Financial Services Commission

Press Release

February 22, 2021

FSC TO STRENGTHEN LIQUIDITY MANAGEMENT OF SPECIALIZED CREDIT FINANCE COMPANIES

The FSC announced a set of measures aimed at strengthening the liquidity management of specialized credit finance companies on February 22. The measures include (a) establishing best practice guidelines, (b) strengthening disclosure requirements and (c) gradually reducing the maximum leverage on credit finance (non-credit card) businesses.

BACKGROUND

Specialized credit finance businesses are lenders without deposit-taking functions.[1] They usually finance their business through borrowings or the issuance of corporate bonds and asset-backed securities (ABS). In particular, their heavy reliance on debt finance, about 73.9 percent of their financing,[2] creates a problem of risk transfer to financial institutions holding their corporate bonds, especially if credit finance companies face solvency problems. In this regard, there have been concerns about credit finance companies turning into a conduit of systemic risk in times of an unexpected economic shock such as COVID-19. Therefore, liquidity problems of credit finance businesses can pose a risk not only to the borrowers with mid-to-low credit backgrounds but also to the real economy as they may cause a drop in consumption and corporate facility investment.

KEY MEASURES

I. BEST PRACTICE GUIDELINES ON LIQUIDITY MANAGEMENT

The best practice guidelines on specialized credit finance companies' liquidity management will be introduced for implementation beginning in April this year.

- **(TARGET)** Bond issuing credit finance companies and those with more than KRW100 billion in total assets will be subject to the new guidelines.[3]
- **(ROLE OF BOARD AND MANAGEMENT)** Board of directors should oversee the establishment and operation of liquidity management strategies and the company management should prepare specific management process and criteria and regularly report to its board members.
- **(LIQUIDITY RISK INDICATORS)** Major liquidity risk indicators include corporate bond maturity distribution, liquid asset ratio, short-term debt ratio, etc. Early warning indicators include a decline in credit standing, abrupt increase in credit spreads,

[1] The size of their total assets amounts to KRW307 trillion, 10.8 percent of the non-banking sector and 4.7 percent of the whole financial industry as of the end of June 2020.

[2] As of the end of September 2020

[3] 56 out of 120 specialized credit finance companies or 99.4% in total assets

large outflow of liquidity, skewed distribution of assets or debt, etc.
- **(Liquidity Assessment and Management)** Specialized credit finance companies should develop crisis situation scenarios and regularly test their appropriateness and draw up and operate emergency financing plans.

II. Disclosure Requirements

The disclosure requirements on credit finance companies' liquidity management status are governed by the rules of the Credit Finance Association. However, it has been pointed out that they have been inadequate as the disclosure requirements only deal with various quantitative indicators. As such, qualitative indicators will be included to bolster the credit finance companies' disclosure requirements on a par with those governing the banking sector.

III. Liquidity Monitoring Indicators

Currently, there are three quantitative and four qualitative criteria for liquidity assessment. However, it has been noted that these indicators do not adequately take into account the real situations, especially during the liquidity crunch experienced in the wake of the COVID-19 pandemic. As such, improvements will be made to the liquidity assessment criteria to help them better reflect the credit finance companies' abilities to respond to liquidity crisis.

IV. Gradual Reduction of Maximum Leverage

The authorities will seek a revision to the relevant supervisory regulation to gradually lower the maximum leverage allowed for credit finance (non-credit card) companies from the current level of ten times to nine times in 2022-2024 and eight times from 2025.

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