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STRATEGIC BUSINESS INTELLIGENCE FOR THE FINANCIAL SERVICES COMMUNITY

The Korea Banking Risk Dialogue 2013

Seoul, South Korea, July 10th 2013 ▪ PROCEEDINGS REPORT

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In Attendance

The session was attended by the following:

1. **Brian Kim** Head BCBS, Financial Supervisory Service
2. **Hongmoo Kim** Vice President & CRO, Nonghyup
3. **Kyungsup Han** CRO**,** Managing director, KB Financial Group
4. **Kunho Lee** SEVP & Chief Risk Officer, KB Kookmin Bank
5. **Sangho Lee** CRO, Deputy President, Shinhan Bank
6. **Chanik Park** Head, Market Risk, Standard Chartered Bank Korea
7. **Minkyung Hwang** Senior Vice President, Operational Risk, Standard Chartered Bank Korea
8. **Jaejoon Lim** Business Development Derivatives Market, Director, KRX
9. **Kwangseok Lee** General Manager, Risk Management, Nonghyup Financial Group
10. **Jaehong Park** General Manager, Risk Management, Hana Financial Group
11. **Miae Han** General Manager, Credit Risk Management, KB Kookmin Bank
12. **Jonghwan Han** General Manager, Risk Management, KB Kookmin Bank
13. **Imgeun Kim** General Manager, Risk Management, Shinhan Bank
14. **Heuiseop Han** General Manager, Risk Management, Woori Bank
15. **Keunsik Kim** General Manager, Risk Management, Woori Bank
16. **Jiil Kim** Deputy General Manager, Risk Management, Woori Bank
17. **Inyeob Choi** General Manager, Investment Banking, Kwangju Bank
18. **Keesook Lee** Senior Manager, Integrated Risk Management, Korea Exchange Bank
19. **Daeeun Jekal** Senior Manager & Senior Specialist, Risk Management, Daegu Bank
20. **Kunyong Yun** Vice Research Fellow, Nonghyup Economics Research Institute
21. **Tsuyoshi Oyama** Former Deputy Director at Bank of Japan, & Partner of Deloitte Touche Tohmatsu
22. **Rona Morgan** Former Head, Risk Strategy, HSBC Asia Pacific
23. **Tongsuk Kim** Professor, College of Business, KAIST
24. **Olfa Maalaoui Chun** Professor, College of Business, KAIST
25. **Murray Wood** Regional Director, AON Financial services & Professions group, Asia
26. **Eric Hoffman** Chief Commercial Officer & Managing Director, AON Korea
27. **Kevin Kim** Senior Managing Director, AON Korea
28. **Yutaka Imanishi** CEO Asia Pacific, TriOptima Asia Pacific
29. **Chulwoo Han** Consultant for TriOptima, CEO of CMPR
30. **Mikael Nyberg** Managing Director, Advisory Services, Enterprise Risk Solutions, Moody's Analytics
31. **Chris Yoon** Country Director, Moody's Analytics Korea
32. **Mathew Welch I**nternational Resource Director, The Asian Banker
33. **Boon Ping Foo** Managing Editor, The Asian Banker

Key Discussion Points

The following key discussion points were drawn from the dialogue and expanded below:

1. Macroeconomic developments and impact on Korean banking sector
2. Basel III implementation and key risks faced by Korean banks
3. Managing counterparty credit risk in OTC derivatives
4. Adopting a strategic risk management framework

Detailed Discussion Points

The following detailed discussion points represent the contribution of all participants

1. **Macroeconomic developments and impact on Korean banking sector**
    a. Sluggish global economic condition has had negative impacts on the Korean economy. Korea is highly dependent on exports; the current economic slowdown is likely to continue due to the strong Korean Won and sluggish economies of more advanced countries.
    b. Domestic economy bogged down by heavy household debt burden, high insolvency risks of construction companies and rise in the number of so-called 'house poors'.
    c. The country suffers from low interest rate, economic growth and exchange rate.
    d. Short to mid-term banking industry outlook not favourable due to following:
        i. Deteriorating net interest margin: may weaken further from current 1.95% to as low as 1.8%.
        ii. Increasing household debt which may be exacerbated if house price slides or interest rate soars.
        iii. Weakening housing and real estate market which could persist for next two-three years.
        iv. Sluggish shipping and ship-building businesses, as well as exports, will shrink banks' profitability.

