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**Balancing Prudential Regulation and Competition Considerations in Banking – Note by
Korea**

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1. Introduction

1. The soundness of the financial system serves as an essential foundation for the sustainable growth of the national economy. Financial institutions, including banks, perform core functions such as financial intermediation, payment services, and credit provision. In particular, the failure of a single financial institution carries the potential risk of spreading beyond the institution itself and triggering a systemic crisis across the entire financial sector. Accordingly, financial authorities in many countries have introduced various forms of prudential regulation, including capital adequacy requirements, liquidity requirements, and restrictions on asset management.

2. However, prudential regulation inevitably constrains the business freedom of banks and other financial institutions and raises barriers to market entry, often resulting in an oligopolistic market structure dominated by large banks. Such a structure may slow down efficiency and innovation in the financial industry, and raise concerns that consumer welfare may ultimately decline. Excessive prudential regulation can restrict market entry and weaken competition, whereas excessive competition may increase risk-taking and threaten the stability of the financial system. Therefore, the role of the competition authority in the banking sector is crucial, and achieving an appropriate balance between prudential regulation and competition constitutes a key policy task in seeking a balance between financial stability and efficiency.

3. This paper examines cases in which prudential regulation and competition policy have been harmonized in the Korean financial sector, focusing on the banking industry and major enforcement cases under the competition law. It also discusses the importance of cooperation between the competition authority and the financial authority, based on the past collaboration between the Korea Fair Trade Commission (KFTC) and the Financial Services Commission (FSC). The discussion aims to draw policy insights for achieving a balanced pursuit of the dual goals of financial stability and competition promotion.

2. Institutional Background and Competitive Landscape of the Korean Financial Sector

4. Korea's financial industry has placed top priority on prudential soundness in the wake of a series of crises, including the Asian financial crisis and the global financial crisis. At present, the Financial Services Commission (FSC) and its subordinate body, the Financial Supervisory Service (FSS), are responsible for the prudential supervision of banks. They apply strict capital adequacy, liquidity ratio, and lending limit requirements under the Banking Act and related supervisory regulations.

5. However, as regulations designed to ensure the soundness of the financial system have long been strongly implemented, they have also led to entrenched market dominance by a small number of large financial institutions across several sectors, including banking and insurance. In the banking industry, the five major commercial banks account for about 80 percent of market share (based on deposit volume). In the insurance market, CR3 in the life insurance industry takes up 52.1 percent, while CR4 in the non-life insurance industry takes up 71 percent, indicating a market structure with limited competition. By contrast, the securities market remains relatively competitive, as the top three firms account for

around 40 percent, and new securities firms have entered the market with the development of fintech.

6. Meanwhile, competition policy in the banking sector, as in other industries, falls under the jurisdiction of the KFTC. Banks and other financial institutions are equally subject to the Monopoly Regulation and Fair Trade Act (MRFTA), and the KFTC has consistently enforced the law in cases where price-fixing or bid-rigging has been detected in the financial sector. In addition, the Commission has achieved progress in identifying and improving anticompetitive regulations to promote competition in the financial industry.

3. Cases of Promoting Competition through the Improvement of Prudential Regulation

7. The following are major cases in which market competition was revitalized through the relaxation or improvement of prudential regulation.

3.1. Rationalizing Banks' Investment Limit Regulation on Securities (2025)

8. To maintain the soundness of banks, Korean financial authorities have strictly limited banks' investment in debt securities with maturities exceeding three years to within 100% of their equity capital. This regulation aims to manage interest rate fluctuation risk and liquidity risk associated with long-term bond investments. It excludes low-risk government bonds, Bank of Korea monetary stabilization bonds, and government-guaranteed bonds.

