ANNEX – Republic of South Korea

A. Overview of the banking sector

Institutional and legal framework

1. The Financial Supervisory Service (FSS) is South Korea's integrated financial supervisory authority. Prior to its creation in 1999, four separate sector-based authorities carried out financial supervision, with the Finance Ministry exercising significant powers over them.

2. The institutional and systemic shortcomings during the 1997 Asian financial crisis reinforced the need for reform of the regulatory and supervisory structures and frameworks. Therefore, a two-tier system was created:

   i. The Financial Services Commission (FSC) assumed the primary responsibility to set the government's financial market policies, propose changes to financial legislation to the National Assembly, make rules, grant regulatory licenses, and decide on major enforcement actions.

   ii. The Financial Supervisory Service (FSS) was entrusted with the tasks of banks' prudential supervision, capital market supervision, consumer protection, and other oversight and enforcement activities as delegated by the FSC. The FSS was also granted administrative functions in support of the rulemaking and licensing activities of the FSC.

3. Therefore, under the guidance and supervision of the FSC, the FSS deals with matters, concerning: i) examination of financial institutions' business operation and property profile; ii) sanctions against financial institutions following examinations; and iii) protection of financial consumers such as dispute mediation.

4. South Korea's legal framework governing the banking business consists of the following:

   i. Banking Act (BA), which is legislated and amended by the National Assembly;

   ii. Enforcement Decree of the Banking Act (EDBA), which implements and supports statutes enacted by the National Assembly with detailed rules;

   iii. Regulations on Supervision of the Banking Business (RSBB), which is written and amended by the FSC to complement enforcement decrees and ensure full enforcement of statutes;

iv. Detailed Regulations on Supervision of the Banking Business (DRSBB), which is written by the FSS in support of the RSBB to ensure effective performance of supervisory duties and functions.

5. The aforementioned law and regulations provide for:

   i. authorization of banks;
   ii. ownership restrictions on banking shares;
   iii. governance;
   iv. businesses that banks may engage in;
   v. prudential requirements;
   vi. supervision and examination of banks

Overview of the South Korea financial system

6. Korea's financial sector has traditionally been dominated by banks and Non-Bank Deposit Institutions (NBDIs), which amount for nearly 70% of the total assets. The financial sector has been growing quite rapidly over the past decade, with financial sector's aggregate assets more than tripling from 1,562 KRW/tn in 2004 to 5,489 KRW /tn at end-2017. Over the same period, the banking sector grew from 1,142 KRW/tn to 2,978 KRW/tn (see Table 1 next page). In terms of value added, at end-2017, the financial sector (including insurance) accounted for 4.96% of the gross domestic product (nominal GDP).

7. Non-bank financial companies (or Non-Bank Depositor Institutions, NBDIs) provide financial services similar to banks, such as deposit-taking and lending, but they are treated differently from banks for their unique characteristics and customer basis. Generally, mutual savings banks, mutual credit cooperatives and specialized credit financial companies are collectively called non-bank financial companies.

8. Mutual savings banks' main business activities involve deposit-taking and lending for less creditworthy borrowers and SMEs; mutual credit cooperatives engage in deposit-taking and lending for cooperative members; specialized credit financial companies specialize in retail and corporate lending. However, while NBDIs are all involved in deposit-taking and loan-granting activities, their regulatory and supervisory framework is different from the one to which banks are subject. MSBs are regulated under the Mutual Savings Banks Act, while MCCs are regulated under the law legislated by their national federations, and specialised credit companies are regulated under the Specialized Credit Finance Business Act.

9. The supervisory framework is also different. The FSS (under the guidance of the FSC) is the supervisory and examination authority for banks, the merchant bank and the MSBs. The FSC also provides the framework for the prudential regulation and supervision of MCCs, but the supervision and examination powers are given to other bodies, according to the different type of cooperative. For credit unions, the FSC is the regulator while the FSS is the supervisor, but examinations are conducted primarily by the credit union federation.

Table 1 – South Korea: Financial system structure and size (end-2017)

	Number	**Assets** (KRW trillion)	**Share of total** (%)
Banks	**57**	**2,978**	**54.3**
NBDIs	3,652	756	13.8
- Mutual savings banks (MSBs)	79	60	1.1
- Mutual credit cooperatives (MCCs)	3,571	623	11.3
- o/w credit unions	898	82	1.5
- o/w cooperatives	1,358	390	7.1
- o/w community credit cooperatives (CCCs)	1,315	150	2.7
- Merchant bank	1	2	0.0
- Korea Post	1	71	1.3
Credit-specialised financial companies	97	245	4.5
Securities companies	55	390	7.1
Futures companies	5	3.3	0.1
Asset management companies	215	7.1	0.1
Life insurance companies	25	832.8	15.2
Non-life insurance companies	32	277.1	5.0
Total	**4,138**	**5,489**	**100**

Source: FSS Korea

10. Even though specialized banks were established on the basis of their own governing laws, they are subject to the Banking Act for supervision and regulation, with minor differences in regulatory and supervisory treatments because of the unique characteristics that specialized banks have.

11. Financial investment services companies are firms authorized as service providers for financial investment products. A different regulatory treatment applies according to the type of financial investment service (dealer, broker, collective investment manager, investment advisor and trust Service Company). Taken together, specialized banks and financial investment services account for slightly less than 15% of total assets of the Korean financial system.

Structure and performance of the South Korea banking sector

12. National banks operate nationwide, while regional banks are subject to certain geographic restrictions in their business operations. Specialized banks[1] refer to government-affiliated policy banks that have been established under individual legislation enacted by the National Assembly. The Banking Act recognizes foreign bank branches as equivalent to domestic banks in respect of banking activities and for supervision purposes.

13. More than half of the Korean banking sector in terms of assets is composed by commercial (national banks), while more than 30% is accounted for by specialized banks.

Table 2 – Banking sector in South Korea

		Total assets (trillion won)	Share (%)
Commercial banks(A)		1,562.1	52.2
	Foreign banks	127.8	4.3
Local banks(B)		210.9	7.0
Internet bank(C)		7.2	0.2
Commercial banks(D=A+B+C)		1780.2	59.5
Specialized banks(E)		973.2	32.5
Domestic banks(F=D+E)		2753.5	92.0
Foreign bank branches(G)		239.5	8.0
All banks(F+G)		**2992.9**	**100.0**

Source: FSS Korea

14. In terms of recent performance, the banking sector remains well capitalized, with the CET1 ratio increasing to around 15% at end-2017. MSBs also show a sound capital adequacy ratio (14.2%, although computed according to Basel I), while the capital position of MCCs (expressed by the net worth ratio) appears less strong. The ratio of loans classified as substandard or below (SBLs)—loans classified substandard, doubtful, or presumed loss— kept declining over the past three years, reaching 1.2% and 1.3% at banks and MCCs. This trend was mainly due to banks' efforts to strengthen risk management of corporate loans, reduce new toxic assets, and actively resolve NPLs. MSBs show a higher figure (around 5%), most likely due to an increase in the share of vulnerable borrowers in the process of expanding household lending. However, the SBL ratio has substantially halved from 2016.

