELS | o Branch reduction, liquidation and selling of affiliated companies, executives change, takeover by other companies, etc. | o Decision of Financial Supervisory Commission  
o Hold off the binding force |
| Management Improvement Order | o Below 2% of BIS capital ratio  
o Below 5th level of CAMELS | o In not recoverable stage, so start bankruptcy procedure  
o legal administrator appointed by Court | o Decision of Financial Supervisory Commission  
o Hold off the binding force |

(3) Liquidity Regulation
When there is difference between amount received and amount payable in banks, insolvency problem can occur. Even though banks have ability to pay in terms of asset structure, regulation to secure liquidity needs to be set up because insolvency by temporary liquidity incapability may transfer risk to the entire market by Contagion Effect. There are two main examples about liquidity regulation. These are loan capital limit regulation and reserve requirement. The former limits that 50% of received amount through deposit can be used as loan finances. In the latter, reserve requirement should be prepared for each deposit so that 7%, the highest reserve requirement according to Art. 28 Nr. 2 of Act on the Bank of Korea. The reserve requirement policy makes certain amount of fund accumulated in order to respond to depositors’ withdrawal requests. Consequently, it requires low reserve requirement ratio as withdrawal frequency and possibility in long-term saving deposit drop, and high low reserve requirement ratio in and general savings. Today, this system is used as a monetary policy to adjust money supply which central bank absorbs money on the market.12)

5. Interest Conflict Regulation

banking Act Art. 35-2, credit offering limit for major shareholders of financial institutes, prohibits interest conflicts. Art. 35-2, para. 2 states that the maximum limit that financial institute can give to large shareholders is maximal 25% of equity capital, and even they can give credit within 25% according to standard differentiated by the presidential enforcement decree.13) Furthermore, it mentions additional limits such as that unanimous agreement of the entire directors should be obtained to grant amount over the specifically differentiates standard. However, it is pointed out that 25% limit is excessive compared to parent bank’s credit offering limit to affiliated

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13) Art. 35-2 para. 2 “The credit which a financial institution can extend to all of its large stockholders shall not exceed an amount falling under the ratio as determined by Presidential Decree within the scope of 25/100 of the relevant financial institution’s equity capital.”
bank, which is 10%, and that regulation is not sufficient about possible credit of member of executive board and employees other than major shareholders to prohibit excessive credit offering.

banking Act Art. 35–3 stipulates that large shareholders can not acquire issued stocks of the financial institution in excess of an amount falling under the ratio determined by presidential decree within the scope of 1% of the relevant financial institution's equity capital and Art. 35–4 states that major shareholders cannot practice inappropriate power for personal advantages against interest of financial institutes.

6. Personnel Regulation

Personnel regulation starts from the stage of bank establishment. banking Act Art. 8 asks probity and public interest of organizer or the management. Art. 18 states requirement that executive-to-be should have. For example, those who have history of criminal penalty or who used to be executives of financial institutes subject to prompt corrective action or decision before contract cannot be appointed as executives. Such regulation is required because financial industry, which manages others’ asset as fiduciary, needs those who get qualified as good manager. Eligibility screening system of major shareholders is also very important personnel regulation system. This eligibility screening of major shareholders is meaningful in banks. Banking industry is the traditional 1st financial industry and personnel regulation is well established to protect depositors’ interest. However nowadays this regulation has greater meaning in not banks but saving banks as seen in the recent scandals.

V. Changes of Financial Regulation Methods and New Regulation Issues

1. administrative guidance as Regulation Method (Gyoseishido, 行政指導, Verwaltungsanleitung)\(^\text{14)}\)

(1) Administrative guidance and Recent Discussion related to Financial Regulation

Regulation through administrative guidance is preferred as one of non–typical methods of financial regulation. Its original purpose is that the government attracts economic

activities to certain direction based on agreement of partners. However, usual problem in the administrative guidance is that the administrative guidance is non-authoritative mean in formal aspect, but in practical aspect, it is controversial that actual binding force is implemented based on authoritative relationship behind, for example the relationship between FSC and financial institutions. Supervisory authorities have preferred such administrative guidance as a regulation mean toward financial businesses. Especially, this has been useful because sectoral regulator can form closer relationship through frequent contacts comparing to general regulator for example FTC. However, the administrative guidance is authoritative in reality and not acknowledged as concept of authoritative measure(Choebun, 處分, Verwaltungsakt) which has enforcement. Therefore, there has been controversy in method of remedy for violation of private right and lots of criticism for improvement. One example of external pressures to improve the administrative guidance is KORUS. During the FTA negotiation, U.S.A. asked improvement of the administrative guidance which has possibility to cause uncleanness and abuse of power in the financial negotiation annex 13 B–D(T transparency).