9. However, such uniform investment limit regulations have caused banks to rely excessively on interest income, creating an interest-dependent profit structure. In 2023, interest income accounted for 91% of total profits earned by domestic banks. Yet, under conditions of a declining average economic growth rate, population decrease, and aging society, the strategy of relying primarily on loan-based profits has reached its limit. Accordingly, banks needed to diversify their businesses and expand non-interest income sources, but the investment limit regulation made it difficult to secure competitive investment instruments. In particular, including highly safe and low-risk bonds within the scope of the regulation excessively constrained banks' autonomous asset management.

10. In this regard, the KFTC pointed out that the regulation could hinder banks' business diversification and innovation, and proposed that the financial authorities reasonably adjust the regulatory scope without undermining the purpose of prudential regulation. Specifically, the KFTC recommended that local government bonds—whose risk levels are comparable to those of government bonds or monetary stabilization bonds—and special bonds issued by public institutions and special corporations whose losses can be institutionally covered by the government be excluded from the investment limit regulation. The financial authorities accepted the KFTC's recommendation, and a partial amendment to the Banking Act excluding low-risk local and special bonds from the investment limit regulation has been introduced and is currently under deliberation at the National Assembly.

11. This improvement to the investment limit regulation is expected to expand banks' investment capacity, which in turn will encourage diversification of their business portfolios and improve the interest income-centered and uniform market structure. It serves as a successful example of achieving both soundness and competition by differentiating prudential regulations according to risk level.

3.2. Improving Entry Regulation for Stricter Incorporation Approval Requirements of the Korean Federation of Community Credit Cooperatives (KFCC) (2023)

12. To address the rising insolvency of real estate PF and increasing financial misconduct in the Korean Federation of Community Credit Cooperatives (KFCC), the supervisory authority sought to tighten the approval requirements for establishments. During the real estate boom in 2020, the KFCC aggressively expanded its high-risk real estate PF loans to increase returns for its contributing members. However, as the property market declined, profitability fell, while embezzlement and improper lending by executives and employees surged, leading to a bank run. In response, the authority introduced the Comprehensive Plan for Strengthening the Soundness of the KFCC. Specifically, the plan proposed to (i) increase the minimum number of persons who consent to the establishment tenfold (from 100 to 1,000) and (ii) raise the minimum total sum of investments by tenfold (from KRW 500 million to KRW 5 billion, KRW 300 million to KRW 3 billion, and KRW 100 million to KRW 1 billion, depending on the region and population size).

13. However, based on the results of a competition impact assessment, the KFTC expressed concern that overly stringent incorporation approval requirements could make it difficult to set up credit cooperatives at the regional level, thereby restricting local financial competition and financial inclusion. Specifically, (1) if the approval requirements were strengthened, 26.2% of existing cooperatives would fail to meet the raised investment fund criteria, and 44.3% of rural cooperatives have fewer than 1,000 members, which could significantly limit consumers' access to financial services, particularly in rural areas, and (2) there was also no empirical evidence that stricter approval requirements would prevent financial misconduct such as embezzlement or enhance soundness. Improving governance would be a more effective measure to strengthen soundness.

14. Reflecting the KFTC's opinion, the supervisory authority decided not to change the minimum number of persons who consent to the establishment. Regarding the minimum total amount of investments, it revised the regulation to apply the strengthened standard only to newly established credit cooperatives after a five-year grace period and reduced the proposed increase from tenfold to three-to-fivefold (from KRW 500 million to KRW 2 billion, KRW 300 million to KRW 1 billion, and KRW 100 million to KRW 500 million). This regulatory improvement has encouraged the establishment of sound new credit cooperatives and laid the groundwork for continued market entry at a reasonable level. Therefore, it pursues both financial stability and competition promotion as a representative example.

15. These two cases demonstrate that rationalizing financial regulations in line with the changing environment and market conditions can enhance market competition and consumer welfare without undermining the stability of the financial system. In particular, since entry and business regulations tend to remain rigid once introduced, this highlights the need for continuous improvement through rigorous competition impact assessments and consultation between the financial and competition authorities.

3.3. Raising the Limit on Overseas Remittances (2018, 2025)

16. Although this case does not concern the promotion of competition among banks, it demonstrates the KFTC's efforts to foster competition between banks and non-bank financial institutions.

