Updates on the Discussions regarding Improving Management and Operating Practices of Banks and the Banking System

The Korean financial authorities have recently established a task force to explore measures to address the market dominance of commercial banks and to promote competition in the commercial banking sector. The TF (as defined below) has discussed the following key issues.

I. Background

The "Task Force on Improving Management and Operating Practices of Banks and the Banking System" (the "**TF**") was launched as a follow-up to the 13th Emergency Economic and Public Livelihood Meeting presided by President Yoon on February 15, 2023. The Financial Services Commission and the Financial Supervisory Service held the first TF meeting on February 22, 2023, during which 6 major tasks were designated and it was agreed to develop countermeasures by the end of June. On March 2, 2023, the first working group meeting of the TF was held to discuss the specific task items for accomplishing the 6 major tasks.

II. Six (6) Major Tasks - Highlights

The 6 major tasks are: (1) promoting competition in the banking sector; (2) improving interest rate systems; (3) improving wage systems; (4) strengthening total loss absorbing capacity, (5) increasing the portion of non-interest income; and (6) promoting social responsibility activities.

More specifically, the following items are scheduled for discussion regarding each of the 6 major tasks:

- **Promoting competition in the banking sector:** measures to promote competition including promoting not only existing competition within the banking sector but also competition between banks and non-banks, allowing entry into the banking sector (e.g., small licenses, challenger banks), and promoting substantive competition by removing operating barriers between the finance sector and IT sector.

- **Improving interest rate systems:** reforming the interest rate disclosure system such as the system for disclosing the deposit-loan interest rate difference.

- **Improving wage systems:** introducing say-on-pay (a process whereby a company's shareholders have a right to vote on the remuneration of the executives of a company) and strengthening claw-backs (a process whereby incentives or bonuses of executives and/or employees may be reclaimed or reduced depending on the fluctuation of a company's profit).

- **Strengthening total loss absorbing capacity:** introducing stress capital buffers and accumulating countercyclical capital buffers.

- **Increasing the portion of non-interest income:** measures to increase the portion of non-interest income among the income earned in the banking sector, such as permitting a financial services company to engage in non-financial businesses and expand into overseas markets.

- **Promoting social responsibility activities:** introducing performance disclosures.

III. Key Details of the First Working Group Meeting (Mar. 2, 2023)

1. Introducing Small Licenses and Small-Scale Specialized Banks

A possibility of establishing specialized banks, which would take on specialized work scopes currently undertaken by banks, was discussed. Some examples include: (a) banks specializing in lending to small and medium-sized enterprises, micro-enterprises, or venture businesses; (b) banks specializing in mortgage loans or payment settlement services; and (c) banks specially targeting mid-to-low credit customers. As market-entry regulating measures, two (2) proposals were discussed. . The first proposal contemplates a single small license, which regulates the types and methods of business by imposing inspections and adding requirements at the time of evaluating each application for license for being granted individual licenses. The second proposal contemplates subdividing banking activities (e.g., loans and deposits, domestic/foreign exchange) and forms of business (e.g., customer (individual vs. corporate), geographical coverage (national vs. regional), branch office types (online vs. offline)) and then allowing a mix-and-match of these subdivided banking activities and forms of business.

2. Granting Additional Banking Licenses

The working group also discussed an option to allow formation of new commercial, regional, and on-line-only banks. Potential advantages for allowing financial holding companies to operate on-line-only banks include increased competition between financial holding companies through diversification of business models as well as various innovations and increased customer benefits through competing with big-tech platforms. On the other hand, some voiced an opinion that it would be more appropriate to reduce the dependency on generating profit from the loan-to-deposit interest differences and encourage banks to develop differentiated services rather than simply increasing the number of market players. .

3. Converting Mutual Savings Banks and Regional Banks (Mutual Savings Bank → Regional Bank; Regional Bank → Commercial Bank)

The working group considered an option of allowing conversion of regional banks into commercial banks (or from mutual savings to regional banks) upon application together with fulfillment of the prerequisites such as capital requirement and equity control. In this connection, alternatives were proposed such as (1) merger of mutual savings banks to expand the geographical areas of business, and (2) seeking cost reduction through use of a common IT system by a regional bank holding company which has two or more regional bank subsidiaries as well as facilitating competition with commercial banks by relaxing the restriction on information sharing among affiliates.

4. Permitting Credit Card Companies to Engage in Comprehensive Payment Settlement Services

The working group also considered creating a system for "comprehensive payment settlement businesses" that allows bank-level general payment settlement services, in addition to "easy payment" and "easy money transfer" by amending the Electronic Financial Transactions Act. Advantages of having such systems are : (a) alleviating the alleged oligopoly in the banking sector by promoting effective competition between banks in the deposit and payment settlements as well as (b) providing new types of services to credit card customers, together with fintech Scale-up through competition. However, it was pointed out that that the government agencies, the Bank of Korea, and financial services companies should engage in more in-depth discussion under the principle of the "same activity, the same risk, and the same regulation."