[1] Five banking institutions operate as specialized banks under the respective legislation. They are Korea Development Bank, Export-Import Bank of Korea, Industrial Bank of Korea, NongHyup Bank of the National Agricultural Cooperative Federation, and Suhyup Bank of the National Federation of Fisheries Cooperatives. They are all subject to the Banking Act, and thus are supervised and regulated as other banks

Table 3 – Financial soundness indicators

		2015	2016	2017
Capital ratio (net worth ratio for MCCs and CCCs)	Banks	13.9	14.8	15.2
	MSBs	14.1	13.9	14.3
	MCCs	7.8	7.7	7.8
Substandard-or-below loan (SBL) ratio	Banks	1.8	1.4	1.2
	MSBs	10.2	7.1	5.1
	MCCs	1.8	1.4	1.3
Liquidity ratio	Banks	104.8	108.2	101.2
	MSBs	119.3	120.0	120.2
	MCCs	56.7	51.6	54.9

Source: FSS Korea

Implementation of Basel III standards

15. In recent years, the Korean authorities have undertaken several initiatives designed to strengthen the prudential framework relating to bank capital and their supervisory framework. The Basel II Pillar 1 standards have been in effect from January 2008 and, subsequently, Basel 2.5 and Basel III were implemented with effect from February 2012 and November 2013, respectively. In January 2016, the FSS issued regulations regarding Pillar 2 that stipulate the new requirements for banks' internal capital adequacy assessment process (ICAAP), as well as the framework for the supervisory review and evaluation process (SREP).

16. The Korean authorities issued the final rule on Basel III risk-based capital in November 2013 to implement the Basel III framework (taking effect in December 2013). It is currently planned to introduce the new Basel III Large exposure framework in line with the Basel III timeline, i.e. from January 2019.

B. Detailed Assessment of Republic of South Korea

<table>
<tr><th colspan="3">Country: Republic of South Korea</th><th></th></tr>
<tr><td colspan="4">Assessment of particular topics and sections</td></tr>
<tr><td colspan="2" rowspan="2">Topic I</td><td rowspan="2">Supervisory Framework</td><td>Topic Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td colspan="2">Rationale for overall topic assessment</td><td colspan="2">
The supervisory framework has been assessed as "equivalent" to the EU framework. Korea introduced Basel III International Regulatory Standards for Banks and associated supervisory standards in December 2013. The supervision is conducted by two authorities – Financial Supervisory Service (FSS) and the Financial Securities Commission (FSC).
The prudential supervisor of banks and capital market is the FSS while the FSC sets government's financial market policies, proposes changes to financial legislation and makes rules. Clear provisions are in place for the supervisory rights and powers of the FSS, its independence and autonomy. The supervisory authorities have the powers to issue corrective order, impose business suspension, charge administrative fine, and enforce sanctions against non-compliant financial companies and their executives and employees.
The supervisory review process is aligned with the SREP procedures governing supervision in the EU. FSS can impose a number of supervisory measures on banks, including a Pillar 2 capital add-on, which is levied by scaling-up the RWAs.
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<tr><td rowspan="3"></td><td rowspan="2">Section 1</td><td rowspan="2">General questions</td><td>Section Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">
Prudential supervision
Supervisory activities in the financial sector are performed by two authorities, the Financial Supervisory Service (FSS) and by the Financial Securities Commission (FSC). The prudential supervisor of banks and capital market is the FSS while the FSC sets government's financial market policies, proposes changes to financial legislation, makes rules, grants regulatory licences and decides on major enforcement actions. The FSC can delegate oversight and enforcement activities to the FSS but the examination functions with the FSC, the Bank of Korea and the Korea Deposit Insurance Corporation are coordinated by the FSS.
The FSS supervises the financial services firms across entire financial market: banks, non-bank financial companies, financial investment services providers and insurance companies.
Prudential regulation
All banks in Korea are subject to prudential regulation; however, the applicable rules to banks and non-bank financial institutions are different:
i. Banks include commercial banks, specialized banks and foreign bank branches and they are all subject to the Banking Act and Basel III standards that have been implemented via Detailed Regulation on Supervisory Banking Business (DRSBB).
ii. Non-bank financial institutions include mutual savings banks, specialised credit finance companies and mutual credit cooperatives and they are not classified as banks, as they are not subject to the Banking Act.
iii. Financial investment service providers and insurance companies are subject to a different set of rules and they were not subject to the current assessment exercise.
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		Prudential supervision of banks is conducted on individual basis but when a bank is part of a group, consolidated supervision is applied. The scope of consolidation for prudential purposes is based on the scope of accounting consolidation. **Recent developments** As part of its efforts to continuously improve the regulatory framework for banking operations in line with Basel standards, the FSS introduced Basel III International Regulatory Framework for Banks and associated supplementary standards in Korea on 1 December 2013. Since then, the minimum capital standards and phase-in arrangements have been the same as put forth by the Basel Committee on Banking Supervision. Regulatory Consistency Assessment Programme (RCAP) was conducted in Korea in 2016 and the prudential regulatory framework was evaluated to be largely compliant with the minimum standards under Basel framework, applicable to internationally active banks on a consolidated basis.	
	Section 2	**Competencies of supervisory authorities**	Section Assessment Equivalent
	Rationale for section assessment	**Supervisory rights and powers** Clear provisions are in place for the supervisory rights and powers of the FSS. The FSS is an independent organisation; its independence is ensured by the Act on the Establishment of Financial Supervision Organisation ("Establishment Act"). Even though the FSC supervises the FSS (approval of FSS bylaws and approval of budget and accounts of FSS), from an operational point of view, the FSS is fully independent when implementing its own financial supervision work (examinations, investigations, sanctions and enforcement for financial institutions). The FSS coordinates its examination functions with the FSC, the Bank of Korea, and the Korea Deposit Insurance Corporation in order to ensure timely and effective examination and supervision. The FSS Governor is appointed by the President of Korea at the request of the FSC Chairman. Moreover, up to four senior deputy governors and nine deputy governors may be appointed under the Governor. The Governor, senior deputy governors and the deputy governors each serve a **three-year term** that may be renewed. Clear reasons should exist for the dismissal of any of the FSS governors (bankruptcy, sentence to imprisonment, violation of the Establishment Act, physical or mental impediment). As a government regulatory authority, the FSC is staffed by civil servants, while the FSS is a specially legislated supervisory authority that is staffed by private sector employees, who are not part of the government civil service system. **Licensing of banks** The FSC has the power to issue and revoke banking licenses. The provisions for the authorisation of credit institutions are largely equivalent to the CRD. The initial minimum capital requirements for banks are much higher in the Korea than the 5 million EUR foreseen in the EU regime. Korean banks are required to have a minimum of the Korean won equivalent to EUR 75.3 million. **Fit and Proper** The criteria (positive and negative conditions) that a person needs to fulfil to hold executive positions ("Fit & Proper" test) are established in the Banking Act and reflected in the Act on Corporate Governance of Financial Institutions ("Governance Act") and, as long as the candidate meets the criteria, he/she can be appointed by the Board of Directors. The Banking Act and the Governance Act provide a number of criteria that restrict the access to the position of bank executive. In addition to restrictions connected primarily with criminal offences, the members of the Board of Directors must possess demonstrated expertise, experience and knowledge	

