

## 3<sup>RD</sup> WORKING GROUP MEETING HELD ON IMPROVING MANAGEMENT, OPERATING PRACTICES OF BANKS AND BANKING SYSTEM

The FSC and the FSS held the 3<sup>rd</sup> working group meeting<sup>1</sup> of the taskforce on improving the management and operating practices of banks and banking system on March 15, chaired by FSC Vice Chairman Kim So-young.

### **DETAILS OF 3<sup>RD</sup> WORKING GROUP MEETING DISCUSSIONS**

First, participants discussed policy direction for prudential regulations on banks to improve their loss absorbing capacity. Financial authorities introduced their plans to ensure that banks have sufficient loss absorbing capacity in preparation for future uncertainties by bolstering prudential regulations. In this regard, authorities will consider imposing countercyclical capital buffer (CCyB) to enhance banks' overall capital adequacy ratio and introducing stress capital buffer depending on each bank's risk management status and stress test result. In addition, authorities are currently working on revising the regulations on supervision of banking business, which will authorize financial authorities to request banks to set aside special reserves for loan loss and conduct a regular inspection every year on banks' models for forecasting estimated loss and demand improvements if the results are deemed insufficient.

Regarding these measures for enhancing banks' loss absorbing capacity, participants said that it is necessary to consider appropriateness not only in the amount of capital buffers but also in the timing and the pace of implementation. First, participants said that improving the effectiveness of CCyB accords with the recent developments in capital requirements and research direction. If prudential regulation is tightened in the banking sector, however, it may cause a balloon effect in which potential risks move to the non-banking sector. In this regard, participants emphasized the need for a balanced approach, which considers the soundness of the nonbank sector as well. They also stated that it is necessary to keep close tabs on the real estate market, given similarities between the credit cycle and the real estate cycle.

Next, participants held in-depth discussions on major banks' employee remuneration system such as bonus payout, etc. Participants discussed plans to improve banks' current bonus remuneration system and pointed out various factors that need to be considered in the improvement process. Given that banks' bonus is linked to profit growth which depends on not only banks' own innovative efforts but also market situations such as an interest rate rise, it needs to be approached differently from that

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<sup>1</sup> Working group meeting participants include officials from the FSC, the FSS, the Bank of Korea, private sector experts, financial industry groups and research institutions.

of an ordinary business. Therefore, it has been suggested that banks' bonus remuneration should consider whether it is for the performance resulting from an innovative business project or idea, or due mainly to differences in deposit and loan interest rates. Participants also commented that the bonus remuneration system should be designed to ease the boom and bust cycles. For this, assessment needs to be made on both short- and long-term performance with the availability of bonus deferral plans, while diversifying means of payment with stocks, stock options, etc. Participants also suggested that the bonus remuneration system needs to adequately consider the public service aspect of banks such as bolstering the asset and capital soundness and strengthening consumer protection, instead of simply being linked to short-term profits, and that its focus should be not on increasing the firm's present value but on improving its future value over a medium- to long-run. Considering that overseas financial institutions are very transparent in disclosing their performance to the public and the market, participants emphasized that it is important to make efforts to actively open up and disclose information about the bonus remuneration system including issues handled by remuneration committees, whether a say-on-pay vote is available, etc.

In response to these suggestions, the banking sector said that making improvements to the bonus remuneration system requires considerations and consensus among all stakeholders including executives, employees and unions. In this regard, on the level of bonus and severance pay, building a common understanding is important not only with employees and unions but also with the general public. In the process of making improvements to the remuneration system, the banking sector said that it is necessary to take into account a variety of factors considering their impact on recruiting talented employees, etc.

## **FURTHER PLAN**

In the 4<sup>th</sup> working group meeting expected to be held on March 22, authorities plan to look into the current progress and further plan of the deposit product comparison and recommendation service, which is designated as an "innovative financial service" under the regulatory sandbox program, and discuss various ways to improve the competitiveness of internet-only banks.

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