Financial Services Commission
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Press Release

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2ND ROUND OF STRENGTHENED REGULATION ON FINANCIAL INSTITUTIONS' FX SOUNDNESS

Background

Since the government implemented the new rules to strengthen regulations on financial institutions' FX soundness in January 2010, FX liquidity ratio has risen, the management of FX derivatives trade has been strengthened, and the overall FX soundness of banks has improved. However, the regulation to limit banks' FX liquidity ratio has been applied to only domestic banks, not to local branches of foreign banks; therefore, foreign banks are still exposed to risks of mismatch between long-term assets in the Korean won and short-term borrowings in foreign currency.*

*As of end-March, 2010, foreign currency-denominated borrowings by local branches of foreign banks amounted to USD 82.9 billion, 79% of their total borrowings (USD 105.4 billion). The won-denominated assets held by local branches of foreign banks stood at USD 58.5 billion, 51% of their total assets under management (USD102.3billion).

Plans

1. Regulations on domestic banks will be tightened to raise FX liquidity ratio and Mid-to Long-term Financing ratio in foreign loan portfolios. Domestic banks are required to manage FX liquidity ratio internally on a daily basis and report to financial authorities on a monthly basis. Securities held to maturity in foreign currency as well as foreign currency borrowings will be included when calculating the ratio of mid-to long-term financing in foreign loan portfolios. The ratio will be raised from 90% to 100%.

2. The government will provide guidelines for local branches of foreign banks so that they can manage FX liquidity risk on a voluntary basis. Under the new guidelines, they will be advised to voluntarily manage their FX liquidity risks and acquire safer and longer term FX funding sources. However, some of the standards will be waived if their head office submits a letter of commitment to provide FX liquidity for its branch in Korea at times if needed. Implementing the new guidelines for local branches of foreign banks, a three-month grace period will be given to smooth out the transition. In managing FX liquidity risk, they will be subject to basically similar rules applied to domestic banks such as currency-specific liquidity risk management, diversification of funding source, and contingency funding plans. The guidelines will reflect opinions from local branches of foreign banks, if any.

3. The limit on currency forward transactions will be lowered from 125% to 100% of the real transactions being hedged.

Implementation Schedule

FX Liquidity Weighting and Mandatory Minimum Holdings of Safe FX Assets, announced in November 2009, will be implemented starting July 1 as scheduled. The government plans to implement *the 2nd Round of Strengthened Regulations on Financial Institutions' FX Soundness* in July after consultations with banks and revisions. However, considering the fact that the FX liquidity guidelines for foreign banks are newly introduced and implemented, a three-month grace period will be given to help them adjust to changes.

In line with the global discussion, the government plans to decide how and when FX leverage ratio, excluded from the pending measures, will be introduced.

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