2. **Basel III implementation and key risks faced by Korean banks**
    a. Basel III implementation in Korea will commence on December 1, 2013, as the Financial Services Commission (FSC) looks to abide by the agreement reached with BCBS.
    b. FSC's banking supervision priorities are to manage risk from household debts, strengthen risk surveillance (regular stress test) and pursue prompt restructuring of ailing companies.
    c. The recent global financial crisis was caused by misalignment of market players' incentives and weak bank regulation and supervision. The conditions are very different in the current Korean banking sectors.
    d. Banking regulation and compliance have been identified as key risk management concerns, as operational risks associated with regulatory compliance has taken on increased importance.
    e. Operational risks may be substantially mitigated by appropriate insurance coverage, with solution and capital charge offset one of the biggest potential advantages for Korean banks.

3. **Managing counterparty credit risk in OTC derivatives**
    a. Two possible solutions to managing counterparty credit risk in OTC derivatives were discussed – central counterparty clearing (CCP) and portfolio reconciliation and compression.
    b. Clearing via CCP may be very effective in limiting counterparty risk and reducing systematic risk.
    c. However, establishing CCPs in Korea may also be the source of systemic risk if it is NOT appropriately managed!
    d. Added costs of a CCP could limit the volume of future hedging and derivative transactions, possibly impacting the viability of a CCP.
    e. Portfolio reconciliation and compression has become market standards in terms of OTC derivatives post-trade risk mitigation. Imposed as requirements in EU and US laws, major Asian financial regulators are looking into this, as a best practice guideline for their own regulation of financial institutions.
    f. Banking sectors in most Asian countries have adopted portfolio compression, and to an extent, international banks in Korea. However, Korean domestic banks have yet to adopt said practice. There is significant risk mitigation that can be achieved through such a practice.

4. **Adopting a strategic risk management framework**
    a. Regulation will continue to dominate the risk management landscape.
    b. Banks have to consider risk management not only as a compliance requirement, but also as a strategic management tool that drives strategic business decisions.
    c. Stress scenario development is the most important process when conducting stress testing. To conduct stress testing activities that are appealing to senior management and other stakeholders, the scenarios must satisfy the following six conditions: they must be objective, forward-looking, comprehensive, dynamic, and also must hit the firm's weak spots and challenge the firm's risk appetite.
    d. Stress testing may become a mandatory requirement to determine regulatory capital adequacy. Defining an organisation's risk appetite is important in order to align its strategic business intent and operations, as it will help define the amount of risk an organisation is willing to take to achieve an expected goal.
    e. A risk appetite buffer is used to deal with the uncertainty of an event or scenario occurring that forces a breach of the risk appetite statement. Risk management is too often seen as a constraint on business. However when an organisation understands the trade-off between its risk appetite and business goals, risk management can be a tool to facilitate business growth and performance decisions.
    f. Risk appetite is ultimately the responsibility of a bank's board. Risk appetite should be integral to the Internal Capital Adequacy Assessment Process (ICAAP).
    g. A good risk appetite framework drives clear articulation of the organisation's strategy and its attitude to risk. It will force understanding of risks to which an organisation is exposed as well as comfort levels required to help build confidence.

Conclusion

The dialogue highlighted the pace of development in risk management, which is evolving at a rate that is even faster than the regulatory environment. New risk management strategies, tools and techniques are being introduced even as the global banking industry grapples with Basel III implementation.

Prudential bank regulations continue to adapt to the new waves of development and thinking happening at both practitioner and regulator levels to better manage risks in the banking business.

It is critically important that the risk management function has a seat at the board table to inform and guide strategic business decisions.

Photos of Dialogue

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