17. Before 2018, banks were permitted to process overseas remittances of up to USD 50,000 per person annually. In contrast, non-bank institutions, such as small-sum overseas remittance business entities, were subject to an annual limit of USD 20,000 for both sending

and receiving remittances per individual. The KFTC, while maintaining the purpose of the remittance limit regulation, suggested that the financial authority raise the limit for small-sum overseas remittance business entities to improve competitive conditions among businesses and enhance consumer welfare. Accepting the KFTC's suggestion, the financial authority raised the annual remittance limit for small-sum overseas remittance business entities to USD 30,000 in 2018. At the same time, securities companies were also permitted to provide overseas remittance services up to an annual limit of USD 30,000, which was further expanded to USD 50,000 in 2019.

18. However, since July 2023, although the annual overseas remittance limit for banks has been raised to USD 100,000, securities companies have remained subject to the previous limit of USD 50,000, bringing back restrictions on competition between banks and non-bank financial institutions in the overseas remittance market. The KFTC therefore recommended that the financial authority increase the remittance limit for securities companies to alleviate user inconvenience caused by discriminatory limits and enhance consumer benefits through greater competition in the market. The financial authority is currently reviewing the proposed institutional improvement.

4. Enforcement of the MRFTA in the Banking Sector

4.1. Foreign Exchange Fee Cartel Case (2008)

19. In 2008, the KFTC imposed corrective orders and a total fine of KRW 9.6 billion on eight banks for colluding to introduce new fees for the purchase of export bills and the acquisition of bankers' usance. During the investigation, the banks argued that the case raised concerns of double regulation by both the KFTC and the financial authority. However, the financial authority confirmed that it had not provided any administrative guidance regarding the introduction of the new fees. In fact, the banks had engaged in price collusion independently of the financial authority's administrative guidance. They acted to offset the financial burden caused by prudential regulations (an increase in loan-loss provisions) and policy reforms (changes to the calculation method for foreign currency loan interest aimed at easing the burden on exporters). This case also led to the signing of a memorandum of understanding (MOU) between the KFTC and the financial authority in 2007 to enhance regulatory efficiency.

4.2. Information Exchange Cartel Case

20. Since the amendment to the MRFTA in February 2021, the KFTC has been able to regulate practices of business entities that restrict market competition by agreeing to exchange information. The KFTC is currently investigating, as the first case applying the amended provision, an agreement among banks to exchange information on transaction terms. The banking industry has long been subject to extensive regulation by the financial authority due to its public nature. In particular, banks have traditionally exchanged various types of information in the process of jointly responding to institutional reform initiatives designed to secure the soundness of the financial system. The KFTC expects this case to establish a reference for distinguishing between "anticompetitive information exchange" concerning prices, output, or transaction terms and "information exchange aimed at improving efficiency" through financial soundness enhancement.

5. Cooperation Framework between the Competition Authority and the Financial Authority

5.1. Overview of the MOU between the KFTC and the FSC

21. Since 2007, the KFTC and the FSC have signed and implemented "an MOU for establishing an efficient regulatory framework for financial institutions". The MOU aims to promote cooperation between the two authorities to minimize the regulatory burden on financial institutions resulting from overlapping investigations and sanctions, while respecting each other's authority under their respective laws.

22. First, with regard to merger reviews of financial institutions, the KFTC is required to fully take into account the FSC's opinions on the specific characteristics of financial markets. The FSC, for its part, must consult with the KFTC in advance on whether mergers or acquisitions, or the inclusion of subsidiaries under its laws, could restrict competition in the relevant markets.

23. Second, in the case of unfair trade practices, both the KFTC and the FSC may conduct investigations and take necessary measures in accordance with their respective statutes. However, when the actions taken by one authority are deemed sufficient to achieve the purpose of its law, the other authority refrains from taking additional measures. When the actions of one authority are insufficient to achieve that purpose, the other authority may take supplementary measures to minimize the burden on financial institutions.

