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Luncheon Speech

The Future of Financial Regulation

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The speech transcript below is provided for the convenience of the press. Please bear in mind that there may be slight discrepancies with the actual contents

I . Introductory Remarks

Good afternoon, ladies and gentlemen!

Let me first thank Chairman Kim Pyung-Joo and President Nam Chong-Hyun from the Institute for Global Economics (IGE), as well as Mr. José Viñals from the IMF, for inviting me to this occasion.

Further, I wish to welcome all of you from Korea and abroad who have given your valuable time to attend this conference.

I'm happy to say that there now appears to be some light at the end of the long and dark tunnel of this crisis.

I would like to express my gratitude to all of you in the financial sector and to the Korean people.

It has been your efforts that have allowed Korea to recover so quickly.

Now it is time to refocus the international community's cooperation and commitment to future-minded financial reforms.

I am confident that today's conference on the "G20 Initiatives" will be a very meaningful occasion for this.

II. Lessons Learned from the Crisis

Ladies and gentlemen!

Before the crisis, financial markets were plagued by excessive risk-taking under the assumption that the 'market is always right'.

We lost sight of fundamental principles such as the trade-off between risk and return.

And our appetite for leverage seemed to have no limits.

Decades of relentless financial innovation alongside stable economic growth provided legitimacy for such an approach.

But this crisis is demonstrating yet again that the financial industry must be developed under an appropriate regulatory framework.

We are now all well aware that, unlike other industries, the financial sector contains systemic externalities.

Simply put, the problems of a single financial firm can bring down the entire market.

And this systemic risk has become even more potent due to the complex and interconnected global financial system we have today.

Unfortunately, regulators were not sufficiently ready for this when the latest crisis broke out.

Their focus on firm-specific micro prudential regulation failed to halt the spread of risk throughout the markets until it was too late.

III. Constructing a Post-Crisis Financial System

Now, the international community must embark on building a new financial system that doesn't tolerate reckless leverage build-ups or excessive risk-taking.

Externalities that can lead to market failures must be contained by tightening the relevant ex-ante regulations.

Further, regulatory authorities must keep better track of systemic risk and be given the capacity and means of controlling it.

Thankfully, the work of reforming the financial system is being carried out now at the global level, centered on the G20 and the FSB.

The FSB is exploring ways of handling economic disruptions and systemic risk through macro prudential regulation.

And given how inadequate existing prudential regulations were shown to be, an overhaul of them is being conducted as well.

In addition, efforts are being made to close regulatory loopholes and to better link compensation to long-term performance.

In all, we are tackling financial market reform across a great many areas, from ratings agency reform to improving accounting standards.

And if the international community succeeds in these efforts, then I fully believe we will win back trust in the global financial system.

As a host nation for the next G20 summit, Korea is actively taking part in these efforts.

Unfortunately, most of the issues under discussion at present are more of interest to the advanced markets.

As of yet, emerging markets are not able to have their voices heard loudly enough.

One issue of particular concern is that foreign currency liquidity problems can create systemic risk in emerging markets.

Korea and other emerging economies went through much hardship during the crisis as a result of this.

Without alternative mechanisms in place, emerging nations are forced to build up their foreign reserves, which can worsen global imbalances.

So clearly, this calls for solutions at the global level.

In this respect, our government has continuously brought up the necessity of developing stability mechanisms for emerging market currencies.

And we welcome the global consensus that has emerged at the G20 and the FSB towards making diverse efforts on this.

We will continue to call upon the international community to consider the concerns of emerging economies.

IV. Concluding Remarks

Ladies and gentlemen!

History tells us that crises keep occurring.

And each time they do, they spur momentum for reform.

Yet this initial embrace of change too often loses steam soon after.

But this crisis has hit us particularly hard, and I expect all nations to be sincerely committed to financial system reform.

At the same time, however, we must watch out that regulatory tightening is not excessive so that healthy innovation can be accomplished.

In this respect, regulators and the markets will have to work together on the optimal system for balancing innovation with stability.

With that, let me conclude by expressing my hope that this conference serves as an invaluable opportunity to share our experiences and insights on these issues.

Thank you so much.