"The United States welcomes Korea’ ongoing initiative to expand and enhance transparency, noting in particular the adoption by the FSS of the Operational Rule on Administrative Guidance and the introduction of the no-action letter mechanism. Korea shall, to the extent practicable, continue its existing practice of issuing in writing any administrative guidance to a financial institution or cross-border financial services supplier. At the request of an affected party, Korea shall put any oral administrative guidance provided into writing and post it on a public Internet site. During any review of previously issued administrative guidance, Korea shall provide interested parties an opportunity to comment on that guidance."

When the administrative guidance became an issue in the FTA negotiation procedure, the Financial Services Commission enacted operational rule on administrative guidance in 2007. This guidance states minimum limit rule, document first rule and open-to-public rule as its gist and regulates that the administrative guidance can remain up to 1 year and be sunset. The Financial Services Commission has been using ‘No Action Letter’ system that the U.S. SEC operates instead of the administrative guidance since 2007. This system is that an individual or entity who is not certain
whether a particular product, service, or action would constitute a violation of the federal securities law may request a "no-action" letter from the supervisory agency staff. Most no-action letters describe the request, analyze the particular facts and circumstances involved, discuss applicable laws and rules, and, if the staff grants the request for no action, concludes that the supervisory agent staff would not recommend that the commission take enforcement action against the requester based on the facts and representations described in the individual or entity's original letter.\(^{15}\)

(2) Regulation by administrative guidance and Conflict Cases among Regulating Authorities (FSC vs. FTC)

FSC asked the financial institutions cooperate for raising mortgage rate to control the rise of asset prices and interested banks adjusted their rates. However, FTC imposed penalty surcharge to the banks with title of unfair common action for there was agreement among the them while adjusting the rates in 2006.\(^{16}\) The banks made complaints to the FTC saying that FSC conducted administrative guidance and as a result, they raised the mortgage rates. Against their assertion, FTC declared, based on monopoly regulation and fair trade Act Art. 19 that no enterpriser shall agree with other enterprisers by contract, agreement, resolution, or any other means to engage jointly or let others engage in such kinds of activities that unfairly restrict competition. Also, FTC pointed out that the administrative guidance was not corresponding to any reasonable actions declared in the Art. 58\(^{17}\).

2. Competition over Authority between Sectoral Regulation Agency (FSC) and General Regulation Agency (FTC)\(^{18}\)

With regard to the sanction of FTC to the activity according to the administrative guidance, competition between sectoral regulation agency and general regulation agency over authority became important issue. Authorities related to power of financial supervision had been mainly between the Financial Supervisory Commission and Bank

\(^{15}\) http://www.sec.gov/answers/noaction.htm

\(^{16}\) FTC decision 2005조4247, 4248(Kookminbank case 2006-216); decision 2005조714249(citibank case 2006-203); for a similar case of insurance sector see supreme court 2011.5.26, 2008면20376

\(^{17}\) Article58 (Legitimate Actions Taken Pursuant to Acts and Subordinate Statutes) "This Act shall not apply to acts of an enterpriser or enterprisers organization as committed in accordance with any Act or any of its decrees."

