

Development of Financial Safety Net in line with Globalization of Banking Business

Since the financial crisis, there has been a huge increase in the entry of foreign capital into the Korean banking industry and a steady rise in the market share of foreign banks. Given that in the case of insolvency of a foreign bank its parent bank determines whether or not to provide assistance depending on its management strategy rather than on the financial stability of countries where its subsidiaries or branches are located, appropriate measures need to be developed to minimize possible destabilizing effects on the Korean financial system. Since prompt assistance from parent banks may not be available in case of a temporary shortage of liquidity of foreign banks, emergency liquidity assistance from the central bank of a host country is required to minimize the instability of that country's financial system. If domestic collateral is not sufficient to provide liquidity, overseas assets may be taken as security. European countries, a large share of whose banking markets are held by cross-border banks, actively accept overseas assets as collateral. In order to make it easy for a central bank to take overseas assets as collateral against the provision of emergency liquidity assistance, agreements between the respective central banks need to be entered into to put the necessary systems in place. The following merit consideration as such systems — a correspondent central banking model, overseas securities settlement system participation model and a CSD to CSD Link model.

Meanwhile, devices are required to protect domestic creditors in case of the closures of foreign banks: the introduction of asset pledge requirement and asset mainenance requirement for foreign bank branches can be considered in addition to the current operating fund systems. Particularly, the sale of a subsidiary of a foreign bank to a third party should be undertaken only after close consultation with the supervisory authorities on its timing, a method of disposal and the acquiring party. Even when a cessation of operations is inevitable, efforts need to be made to minimize the effects on Korea's financial stability during the process of liquidation.

In addition, to deal effectively with the insolvency of foreign banks, a basis for effective collaboration to take collective counteractions needs to be built up including the conclusion of MOUs between the supervisory authorities and central banks of the host and home countries with all view to the prevention of insolvency and the management of risks as well as conference calls.

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