		in banking and finance and bank management and do not pose any harm to the public interest. All the criteria need to be met during the whole directorship tenure. At least half of a bank's Board of Directors must be outside directors (defined as directors who are not engaged in the general affairs of the Board of Directors). Banks are required to establish a recommendation committee for the outside directors who then recommends candidates to be selected and appointed by shareholders at a general shareholders meeting. Qualitative criteria are established for the appointment of the following executive directors: i. CEO; ii. Outside directors; iii. Other members of the Board of Directors; iv. Key function holders, including compliance officers. The Banking Act and the Governance Act provide a number of criteria that restrict the access to the position of bank executive. No executive or employee of a bank shall be an executive or employee of the Bank of Korea or any other bank or a bank holding company (except when he/she becomes executive of a subsidiary of the bank in question). From a procedural point of view, there is no need for a preventive approval from FSS. Banks must provide the relevant documentation and a justification to FSS after the appointment, after assessing themselves for the fit and proper requirements, so that unsuitable candidates are not appointed.	
	Section 3	**Prudential Supervision**	Section Assessment Largely Equivalent
	Rationale for section assessment	**Supervisory scope** With regards to the supervisory scope, the FSS exercises supervision both at the consolidated level and at the level of the individual institution. For consolidated financial statements, companies subject to consolidation and the scope of consolidation is according to accounting standards. Banks include commercial banks, regional banks and foreign bank branches – all regulated under the Banking Act and required to adhere to Basel III and DRSBB. Non-bank financial institutions are not subject to the DRSBB. **Supervisory powers** Both the FSC and the FSS are legally empowered to impose a set of administrative measures and penalties towards banks. The FSS has the administrative power to demand: 1) reports and other materials, 2) examination of business operation and financial status, 3) corrective actions, and 4) disciplinary punishment to financial institutions. The FSS may also recommend dismissal of executives and suspend the business operation of a financial institution. The FSC, who grants and may withdraw the operating licence, may also impose administrative fines on violations of legal limits (credit extension limits, equity investment limits and property ownership limits). The amount of fines is determined on the basis of the level, frequency and duration of violations and the size of the benefit gained from the violations. When fines are imposed, the FSC can impose additional enforcement actions.	

<table>
<tr><td rowspan="2"></td><td>Section 4</td><td>Supervisory Review Process</td><td>Section Assessment
Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">

ICAAP

Institutions should prepare policies and procedures designed to identify, measure, and report all material risks for the bank’s internal capital adequacy management. They should also set capital adequacy goals with respect to risk, reflecting the bank’s strategic focus and business plan, and should implement an adequate process of internal controls. Banks must submit to FSS an ICAAP report yearly, including risk management structure, risk identification, risk limits, the result of stress tests, and a capital contingency plan.

Examinations

The FSS examiners perform full-scope and targeted examinations of financial institutions to help ensure appropriate safety and soundness standards and enforce compliance with laws and regulations. FSS examiners conduct full-scope examination to evaluate financial institutions’ overall financial, management, operational, and compliance performance. The selection of financial institutions that are to undergo a full-scope examination is made in advance during the annual examination planning. The determination of the timing and duration of a full-scope examination and the number of examiners to be assigned is normally made with due consideration given the size, complexity, and risk profiles of the subject institution, findings from the previous examination, and issues of supervisory concerns that have been raised from off-site monitoring.

Supervisory Review Process

The FSS assesses banks according to the CAMEL-R approach (Capital adequacy, Asset Quality, Management, Earnings, Liquidity, Risk Management). Each component of this framework is based on quantitative and non-quantitative elements, for which FSS has dedicated examination and supervisory manuals. The non-quantitative element includes the assessment of how the bank is controlling the risks. The combination of the six elements then provides a rating for the institution.

At the end of a full-scope supervisory examination, the supervisory team assigns supervisory ratings according to the CAMEL-R model, which are then aggregated into a composite rating. In addition, the FSS retains the chance of adjusting the rating obtained during full-scope examination, through an assessment of the quantitative components of the framework (the so-called CAEL evaluation model, based on Capital adequacy, Asset quality, Earnings and Liquidity), on the basis of dedicated reports that banks are required to send to the FSS on a quarterly basis. This way, the supervisor can rely on a continuously updated rating (i.e. on a quarterly basis for each institution).

Supervisory powers to levy higher capital/liquidity requirements

Following the annual rating, the FSS can impose a number of supervisory measures on banks, including a Pillar 2 capital add-on, which is levied by scaling-up the RWAs.

A wide range of supervisory measures can be taken in case:

internal capital adequacy management and risk management are insufficient;
the bank holds exposures that pose significant risk;
the bank is operating at the insufficient level of capital in comparison with internal risk.

Supervisory review of internal models

The FSS requires banks to submit the results of their validation of internal rating risk factor at least once a year. These results are then considered in the annual supervisory review. If the FSS finds that a bank fails to meet minimum requirements or material change to the model, it can require a RWAs surcharge and a written plan to increase capital.

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	Section 5	**Professional Secrecy and International Cooperation**	Section Assessment Equivalent
	Rationale for section assessment		**Professional secrecy** The obligation of confidentiality for the FSS employees covers all the information that they come to know during their service. While external experts are rarely involved in the FSS's projects, they are required to sign a confidentiality agreement. If they violate it, they will be subject to civil or criminal punishment. In both cases, it is an ongoing obligation (i.e. it extends beyond the termination of employment). Korea's legal framework allows the FSS to obtain information classified as confidential and share it with other supervisors and with other administrative bodies only under strict criteria. In case the confidential information is received from foreign authorities, the FSS Korea is required to seek their approval prior to disclosing such information ("principle of express agreement"). Disclosure of confidential information in breach of the professional secrecy duty is punishable and may lead to imprisonment, fines, and suspension of qualifications. **International cooperation** The FSS hosts and participates in international supervisory colleges and has agreements of information sharing with foreign supervisory authorities in the form of MoUs.
Topic II		**Own Funds**	Topic Assessment Partially Equivalent
Rationale for overall topic assessment			South Korea's and EU framework for own funds are similar in many aspects; however, the dividend stoppers are included in the South Korean legislation and thus this area is deemed partially equivalent overall.
	Section 6	Own Funds	Section Assessment Partially Equivalent
	Rationale for section assessment		**Own funds requirements** The own funds requirements are similar to those of the CRR: • 4.5% CET1 • 6% T1 • 8% Total Capital CET1 composition and eligibility requirements share many features similar to those of the CRR. On the face of it prior approval with regard to discretionary purchase appeared to differ; however, on an outcomes based approach basis it is similar to the CRR. It was clarified that in the jurisdiction of South Korea, only common shares issued by a stock company can be recognised as CET1. Moreover, there are no other capital instruments that may be recognised as CET1. **Adjustments and deductions** The prudential filters provisions of Korea's jurisdiction share similar features to those of Article 32-35 CRR. Deductions are also similar to those required under the CRR. In addition, a more conservative approach is taken towards the treatment of deferred tax assets. With regard to reductions in own funds while the order of the supervisory approval can differ, outcomes are the same. There is similar treatment for minority interests.

