Financial Services Commission
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Financial Supervisory Service
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Press Release

June 29, 2011

GUIDELINES ON COVERED BOND ISSUANCE

BACKGROUND

The FSC/FSS set up guidelines on the issuance of covered bonds by banks, as one of follow-up measures to implement the Comprehensive Measures on Household Debt. The guidelines are intended to provide a framework for covered bond issuances, diversifying banks' financing instruments and encouraging banks to offer more long-term and fixed-rate mortgage loans instead of short-term and floating-rate ones.

KEY CONTENTS

1. Definition of Covered Bonds

Covered bonds are a type of bonds backed by a cover pool of assets that the issuer provides as collateral. In the event of default, investors are guaranteed dual recourse to both the pool and the issuer.*

*The issuer is responsible for repaying the covered bonds and should offer investors a preferential claim to the cover pool.

2. Requirements for Issuance of Covered Bonds

(Issuers) Covered bond issuers must be banks with the BIS ratio over 10% (as of the end of the previous fiscal year) or securitization entities created by such banks.

(Issuance volume/maturity) An issuer is not permitted to issue covered bonds in excess of 4% of the issuer's total liability. Maturities of covered bonds range from one year to 30 years.

3. Requirements for Cover Assets

(Cover assets) A cover pool should be composed of mortgage loans that meet certain criteria* and mortgage-backed securities (MBS) issued by the Korea Housing Finance Corporation (KHFC). An issuer must maintain at least 5% of the total value of outstanding issuance as excess collateral.

*prime mortgage loans; mortgages of more than 120% of the value of their property; loan-to-value (LTV) ratio of less than 70%; late payments of less than 60 days, etc.

(Evaluation of asset eligibility) An issuer must evaluate eligibility of cover assets on a quarterly basis and provide investors with results of the evaluations. Disqualified assets in the pool should be replaced by qualified assets.

(Long-term mortgage loans with fixed rates) An issuer must ensure that the cover pool is not composed of too much of short-term and floating-rate mortgage loans. Banks should operate funds raised through the issuance of covered bonds in a way to extend more long-term and fixed-rate loans.

EXPECTED OUTCOME

We expect that covered bonds will serve as effective funding tools available for banks even in the event of crises when investors tend to turn more risk-averse.
Also, covered bonds will enable banks to raise funds at a lower cost with long-term maturities so that they can afford to offer more long-term and fixed-rate loans.

FUTURE PLAN

The FSS will send notification of the guidelines to the Korea Federation of Banks and commercial banks on June 30.
After monitoring the issuances of covered bonds in the future, we will have further discussions on whether to come up with legally-binding regulations on covered bond issuances.

For further inquiries:

Emkay Kim
Foreign Press Spokesperson
Financial Services Commission

tel: +82-2-2156-9582
fax: +82-2-2156-9538
e-mail: emkaykim@korea.kr

Soomi Kim
Public Affairs Office
Financial Supervisory Service

tel: +82-2-3145-5803
fax: +82-2-3145-5808
e-mail: soomi.kim@fss.or.kr