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Press Release

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PLAN FOR STRENGTHENED SUPERVISION ON SAVINGS BANKS

The FSC has announced its plan for strengthened supervision on savings banks.

Key Contents

1. To prevent moral hazard of savings banks' largest shareholders

Many of savings banks' largest shareholders fall short of funding capability and social credibility and thus many savings banks have been vulnerable to improper practices by their largest shareholders. Therefore, the FSC plans to tighten its regulatory oversight on the biggest shareholders and hold them more accountable for savings banks' business operations.

2. To curb excessive business expansion of savings banks and promote their soundness

While savings banks have been engaged in disproportionate investment in high-risk assets and excessive businesses expansion, prudential regulations on them remained loose. In order to promote the soundness of savings banks, the FSC will end preferential treatment in loan caps for some savings banks and strengthen supervision on affiliated savings banks.

3. To enhance investor protection

There have been many claims that investors suffered from lack of transparency in accounting and contracts made based on incomplete information. Therefore, the FSC will better protect investors by strengthening market disciplines and curbing subordinated bond issuance by savings banks.

4. To strengthen supervision over the cause of insolvency

The FSC will closely work with related government agencies to seek civil and criminal charges against savings banks' largest shareholders and management if they were found responsible for any business failure and misconduct.



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Details

1. To prevent moral hazard of savings banks' largest shareholders

- 1) When the biggest shareholder is alleged to commit any illegal act, the FSS will be able to launch an investigation into the largest shareholder.
 - Revision of the Savings Bank Act (to be submitted to the National Assembly for 3Q of 2011)
- 2) The FSC/FSS will ask savings banks' largest shareholders who have effective control over the management to become registered executives of the savings banks so that they could be held more accountable for the banks' business operations.
 - Revision of Supervision Rule of Savings Banks (1H of 2011)
- 3) The FSC plans to strengthen qualification for outside directors and make the requirements legally binding.
 - Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)
- 4) Currently savings banks with assets more than KRW300 billion are required to have an auditing body, whether standing or non-standing, in place. The FSC plans to require smaller savings banks (e.g. with more than KRW 100 billion in assets) to set up a standing auditing body. Auditors are required to remain independent and report auditing results on a regular basis. To this end, former employees of the FSS are asked to refrain from being rehired by savings banks as auditors for two years after their retirement.
 - Revision of the Savings Bank Act (to be submitted to the National Assembly for 3Q of 2011), revision of the FSS Standards on Sanctions (1H of 2011), Guidelines by the Korea Federation of Savings Banks (1H of 2011)
- 5) Savings banks are asked to have internal rules to provide whistle blowers with better protection and compensation.
 - Guidelines of the Korea Federation of Savings Banks (1H of 2011), FSS Inspection (2H of 2011)
- 6) If it is found that the biggest shareholder is involved in extending improper loans, both the largest shareholder and the savings bank will be subject to fines. Administrative and legal sanctions against illegal acts of the largest shareholders will become stricter.
 - Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)



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- 7) The FSS will conduct a fit & proper test for the largest shareholders on a regular basis, starting July 2011. The largest shareholders who fail to meet qualification conditions will be given a six-month period to correct the deficiencies. If they still fail to meet the requirement, they will be forced to sell 10 % or more of their shares within six months. If not, the FSC/FSS will be able to impose penalties on them to enforce its order.

Starting this year, savings banks with more than KRW300 billion in assets will be subject to a fit & proper test for their largest shareholders. They are required to submit relevant information and data by the end of September, and the FSC/FSS will complete the review process by the end of December.

- FSS fit & proper test/ FSC approval (after July 2011)

2. To curb excessive business expansion of savings banks and promote their soundness

- 1) Since June 2008, savings banks with their capital-adequacy ratio above 8 percent and sub-standard loan ratio below 8 percent have been exempted from the lending cap applied for the remaining savings banks, which is KRW 8billion per borrower. They have been allowed to lend more by up to 20% of their equity capital. However, the preferential treatment has caused problems such as sharp rise in PF loans by savings banks.

Therefore, the FSC will end the preferential treatment, while we will raise the lending cap per borrower (e.g. from the current KRW8 billion to KRW10 billion) and differentiate caps depending on borrowers' characteristics.

- Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)
- 2) The FSC will consider multiple construction companies for a single project, which share credit risk, as a single borrower and thus limit the amount of loans they can borrow by up to 25% of the savings bank's equity capital.
 - Revision of the Enforcement Decree of the Savings Bank Act (3Q of 2011)
 - 3) In order to prevent a savings bank's problem from spreading into other affiliated savings banks, the FSC have introduced caps on loans that affiliated banks can make to a single borrower since September 2010. The FSC plans to extend such caps to securities investment made by affiliated savings banks.
 - Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)
 - 4) The FSC will introduce separate caps on savings banks' investments in high-risk assets such as property funds, ship funds and overseas securities. For excess investments



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previously made prior to the introduction of caps, the FSC will lead savings banks to eliminate the excess amount as early as possible by gradually raising risk weightings to risky assets when calculating savings banks' BIS ratio.