		Differences with the CRR According to the criteria for classification of common shares as CET1 (Appendix 3 of the Banking Act), distributions of CET1 instruments are "*paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made.*" In addition, *the cancellation of distributions/payments [of Additional Tier 1 capital] must not impose restrictions on the bank except in relation to distributions to common stockholders*". These provisions pertaining to distributions privilege AT1 holders compared to CET1 holders. Dividends stoppers are however not allowed in the CRR.	
	Section 7	General requirements	Section Assessment Equivalent
	Rationale for section assessment	Own funds requirements cover credit, market and operational risk. The provisions on prudential reporting are similar to those envisaged by the CRR.	
Topic III		**Credit Risk Requirements**	Topic Assessment Largely Equivalent
Rationale for overall topic assessment		Korean regulations on credit risk, credit risk mitigation and securitisation are "Largely Equivalent" to the EU framework. Most of the regulations are fully aligned with the CRR provisions. Korea's regulation includes provisions on Credit risk Standardised Approach (SA) and IRB Approach as well as on Credit risk mitigation techniques. The Korean regulation includes largely the same exposure classes as in the CRR and most of the risk weights under SA are identical to the ones envisaged in the CRR, with some exceptions, where the treatment is notably more conservative. The framework for calculating own funds requirements for credit risk using the IRB Approach are overall equivalent to the framework included in the CRR. While there are some qualitative aspects where the treatment seems slightly less conservative than in the EU (the "owner-occupier rule" for residential mortgages and cross-dependence between value of the property and income of the borrower), there are also aspects where the Korean IRB framework can be seen as more conservative than the EU (exposures to SMEs are not granted a more favourable treatment and the 1.06 multiplying factor is applied also to non-formula based IRB capital calculations).	
	Section 8	Capital requirements for credit risk	Section Assessment Equivalent
	Rationale for section assessment	**Standardised Approach** The Korean regulation includes largely the same exposure classes as in the CRR. Most of the risk weights are also identical to the ones envisaged in the CRR, with some exceptions, where the treatment is notably more conservative: - Public Sector Entities: No reduced risk-weights for original maturity less than 3m; - Institutions: No reduced risk-weights for residual maturities less than 3m; - Residential Mortgages: Loan to Value capped at 60% (80% in the CRR). There are also some qualitative differences, which could initially be seen as less conservative, even though the explanation provided by the FSS Korea showed that these gaps are actually closed in the actual practice. In particular: - Definition of residential mortgage loans eligible for a 35% risk weight: the domestic regulations define, among other criteria, as residential houses that are "owned" by the borrowers, as opposed to those that are "occupied" by the borrowers as stated in the Basel standards and in the CRR. The FSS clarified that in Korea almost all residential houses are either "owned for occupation" or "rented out", and that there are barely cases where a borrower who owns a house does not either occupy or rent it, holding it only for speculative purposes.	

- No explicit conditions on cross-dependence between the value of the property and the credit quality of the borrower, unlike in the Art. 125(2) of CRR. However, Art. 49 DRSBB requires that the bank assesses the borrower's default risk as well as his income, on the condition that such income does not derive from the house for which the mortgage has been granted.

Internal Rating Based (IRB) Approach

The framework for calculating own funds requirements for credit risk using the IRB Approach are overall equivalent to the framework included in the CRR:

a. The qualifying standards to apply the IRB approach are mostly in line with those defined in the CRR;
b. The formulae to estimate the relevant risk parameter are the same ones as in the CRR;
c. The criteria for the assignment of the exposures are overall the same as in the CRR.

Notably, there are two aspects where the Korean IRB framework can be seen as more conservative than the EU one:

a. Unlike in the EU framework, exposures to SMEs are not granted a more favourable treatment, as the corresponding risk-weights are not multiplied by the "SME supporting factor" (CRR Art. 501) equal to 0.7619.
b. The 1.06 multiplying factor is applied to all the exposures under the IRB method, including the ones where a fixed risk-weight may apply (in the CRR the scaling factor is applied to the exposures stemming from the formula).

A couple of small differences were found in the qualitative requirements with respect to the periodicity of auditors' review of internal models (it is compulsory, but there is no requirement for an annual review, although this is observed in practice) and the possibility to revert to SA once the authorisation for IRB has been granted (it needs to be approved by the FSS, but there is no hard requirement that this should not lead to lower capital requirements).

Definition of default (both for Standardised and IRB approach)

The definition of default only refers to exposures that are 90-day past due, and to those that are "unlikely to pay". Exposures whose obligor is considered unlikely to pay are not directly stated in Korea's regulations. However, exposures given a 150% RW are classified as exposures whose obligor is unlikely to pay, and are treated as exposures that are 90-day past due (i.e. in default).

	Section 9	Credit Risk Mitigation	Section Assessment
			Equivalent

Rationale for section assessment

The Korean regulation stipulates the same principles, rules and general conditions for the recognition of Credit Risk Mitigation (CRM) techniques for credit protection (funded and unfunded), which correspond to a large extent to the ones implemented in the EU under the CRR framework:

1) Credit protection arrangement must be legally effective and enforceable;
2) Funded credit protection (collateral) must be eligible and sufficiently liquid;
3) Unfunded credit protection: both eligible forms (guarantees, credit derivatives) and eligible providers;
4) Adequate risk management processes.