24. Lastly, the MOU clarifies that cartel conduct falls within the KFTC's jurisdiction. When the FSC issues administrative guidance to two or more financial institutions, it may, if necessary, consult with the KFTC in advance to determine whether such guidance could constitute a violation of the cartel prohibition provisions under the MRFTA. In such cases, the KFTC promptly provides its review results, taking into account the specific characteristics of the financial industry. To prevent confusion among financial institutions, the MOU also stipulates that the KFTC will not impose sanctions on individual financial institutions for actions taken within the scope of the FSC's administrative guidance. Furthermore, if practically binding administrative guidance issued by the FSC serves as a contributing factor to cartel conduct, the KFTC may consider a reduction of fines.

5.2. Cooperation for the Correction of Unfair Financial Terms and Conditions

25. The MOU between the KFTC and the FSC also applies to correcting unfair financial terms and conditions. However, the relevant procedures are more specifically stipulated in the statutes under the FSC's jurisdiction. Pursuant to the Banking Act and the Mutual Savings Banks Act, the financial authority notifies the KFTC of newly enacted or amended terms and conditions submitted by banks. The KFTC reviews the notified terms and conditions, and if they are found to violate the Act on the Regulation of Terms and Conditions, may request the financial authority to take corrective action.

26. The review and correction request for financial terms and conditions is conducted annually. In 2025, in particular, the KFTC reviewed a total of 1,735 financial terms and conditions notified by the financial authority and requested the correction of 60 unfair clauses. In such cases, the financial authority is required to take corrective measures unless there are exceptional circumstances. Generally, it takes about three months from the authority's recommendation for amendment to the actual revision of the terms and conditions.

27. The major unfair clauses for which the KFTC requested correction this year were as follows:

1. A clause which requires reasonable grounds to suspend, restrict, or change a customer's service use but broadly defines such grounds;
2. A clause which defines contract termination reasons in an abstract and comprehensive manner;
3. A clause which infringes consumers' rights by omitting individual notifications;
4. A clause which disadvantages customers by exempting banks from liability for damages regardless of intent or negligence; and
5. A clause which allows banks to unilaterally determine the details of performance.

28. The KFTC determined that these clauses were invalid under the Act on the Regulation of Terms and Conditions and requested the FSC to take corrective action.

29. Meanwhile, in March 2025, the KFTC and the financial authority jointly held an explanatory session for financial associations and financial companies to explain the review system for financial terms and conditions and to collect on-site opinions. The KFTC and the financial authority agreed to continue strengthening mutual cooperation to establish fair trade order and create an environment that protects the rights and interests of financial consumers.

5.3. Brief Conclusion

30. The MOU between the KFTC and the FSC carries significant importance as it helps minimize the regulatory burden on financial institutions arising from dual regulation by the two authorities. In 2015, the two authorities reached a consensus to activate a working-level consultative body to strengthen the practical implementation of the MOU and have since continued to revise and supplement the MOU.

6. Conclusion

31. Financial stability and competition promotion are not conflicting objectives but rather two pillars that jointly support the sustainability of the financial system and consumer welfare. The key is to establish a coordination mechanism and strike a wise balance when the two objectives conflict in the short term.

32. Korea's experience illustrates both the importance and the difficulty of achieving such balance. The cases of improving competition-restrictive regulations show that careful relaxation can generate win-win outcomes. The relaxation of banks' investment limits on securities reduced market inefficiencies while maintaining risk management principles. The adjustment of approval requirements for the incorporation of the Korean Federation of Community Credit Cooperatives achieved both regional financial revitalization and soundness.

33. To address these challenges, the competition and financial authorities should share information on market conditions on a regular basis to broaden their common understanding. When the competition authority and the financial authority respect each other's expertise and work closely together, they can build a financial system that is both more stable and more efficient. The KFTC will continue to make every effort to foster a fair and competitive environment in the financial sector and looks forward to sharing experiences and enhancing cooperation with OECD member countries in this process.