\(^{18}\) Choi, Seung Pil, ibid(fn. 14), pp. 307-320
of Korea or Ministry of strategy and Finance. However, FSC took over most of supervision authorities for financial institution and the conflict between FSC and Bank of Korea or Ministry of strategy and Finance was resolved. Recently, conflicts between FTC and the Fair Trade Commission are still on the highlight. Competent administrative agency that takes charge of specific fields has position as a sectoral regulation agency in that field. However, the FTC in trade order, especially competition field, plays a role of general regulation agency, so they cannot avoid conflicts. The FSC claimed its authority over the competition field in financial sector based on authority drawn from supervision and referring to Act on the establishment of financial supervisory commission, Art. 1 stating "The purpose of this Act is to contribute to the growth of the national economy by promoting the advancement of the financial industry and the stability of financial markets, by establishing sound credit order and fair financial transaction practices, by protecting financial consumers, such as depositors and investors, by the establishment of the Financial Services Commission and the Financial Supervisory Service." On the contrary, the Fair Trade Commission insisted that it could impose penalty in the case based on general supervisory authority in the monopoly regulation and fair trade Act as a competent authority about market competition order. After all, they could not address this case from the legal point of view and ended up closing the trouble merely by making agreement on cooperation in advance through mutual MOU.

Sectoral regulation agency in regulation field show strength in field of professionalism. However, the sectoral regulation agency have problem of high probability to be exposed to 'regulatory capture' or revolving door personnel affairs of the concerned section. For this reason, 'check and balance' between sectoral regulation agency and general regulation agency is important and the authority should be articulated during the legislation process.

3. Expansion of Self Regulation

Important part of financial institutes’ supervisory system today is self regulation system. Autonomous system is efficient as it has longer regulation life span than external control and close control in working field is available. Such self regulation system is expressed as governance through PPP(public–private partnership) because it is administrative cooperation between public and private sectors.\textsuperscript{19) Self regulation}
means that any non-governmental body, including any securities or futures exchange or market, clearing agency, or other organization or association, that exercises regulatory or supervisory authority over financial service suppliers or financial institutions, by statute or delegation from the authority.

Important point of self regulation system is compliance. In other words, by building internal governance structure complying with applicable laws and regulations, it protects institutes and customers both as banking act Art. 23 para. 3 regulates. These days, compliance officer is required obligatorily to conduct compliance professionally. Still there is controversy on the range of obligation for compensation in case compliance officer causes damage to the third or financial institute in collusion with executives.

Groups of each section, such as banker association and financial investment association, in practice self regulation function as well. This self regulation operated by organization in each section makes regulation responsibility of supervisory authority dividend and has positive effect to concentrate on core regulation from a viewpoint of administrative agency. When the self regulation organization in each section face interest conflicts, it is difficult to achieve regulation goal. Therefore consistent supervision on self regulation organizations is necessary. Also, it can be proposed to classify self regulation organization in each section and internal control system to adjust regulation or intervention level by supervisory authority. In the viewpoint of public law, self regulation in each section can be considered as a kind of delegation of authority, but as another method, regulation goal achievement through administrative contract with private entity on the PPP mechanism can be reviewed. 


There is no fixed definition of financial consumer. depositor in banking Act Art. 1 for bank, investors in capital market Act Art. 9 for security investment business and insurance holder in insurance business Act Art. 1 for insurance business are considered financial consumers. There is no special issue about financial consumer protection in traditional deposit and loan business of bank. Rather, obligatory explanation, unfair

20) Choi, Seung Pil, ibid(fn.19), pp. 506–512
suggestion and incomplete sales to investors are raised as new issues in financial investment section these days. Therefore, to protect the financial investors, Capital Market Act, Article 9 para. 1 Nr. 2 ⑤ and Enforcement decree divides them into market counterparty and private customer. Then it lowers protective level for market counterparty and expands the range of protection for private customers. Recently, various financial products based on derivatives are launched and even banks can do such business if having permission of financial investment business. In this sense, scope of financial investment business is getting broader. Still the obligatory explanation is conducted only to meet with formality for 'Duty to explain' in Art. 47 of capital market Act and insufficient explanation in reality on complicated product structure cause frequent problems. On this backdrop, many suggest that financial consumer protection in practical way should be settled. ② ①

Reflecting on these demand, integral financial consumer protection Bureau was established, which combined each section, in Financial Supervisory Service(FSS) this year. At the time of establishment, there was dispute whether to set up independent financial consumer protection agency or not, but due to interest conflicts among supervisory authorities and consumer protection authority, the Bureau was built and operated in the FSS. Some criticize that this bureau can work only within existing supervisory scope as established in FSS. ② Furthermore the function and power of financial consumer protection Bureau is limited in the areas, education, mediation and dispute investigation is criticized as well. Because the bureau has no authority to impose sanction to financial institution related to financial consumer protection, while this authority is exercised by financial service improvement department.