Funded credit protection

There are no differences between the instruments eligible for funded credit protection in the Korean legislation and in the CRR. Art. 60 DRSBB corresponds closely to Art. 197 of the CRR (simplified approach) and Art. 61 DRSBB reflects Art. 198 CRR (comprehensive approach). Moreover, the following similarities were found:

		- Same formula for the calculation of exposures under financial collateral comprehensive method (Art. 62 DRSBB corresponds to Art. 223 CRR), and for own estimates; - Same conditions for the application of 0% haircut in Financial Comprehensive Approach; - Master netting agreements/repo transactions: similar provisions for requirements. However, there are no explicit requirements for the use of IRB models in Master Netting Agreements like in Art. 221 of the CRR. To this extent, the FSS explained that the internal model can be used to calculate the exposure of repo-style transactions under netting agreements only after having obtained the prior approval from the supervisory authority. Currently, there is no Korean bank that uses the internal model for repo-style transactions under the netting agreements. Individual instruments, conditions for recognition of on-balance sheet netting and master netting agreements and protection instruments are compliant with the CRR. **Unfunded credit protection** Similarly to the CRR, guarantees and credit derivatives shall be made on the basis of an appropriate agreement. Recognizable qualifying guarantors and protection sellers shall be either i) sovereigns, public sector enterprises, banks, securities companies, to which a risk weight lower than that of the counterparty is applicable; or ii) persons with ECAI credit rating and risk weight lower than that of the counterparty. Moreover, banks are required to have in place appropriate collateral management policies such as on-going monitoring of the appropriateness of the collateral. It is possible for banks to calculate own estimates of volatility adjustments/haircuts: to his extent, Art 67-68 (application and criteria) and 71 (formulae for haircuts adjustments) correspond to Articles 225-226 of the CRR. Finally, the requirements for guarantees and credit derivatives (Art. 88-90 DRSBB) correspond to a large extent to Articles 213, 215, 216 of the CRR, and Art.98 DRSBB to Art. 214 for public sector guarantees.	
	Section 10	Securitisation	Section Assessment Equivalent
	Rationale for section assessment	The Korea's law on securitisation is overall equivalent to the CRR. Korea's regulation on securitisation includes general definitions of traditional and synthetic securitisations that are based on economic substance of transactions – they are aligned with the CRR. Capital requirements are calculated using three approaches – internal ratings based approach IRBA, external ratings based approach ERBA, and standardised approach (SA). Structural features (liquidity facility, credit enhancement, early amortization and excess spread) of securitisation are aligned with the CRR. The use of credit risk mitigation techniques is in line with the CRR. The specific provisions for exposures in second loss position in ABCP, liquidity facilities and early amortization are in place. STS (Simple, Transparent and Standardised) rules have been implemented but banks do not get the benefits of it. Provisions on securitisation positions under other risks (e.g. credit risk) are also included and they are in line with the CRR. Korea's financial supervisory authorities have regulations in place on disclosures.	
	Section 15	Exposure to transferred credit risk	Section Assessment Largely Equivalent
	Rationale for section assessment	Minimum requirements for recognition of significant credit risk transfer in both traditional and synthetic securitisation have been implemented and these provisions are aligned with the CRR. As in the Basel framework, there is no (5%) risk retention rule that exists in the CRR but there are requirements for due diligence for securitised exposures. Assets are recognized as securitized assets only when the credit risk is completely transferred to a third party (i.e., the originator has no control	

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<tr><td></td><td></td><td colspan="2"> over the original assets). Banks must be able to comprehensively understand the risk characteristics of on/off balance securitized exposure and underlying assets and continuously verify performance information of underlying assets. In addition, banks must understand all the structural characteristics that may affect the performance of the bank's securitized exposure. If these conditions are not met, 1,250% risk weight is applied. This is aligned with the treatment under the CRR. SRT is granted on the basis of a transaction-by-transaction assessment. Originator may exclude underlying exposures from capital requirements only if conditions (operational requirements) are met. Operational requirements are also aligned with the CRR. Korean banks' exposures to securitized assets are minimal. </td></tr>
<tr><td colspan="2" rowspan="2">Topic IV</td><td rowspan="2">Market Risk</td><td>Topic Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td colspan="2">Rationale for overall topic assessment</td><td colspan="2"> Korea's capital adequacy regulation takes into account both the counterparty credit risk (CCR) and all risks under market risk. They have provisions in place also for settlement risk, CVA risk and commodities risk. In general, the legal provisions are based on the same ideas and principles (building block approach) as the CRR provisions for these types of risks and their regulation is almost fully aligned with the CRR. Their concept of trading book is very similar to that of the CRR. Korea has implemented the Basel Committee's recent changes to the counterparty credit risk and CVA risk frameworks, including internal models, which are already considered in the CRR. Market risks and CCR regulations are both equivalent to the CRR. </td></tr>
<tr><td></td><td rowspan="2">Section 11</td><td rowspan="2">Counterparty Credit Risk</td><td>Section Assessment</td></tr>
<tr><td></td><td>Equivalent</td></tr>
<tr><td></td><td>Rationale for section assessment</td><td colspan="2"> In general, Korea's rules for the treatment of counterparty credit risk (CCR) are identical to the respective rules of the CRR. All three models that are in Basel Standards have been implemented in Korea's regulation, but they do not have the Original Exposure Method (OEM), which is in the CRR but not in the Basel framework. All three methods eligible to calculate own funds requirements are aligned with the CRR with regard to the calculation methodologies and accompanying operational requirements (e.g. requirements for the management system when the institution uses internal model, IMM). IMM model can be used under the approval from the Governor and bank can revert to a simpler approach only under exceptional circumstances or for immaterial exposures provided that it would not entail regulatory arbitrage. A few non-material differences were observed, for example Current Exposure Method (CEM) is applicable only to OTC derivatives and that CCR in securities financing transactions (SFTs) can be calculated using only IMM or credit risk mitigation (CRM) under standardised approach for credit risk. Cross product netting agreements are allowed for OTC derivatives and SFTs. Legal criteria include executing a master agreement and a written cross product netting agreement, which is aligned with the CRR. Korea's regulation on CCR is aligned with the CRR and therefore can be considered equivalent. </td></tr>
<tr><td></td><td rowspan="2">Section 13</td><td rowspan="2">Own funds requirement for market risk, settlement risk and CVA risk</td><td>Section Assessment</td></tr>
<tr><td></td><td>Equivalent</td></tr>
<tr><td></td><td>Rationale for section assessment</td><td colspan="2">Korea has a trading book concept in place, which is similar to CRR's trading book concept both with regard to the instruments assigned to it and the requirements for its management, also the principles of prudent valuation. Korea also has very similar conditions for the small trading book derogation but</td></tr>
</table>