A bill for the Electronic Financial Transactions Act introducing the "comprehensive payment settlement business" was proposed in 2021. According to a National Assembly report regarding this bill, a "comprehensive payment settlement business would be able to provide various account-based financial services, meaning that it would perform a role similar to a bank except for providing loan and deposit services. Furthermore, the report assesses that, from the perspective of an electronic financial business, it will be able to participate in the financial network directly, thus reducing costs such as fees arising from using accounts linked with financial services companies, as well as developing various linked services.

5. Permitting Securities Companies to Engage in Payment Settlement Services for Corporate Customers

If the securities companies are allowed to provide payment settlement services to their corporate customers (though the relevant Korea Financial Telecommunications & Clearings Institute regulations will need to be amended), companies will be able to enjoy various payment settlement services provided by securities companies, including cash management services other than simple money transfers (e.g., batch transfer of small amounts such as wages) and payment gateway services (e.g., transfer of funds for electronic transactions between businesses and customers). Anticipated advantages include the strengthening of the investment bank function of securities companies, improvement in the efficiency of payment settlement services, and cost savings. However, some concerns were raised that there might be adverse effects such as decrease in the efficacy of the separation of industrial and financial capital policy due to securities companies becoming more like banks and securities companies becoming personal safes of chaebols (i.e., South Korean family-run business conglomerates) if large businesses and their partners focus their payment accounts to their securities company affiliates.

6. Permitting Insurance Companies to Engage in Payment Settlement Services

Allowing insurance companies to perform payment settlement services as a concurrent business (Article 16 of the Enforcement Decree of the Insurance Business Act will need to be amended) and comprehensive payment settlement services (the Insurance Business Act will need to be amended) were also considered. In case insurance companies are allowed to provide payment settlement services, individual customers will be able to take care of various payment activities such as paying insurance premiums and receiving insurance payments and pension payments from their insurers. In the case of corporate customers, they will be able to handle cash management services (e.g., transfer of wages) and payment gateway services (e.g., transfer of funds for commercial transactions) through insurance companies.

7. Expanding the Scope of Entities that Can Issue Virtual Asset Real-Name Verification Accounts

It was also discussed that the non-bank financial services companies should be allowed to issue real-name verification accounts for virtual assets. The proponents of this idea explained that, unlike banks, the non-bank financial companies such as securities companies have more flexibility to expand new services s such as investment services and collaborating with the security token offering market. However, this proposal was met with an objection that it is premature to expand the scope of financial institutions that can issue virtual asset real-name verification accounts considering that the virtual asset-related legislation is still being drafted and the general direction of the relevant policy has not yet been settled.

IV. Expansion of the Deposit-Loan Interest Rate Difference Disclosure Requirements of the Banking Sector

On March 3, 2023, the Korean financial authorities announced the proposal to expand the deposit-loan interest rate difference disclosure requirements of the banking sector, which had been discussed at the first working group meeting held on March 2, 2023. Key details of the proposal include: (1) disclosing balance-based deposit-loan interest rate differences for each bank in addition to the current disclosure of deposit-loan interest rate differences on new lending; (2) disclosing comparisons of *chonse* loan (a type of housing loan) interest rates; (3) disclosing detailed interest rate information on household loans (e.g., base rate, additional rate, prime rate). The proposal is scheduled to come into effect in July 2023.

V. Agenda for Future Discussions

The second working group meeting is scheduled to be held on March 8, 2023 (Wednesday), and matters relating to the efficacy of the tasks and countermeasures will be discussed, including the following: (1) specific forms of competition and its effects per task regarding promoting competition between the banking sector and non-banking sector; and (2) whether there is any interested new market entrant in the case of the task of inducing new market players. The third and fourth working group meetings will also be held in March, and these meetings will focus on the status of the banking sector in relation to performance-based compensation.

VI. Significance

The tasks discussed in relation to improving the management and operating practices of banks and the banking system are matters that may have a great impact on the work scope and business environment of financial services companies, platform businesses, and virtual asset service providers. In particular, it should be noted that the speed of the discussions is quite fast. Therefore, stakeholders such as financial services companies and platform businesses will need to monitor these discussion very closely.

Yoon & Yang LLC's Digital Finance Team provides effective legal advisory services based on our experience and know-how accumulated from advising financial services companies, platform businesses, and fintech businesses. Please feel free to contact us if you have any questions in connection with the contents of this newsletter.

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