5. SIFI Supervision Strengthening

SIFI, standing for Systematically Important Financial Institution, is a financial institute that has leverage to influence to the entire market when the institute becomes insolvent or goes bankruptcy. Assertion that special and strengthened regulation is needed for this kind of institutes was proved during global financial crisis in 2008. Major contents of the SIFI regulation are to obligate surcharge proportionally to asset of the institute and to secure contingent capital obligatorily. This system was

② Cho, Kyu Jun, Issues and Points, Nr. 335(2011.12), National Assembly Research Services, p.1~4
discussed in FSB (Financial Stability Board) and BCBS (Basel Committee on Banking Supervision) meetings during the time of G20 meeting in October 2011. SIFI is divided into G-SIFI, global unit SIFI, and D-SIFI, domestic unit SIFI. BCBS mentions requirements to be selected as SIFI: size, interconnectedness, replaceability of service, financial institution infrastructure, and cross-jurisdictional activity. For now, nothing has been fixed as to whether the regulation should be applied to domestic banks or not. However, it seems that SIFI regulation might be highlighted as an important issue in the future in the field of risk management and capital eligibility regulation.  

6. Transformation to Negative System from Positive System

With regard to today’s regulation ease, negative system is suggested as a new paradigm mentioned above. The negative system is to expand range of economic activities that people can generally enjoy by specifying regulation objects and requirements and allowing liberality other than these. It is opposite to the existing positive system. The positive system specifies allowed fields and requirements and ban general activities other than these.

Good example of negative system in financial section is capital market Act, Art. 3. This article defines financial investment product as a right achieved by promising to provide money and other objects with property value now or in specific time in the future, with purpose of getting profits or avoiding loss. Stating that it has risk to exceed the total monetary amount paid or to be paid when achieving the right, this article recognizes case with possible loss as financial investment product. Other then specifically banned businesses or sections, investment products can be traded in the market freely.

Foreign exchange transactions Act, Art. 15 defines two cases to get approval for trades between residents and non-residents. First is when it is inevitable to implement agreement and generally-approved international rules, and second is when it is necessary for world peace and safety like anti-terrorism. In these cases, permission in advance should be required, other transactions can be performed on reporting

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23) see FSB, Intensify and Effectiveness of SIFI supervision, 2010.11.2
24) Art. 3 para 1 “Article 3 The term financial investment instrument in this Act means a right acquired by an agreement to pay, at a specific time in the present or in the future, money or any other valuable thing with an intention to earn a profit or avoid a loss, where there is a risk that the total amount of such money or similar, paid or payable, for the purpose of acquiring such right may exceed the total amount of money or similar already recovered or recoverable from the right.
system, which means foreign exchange transactions Act is taking a type of negative system.

VI. Conclusion

Excessive regulation should be alert as it could discourage economic vitality. On the contrary, excessive ease of regulation in market can be attacked by corporative business activities, nature of which tends to pursue profits. Therefore, it is important to keep 'check and balance' between them in continuous care. Recently, the regulation ease is directing toward transformation to the negative system. When it comes to the negative system, it requires careful approach when it is difficult or takes long period of time to overcome at the event of market failure, and when it is difficult to restore to the original state. In these cases, close attention needs to be made in paradigm transformation. Reorganization of regulation system followed by integration of financial sectors is another consistent issue. This integration phenomenon is occurring not only in banks but also in capital investment and insurance industries. Bancassurance and Assurfinance are good examples. Furthermore, financial companies are implementing Allfinance that they can conduct all the businesses in every section and changing to financial conglomerates in terms of structure.25) This phenomenon is occurring in legal field as well and complications happen in authority of supervisory agencies. In this situation, core of financial regulation to bring successful result in the future will depend on how to cope with such integral businesses of financial institutions.