		the two thresholds are lower. In practice, only one bank was below small trading book thresholds at the time of assessment. All banks need to calculate own funds for credit and operational risk regardless of the size of trading book; notwithstanding the trading book limits, and the Governor may designate banks subject to the capital requirements standards. Korea's **market risk** provisions are based on a building block approach taking account of position risk for trading book activities, foreign exchange risk and commodities risk for all business activities. Regarding the approaches to calculate own funds requirements, Korea's regulation allows both for the application of the **standardised approach (SA) and internal models approach (IMA)** and the calculations of capital requirements are identical to the CRR. In case of IMA, the qualitative and quantitative requirements of general character or related to the VaR calculation are also identical to the CRR. Regarding the implementation of Basel III, Korea has implemented the provisions on **Stressed-VaR and Incremental Risk Charge (IRC)** that are mandatory for banks using IMA; and they also have the same concept for correlation trading portfolio. All these provisions are identical to the CRR. Similarly to the CRR, own funds to cover the risk of options can be calculated using either simplified or delta-plus method. Offsetting between entities is allowed on sub-consolidated and consolidated basis. The calculations for the **settlement risk** include the same transactions as under the CRR; also unsettled repos are excluded. Similarly to the CRR, there is a different factor of 8% in period from 4 to 15 working days (5-15 working days in the CRR as the only difference) after due settlement date and 1250% for free delivery exposures until the extension of the contract are identical with the CRR provisions. Korea's capital adequacy regulation imposes own funds requirement for **CVA risk** and both methods, Standardised and advanced, have been introduced in their framework. Unlike in the EU, Korea's regulation does not foresee any exemptions for the CVA risk charge and some minor differences were also observed; however the outcome is more conservative than in the EU. Considering the fact that Korea's regulation on own funds requirements for market and related risks comprises all the elements, which are part of the CRR market risk rules and the rules on CVA risk and that these rules are fully aligned with the CRR, the provisions are considered equivalent to those of the EU.	
Topic V		**Operational Risk**	Topic Assessment Equivalent
Rationale for overall topic assessment		The Korean framework for operational risk can be assessed as "equivalent" to the EU regime. In general, the regulations are driven by the similar principles and follow the similar direction of qualitative and quantitative supervision. Little differences that were observed between the EU and Korea have only insignificant impact and are therefore negligible. Korea has refrained from using the national discretion to implement the alternative standardised approach (ASA), which is implemented in the EU. This is the only significant difference and can be assessed as a more conservative operational risk regulation because only banks in a high inflation rate environment, which is not given in South Korea, or banks with a special business model would choose that approach and benefit by lower capital requirements. However, in Korea most of the systemically important and large banks use the model approach (AMA – about 55% of total OpRisk requirements stem from AMA) for determining the operational risk exposure.	
	Section 12	Operational Risk	Section Assessment Equivalent
	Rationale for section assessment	**Definition** Operational risk is defined in the Korean legislation as risk of loss that is likely to be incurred as a result of inappropriate or erroneous internal processes, human resources and systems, or an external event,	

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which shall include legal risk, but exclude strategic and reputational risk. Legal risk includes, but is not limited to, fines, penalties, punitive damages resulting from supervisory actions, and exposures relative to private settlement.
Regulation
Along the current valid Basel regulation the Korean regulation allows the use of three different approaches to determine the own funds requirement for operational risk in Pillar I which are:

Basic Indicator Approach (BIA) – a P&L-driven Indicator (gross income = GI) is weighted by 15%;
Operational Standardised Approach (TSA) – the GI is distributed to business lines and weighted between 12, 15 and 18 %;
Advanced Measurement Approach (AMA) – model approach with the requirement of the use of different data sources.

Most of the requirements are laid down in Chapter 5 of Appendix 3 Standards for Calculation of Ratio of Capital to Credit and Operational Risks of Risk-Weighted Assets of the DRSBB.
In Section 4 of Chapter V of the DRSBB qualitative/management requirements are defined that reflect the Basel Principles on Sound Management of Operational Risk (PSMOR) as well but since they only refer to TSA/AMA banks it is not directly required for BIA.
The Basel national discretion to implement the Alternative Standardised approach is not used in Korea. The most significant difference between ASA and the standardised approach (TSA) is the limitation of the net interest margin by a standardised net interest margin of m=0.035.
There are some minor differences between the EU and Korean regulation with negligible relevance, for example:

There is no explicit mention of the use of forward looking indicators in case of unavailable data. Mergers and acquisitions or running a new business can trigger such an event of unavailable/inadequate data but this effect is temporary and such events are rare.
The way to revert to a less sophisticated approach needs only the approval of the Governor and requires no additional condition unlike in the EU regulation (Article 313 of the CRR).
Clear conditions for partial use are defined in the Korean regulation (Article 237 DRSBB) but only soft conditions in the CRR (Article 314 CRR).

Supervision
The FSS has practical experience with the supervision of all three approaches (BIA, TSA and AMA), and has established a comprehensive unified supervisory practice with the emphasis on basic principles for the implementation of all elements of the supervisory process.
Banks have to deliver several reports that will be used primarily for the assessment. Such reports are the ICAAP report, stress test report, back testing reports or the evaluation reports in case of model use. The comprehensiveness of loss data - which are crucial for AMA modelling - are assured by supervisory checks during the on-site visits.
</td></tr>
<tr><td colspan="2" rowspan="2">Topic VI</td><td rowspan="2">Liquidity</td><td>Topic Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td></td><td>Rationale for section assessment</td><td colspan="2">The framework for liquidity in Korea is equivalent to that of the EU and can be assessed as "equivalent" to the EU one. The Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) are both established requirements in the jurisdiction.</td></tr>
<tr><td rowspan="3"></td><td rowspan="2">Section 16</td><td rowspan="2">Liquidity</td><td>Section Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td></td><td colspan="2">Short-term liquidity</td></tr>
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<tr><td></td><td></td><td colspan="2">Banks are required to maintain a Liquidity Coverage Ratio (LCR). At present the ratio is currently phased in at 90%, while in the EU it is currently at 100%. There are some slight divergences to the EU law in that the calculation is based on an average 30 day forward looking basis, thus taking an average title and hence a little less conservative than the EU in that aspect. However, there are areas where more conservative approaches are taken such as with regard to foreign branches which are subjects to an LCR of 60% and Korean institutions are required to maintain an LCR of at least 80% in significant currencies.

Long-term liquidity

The Net Stable Funding Ratio (NSFR) is already implemented in the jurisdiction. The NSFR requires that long term (or short-term illiquid) assets be financed with stable resources i.e. capital and long-term liabilities (each weighted according to a function of their liquidity/maturity profile). Both are reported to supervisors on a quarterly basis. Market data is monitored with little time lag, that can be used as early warning indicators to monitor the stressed liquidity conditions of banks.

Other liquidity ratios

Korea also imposes a further liquidity ratio in their jurisdiction which measures loans to deposits.