➤ Revision of the Supervision Regulations on Savings Banks (3Q of 2011)

- 5) For PEFs jointly held by affiliated savings banks, or PEFs over which savings banks have effective control (e.g. 50% shares or more), the FSC will consider the funds a single PEF and limit the amount of lending based on the size of fund asset.

Savings banks will be prohibited from using an SPC under their effective control to make investment in properties for non-commercial use and securities and extending loans beyond caps.

➤ Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)

➤ Revision of the Supervision Regulations on Savings Banks (3Q of 2011)

- 6) The FSC will strengthen savings banks' review processes for borrowers' credibility and oversight on the outstanding loans.

➤ Revision of the Supervision Regulations on Savings Banks (3Q of 2011)

- 7) In the medium and long term, the FSC will further strengthen standards for savings banks' fiscal soundness to reflect the BASEL III reform and sector-specific needs of savings banks.

Currently, savings banks' loan-loss provisions for substandard assets are counted for Tier 2 capital. We are considering gradually reducing the share of provisions for substandard assets out of Tier 2 capital.

In order to prevent savings banks from excessively expanding assets and enhance their capital adequacy, the FSC is considering introducing Tangible Common Equity (TCE) ratio as a complementary measure to assess savings banks' capital adequacy ratio.

3. To enhance investor protection

1) Accounting Transparency

- a) Financial statement reporting made more frequent (6 months → 3 months)
- b) Lowered minimum total asset required report external audit (300 billion won)
- c) Expanded disclosure



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- Disclosure of loan status on PF (project financing) and other business areas; disclosure of fines and penalties that have been paid; disclosure of other key financial and managerial decisions
 - Enhance regulatory disclosure standards through the Mutual Savings Banks Federation building a unified disclosure standard.
- d) Stronger penalties imposed on untimely or false disclosures
- Maximum penalty raised from 5 million won to 50 million won
- e) Lowered minimum requirement for the Securities and Futures Commission (SFC) to assign an external auditor
- External auditor assigned when accounting irregularities exceed 3% of shareholders' equity (previously 5%)
- Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)
 - Revision of the Enforcement Decree of the Savings Bank Act and the Supervision Regulations (3Q of 2011)

2) Limitation on Issuing Subordinated Bonds

Minimizing investor losses through limiting the issuing of subordinated bonds by financially unsound structured mutual savings banks

- a) In principle, allowing only issuances to professional investors, with the exception to making the issuance public when strict requirements are met.
 - b) Before the amendments are made to the Mutual Savings Banks Act, issuance of subordinated bonds will mainly be discouraged, but for banks with sufficient capital will be advised to issuing new stocks as a condition to issuing subordinated bonds.
- Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)

3) Preventing Incomplete Sales

- a) Investors are to be given an explanatory manual containing the bank's recent financial statements including the BIS ratio NPL ratio, and are then made to sign in acknowledgement.
- b) Investors are also to be given explanation of deposit insurance and whether the financial instrument qualifies, and are then make to sign in acknowledgment.



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- c) Mystery shopping will be carried out to inspect proper execution of these new guidelines.
- Revision of the Savings Bank Act (to be submitted to the National Assembly in the third quarter of 2011)

4. Strengthening Supervision over the Cause of Insolvency

1) Enhancing the Capacity and Competence of Supervision

- a) Investigating the cause of insolvency
 - (On savings banks that are believed to be in risk of insolvency) prioritized to be inspected before regular annual inspections – strict inspection on unfair or unlawful activities of the management and the largest shareholder.
 - (On savings banks that are judged insolvent) a thorough inspection on the cause of insolvency and strictly pursuing civil and criminal charge against those who are suspected of being responsible.
 - b) Reinforcement of professional inspection staff and run inspection training programs to bolster the FSS's inspection capacity
 - c) Enhance the Korea Deposit Insurance Corporation's (KDIC) capacity in inspecting the cause of insolvency and the persons who are responsible
 - Expand its outreach in requesting relevant documents(i.e. court administration and tax agency)
 - Stronger level of penalty imposed to the spouse or ones involved with the suspect that do not cooperate in the investigation
 - d) Expansion of FSS and KDIC's joint investigations
 - Double the number of joint investigations to minimize KDIC's losses and utilize outside accounting experts.
- ##### **2) Simultaneous execution of Prosecution, FSS, and KDIC's inspection on the cause of insolvency and the ones suspected responsible**
- a) To speed up the process which was originally done in sequence (FSS, then KDIC, then Prosecution)
 - Although, to not hinder the process of self-initiated efforts by the major shareholder to revive the company experiencing a short of liquidity, the



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inspection will be carried out in flexible terms.

3) Stronger Penalties Imposed to Persons Responsible for Insolvency

- Previously (relief of duty) → Currently (dismissal)
- Prosecution pursued for any amount in illegal lending to the largest shareholder

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