Reporting

Reporting is similar to the reporting regime of the EU, however there are templates for rollover funding and various lengths of funding. The 30-day average for the LCR may be mitigated by the reporting on maturity mismatch.</td></tr>
<tr><td colspan="2">Topic VII</td><td>Capital buffers and macroprudential tools</td><td>Topic Assessment
Largely Equivalent</td></tr>
<tr><td colspan="2">Rationale for overall topic assessment</td><td colspan="2">The framework for capital buffers and macroprudential tools implemented in South Korea can be regarded as “largely equivalent” to the EU one. All the capital buffers applied in the EU regime are currently implemented and mandatory in South Korea, except for the systemic risk buffer. However, the Korean authorities can deploy a number of tools to address risks to financial stability. In case a bank does not comply with the buffers’ requirement, it will be subject to a restriction in the distribution of payments and will be required to submit a plan to the FSS showing how the capital shortfall is going to be replenished. The Bank of Korea acts as designated macroprudential authority, and cooperates with other relevant authorities (FSC, FSS, MOSF) to monitor the insurgence of systemic risks and the stability of the financial system. A number of macroprudential tools are already being used to reduce risks in the financial system, especially those connected with FX-exposures and the accumulation of household debt.</td></tr>
<tr><td rowspan="2"></td><td>Section 18</td><td>Capital Buffers</td><td>Section Assessment
Largely Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">Capital buffers

Three capital buffers are currently in place in South Korea:

- <u>Capital conservation buffer</u>: introduced in 2015, is currently phased in at 1.875%, reaching 2.5% in 2019.
- <u>Countercyclical capital buffer (CCyB)</u>: it can be put in place—with a twelve-month notice—within a range between 0% and 2.5% of RWAs to account for fluctuations in demand and supply of credit. The current level of CCyB is currently at 0%, and the indicators used to determine the CCyB are in line with the same parameters used in Basel and in EU.
- <u>D-SIB/G-SIB buffers</u>: Banks are designated as D-SIBs by the FSS in accordance with a specific methodology, which reflects closely the one adopted in the Basel framework. D-SIB are classified into two buckets according to their importance and then they can be subject to a</td></tr>
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		surcharge of 1% or 2%. Currently, five banks are identified as D-SIB and are subject to a 1% surcharge. No bank is identified as G-SIB. No systemic risk buffer is envisaged in South Korea. However, the FSS Korea can implement a number of tools to prevent buildup of systemic risk: FX limits, DTI limits, LGD limits. In recent months, a number of measures have also been introduced to prevent the build-up of excessive risk-taking in the household sector, with the increase of Debt-to-Income (DTI) levels, the introduction of high levels of Debt-to-Service Ratio (DSR) and lower levels for the Loan-To-Value (LTV) ratios. A sectoral countercyclical capital buffer is currently being studied for the household sector. The buffers consist only of CET1 capital and cannot be used to maintain other capital adequacy ratios. The capital buffer framework is not currently applied to "internet banks", which have been given an exemption until end-2019. Internet banks account for 0.2% of total assets. **Capital conservation measures-MDA** When capital ratios (CET1, TC) fall below a threshold defined by P1+Combined Buffers, then the distribution of capital (dividends, bonus payments, etc) is restricted according to a progressive percentage, in line with the framework and the threshold envisaged in the CRR. In case the capital ratios fall below some values, capital level should be replenished. While the specific elements to be included in the capital conservation plan are not defined in the law, the information requested by the FSS is fairly similar; the FSS has not experienced any violation of the combined buffer yet. The FSS Korea imposes Pillar 2 requirements as a scale-up of RWAs, which in turn feeds directly into the Pillar 1 requirement, which sits below the combined buffer. Therefore, the restrictions of payments and the MDA threshold are activated taking into account both Pillar 1 and Pillar 2 requirements and the combined buffer.	
	Section 19	Macroprudential Tools	Section Assessment Equivalent
		Macroprudential authority The authorities responsible for financial stability policy in Korea include: • Bank of Korea (BoK): the BoK was given responsibility for achieving financial stability under the revised Bank of Korea Act (which took effect in 2011). The BoK has been involved in the conduct of macroprudential policies by pre-emptively identifying potential risks within the financial system and exploring relevant measures together with the other government agencies. In particular, it has strengthened its cooperation with the supervisory authorities (through the regular joint stress tests with the FSS). • Ministry of Strategy and Finance (MOSF), which develops and coordinates economic and fiscal policies, and serves on various decision-making bodies of the financial regulators. • Financial Services Commission (FSC) and Financial Supervisory Service (FSS), which promote “the advancement of the financial industry and the stability of financial markets, establish sound credit order and fair financial transaction practices, and protect depositors, investors, and other financial consumers”. • Korea Deposit Insurance Corporation (KDIC), which contributes to the protection of depositors and the maintenance of the stability of the financial system. **Macroprudential framework** Cooperation among authorities is achieved through two comprehensive bodies: a. Macroeconomic Finance Meeting (MEFM), aimed at promoting cooperation, coordination and information exchange among relevant authorities on the identification and assessment	

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<td colspan="2">of threats to financial stability. It is chaired by the First Vice Minister of the MoSF and is attended by the deputies of the FSC, BOK and the FSS.

b. Emergency Operation Office (EOO), a joint office between the FSC and the FSS, headed by the Vice Chairman of the FSC. It is responsible for the continuous monitoring of financial market risks and the development of measures to respond to a crisis, including the preparation of crisis management protocols.

Macroprudential tools

FX- related measures

To strengthen the stability of the foreign exchange sector, the BoK has pre-emptively operated macroprudential policy measures. In particular, in order to address systemic risk stemming from the high capital flow volatility, the BoK has implemented a number of macroprudential measures, including leverage caps on banks’ FX derivatives positions, and limits on FX liquidity, aimed at improving the stability of the payment and settlement systems.

Household debt measures

Household debt showed a rapid increase in recent years mostly on the back of low interest rates and housing market boom. Therefore, the FSC recently introduced a number of measures to curb speculative demand in the housing market:

- Loan To Value (LTV) ratio: The loan-to-value (LTV) ratio of 40% will apply to their mortgages for buying a housing for rent in the designated speculative areas. Moreover, tighter values shall apply to multiple homeowners.
- Debt to Income ratio (DTI): DTI ratios will be tightened to 40% for home buyers in the designated regions, regardless of types of housing, amount and maturity.
The FSS Korea also explained that a sectoral Countercyclical Capital Buffer (CCyB) is currently under development to address any excess in the extension of credit to the household sector.</td>
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<tr>
<td colspan="2">Topic VIII</td>
<td>Other regulatory requirements</td>
<td>Topic Assessment
Largely Equivalent</td>
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<tr>
<td colspan="2">Rationale for overall topic assessment</td>
<td colspan="2">The Korean regulation on these three topics can be assessed as "largely equivalent". The framework for large exposures is similar to the one implemented in the EU, with the main differences related to the definition of eligible capital and the inclusion of trading book exposure, although their relevance in the Korean banking system is relatively limited. The implementation of the new Basel framework in 2019 will address these differences; however, since a precise timeline of implementation cannot be identified, it could not be taken into account in the assessment.

The definition, the limit and the calculation of the leverage ratio is fully aligned with the provisions set out in the EU regulation, and the only difference is a more conservative one, as the requirement is not only a reporting one, but is a binding one, since 2015. The FSS has adopted all the Basel standards for Pillar 3 disclosure and requires banks to publish a very large number of elements (very much aligned to those required by the CRR), to foster market discipline and transparency of banks’ operations. The FSS also discloses a large amount of information on its supervisory practices and requirements on its website, in line with the best practices observed in the EU.</td>
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<tr>
<td rowspan="2"></td>
<td>Section 14</td>
<td>Large Exposures</td>
<td>Section Assessment
Largely Equivalent</td>
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<tr>
<td>Rationale for section assessment</td>
<td colspan="2">Large exposure definition

The Large exposure as provided in the Korean legislation is an exposure exceeding 10% of the bank's eligible capital, which is defined as the sum of T1 and T2 capital. This is less conservative than in the EU, where T2 capital is permitted up to one third of T1 capital. However, the amount of T2 instruments issued by Korean banks is relatively limited.</td>
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Scope of application
Currently, the large exposure regime applies on an individual basis. Starting from 2019, it will be applied also on a consolidated level.
Large Exposure limits
The large exposure limit for a single client is 20% of the regulatory capital, while for a group of connected counterparties it is set at 25%. Overall, this is slightly more conservative than in the EU, where the limit is set at 25% in both cases (i.e. for a client or group of connected clients). Korea's rules include credit extension limits to a single counterparty or a group of connected counterparties and large extension limits.
Calculation of the exposure value
The calculation of the exposure value is largely aligned with the provisions of the CRR. Exposures exempted are substantially the same as those envisaged in the CRR. Differences are negligible and, if anything, tilted in the direction of more conservative treatment (i.e. fewer exemptions are granted). Credit Risk Mitigation Techniques are allowed, although their scope is narrower than in the CRD (mainly credit guaranteed by an institution with 0-percent risk weight, credit extensions secured by bank deposits and credit derivatives).
Breaches to the Large Exposures regime
While the CRR does not specify the treatment of breaches to large exposures limits (but requires to report the breach without delay to the competent authorities), the regime seems stricter in South Korea as it envisages a penalty of imprisonment up to 3 years or fines up to KRW100 million if the limits are violated (Art. 65-66 of Banking Act).
Connected clients
The definition in the Korean law is slightly different, although very similar in the substance. Art. 35 of Banking Act refers to a "person with whom it shares credit risk". This definition, taken by itself, would be narrower than the one in the CRR (which extends to the control relationship and economic dependency). However, the definition is clarified by the Monopoly Regulation and Fair Trade Act, and in particular its Enforcement Decree, which lists a number of instances that can be considered in line with the ones of economic dependency/control in the CRR.
Monitoring and reporting
Large exposures are constantly monitored through monthly reporting and administrative and accounting procedures to identify and report them. In line with Art. 393 of the CRR, banks need to implement internal guidelines for management and control of large credit extension. As regards reporting, similarly to Art. 394 of the CRR, banks have to report the status of ALL credit exposures exceeding 10% of their eligible capital to the FSS on a quarterly basis. The reporting templates, although slightly less granular than envisaged in the CRR, include the amount of exposures after the application of credit risk mitigation, which are also reported.
Implementation of the new Basel standard
In 2019, the FSS Korea shall align its Large Exposure framework to the final Basel Standard. This implies some differences compared to the EU framework, although they are not likely to be relevant due to the characteristics of the Korean banks (i.e. T1 as only eligible capital, inclusion of the trading book, explicit recognition of the "economic dependence" concept). However, as a specific timeline for the implementation of the new framework is not yet identified, this new framework has not been taken into account in the assessment.
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<td rowspan="2"></td>
<td rowspan="2">Section 17</td>
<td rowspan="2">Leverage</td>
<td>Section Assessment</td>
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<td>Equivalent</td>
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<td>Rationale for section assessment</td>
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Definition and Purpose

The leverage ratio (called Tangible Common Equity Ratio in the Korean legislation) is defined as the ratio of Tier 1 capital to the bank's exposure measure and is expressed as a percentage. The objective of the introduction of the tangible common equity ratio which is in a non-risk based form, as means of supplementing capital regulation based on risks, is (1) to control excessive leverage of banks so that sudden reduction of liabilities may not cause a damage to the overall financial system and economy; (2) to reinforce capital regulation based on risks by preparing a simple and non-risked based backstop.

Total exposures are defined as the sum of:

- on-balance sheet exposures;
- derivative exposures;
- SFT exposures (RP transactions, securities lending transactions, and margin lending transactions);
- off-balance sheet (OBS) items.

Threshold and requirement

The requirement of disclosure has been established since 2015. Since 2018 there is a <u>binding requirement of leverage ratio</u>. The requirement has been fixed at 3%; currently, the aggregate leverage ratio for the Korean banking system stands at 6.7%.

Calculation

The calculation of the following items is the same as in the CRR:

- CCR add-on (for repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions);
- Exposure value of derivatives (mark-to-market method as in Art. 274 of the CRR, table 1);
- Credit Derivatives (identical formula as in Art. 298 of the CRR for PCE).
Netting

The rules for netting of exposures are the same as in the CRR:

- No netting of loans and deposits;
- No offsetting for commodities borrowing and lending and long settlement transactions;
- No physical or financial collateral, guarantees or other credit risk mitigation techniques to reduce the exposure measure;
- offsetting against securities financing transactions is prohibited.

Disclosure

The leverage ratio must be disclosed every quarter in the bank's publications. The leverage ratio has been disclosed on the website of individual banks and bank associations since 2015. The templates in Appendix 3-8 are essentially the same as the ones in COM DR 2016/200.

Reporting and use in prudential supervision

Pursuant to Article 26 of the RSBB and Article 17 of the DRSBB, banks are required to report their leverage ratio, which is a prudential guidance ratio, to the FSS on a quarterly basis in their business report. The reported leverage ratio is then reviewed by the FSS as one of the items under the capital adequacy category.
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<td rowspan="2"></td>
<td>Section 21</td>
<td>Disclosure</td>
<td>Section Assessment
Equivalent</td>
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<tr>
<td>Rationale for section assessment</td>
<td colspan="2">
Application of the Basel Committee Standards for disclosure

The FSS has already applied the following disclosure requirements of the Basel Committee to the relevant regulations:
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		- Basel II framework (Part 4: The Third Pillar-Market Discipline) (2004); - Revised Pillar 3 disclosure requirements (2015); and - Pillar 3 disclosure requirements-consolidated and enhanced framework (2017). **Scope of information to the public** Art. 41 RSBB is similar to Art. 431 of the CRR – institutions need to provide information, on a quarterly basis, on the following matters: 1. organization and manpower; 2. financial statement, profit and loss; 3. financing and operation of funds; 4. management indicators regarding soundness, profitability, productivity, etc.; 5. management policy and risk management. All the elements in Art. 435-451 of the CRR need to be included in the disclosure to the public with the temporary exception of unencumbered assets, which will be introduced after the third phase review of Basel Pillar 3 framework. **Supervisory Disclosure** The FSS website includes an extremely detailed description of the supervisory process and the supervisory methodology employed to assess banks (CAMEL process, scoring matrix, etc), comparable to the best practices available in EU.