Financial Services Commission
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Press Release

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LEGISLATION NOTICE OF COVERED BONDS ACT

BACKGROUND

Since the global financial crisis, there has been growing need for a legal framework to issue covered bonds in order to ensure financial institutions' stable funding channel and financial markets' stability.[1] Covered bonds are expected to reduce financial institutions' funding cost and serve as a stable funding channel in the event of financial crises. It is also expected that covered bonds will help improve the structure of household debt by providing financial institutions with a funding source of long-term and fixed rate loans.

KEY CONTENTS

1. Definition of covered bonds

Covered bonds are a type of bonds secured by a cover pool of assets that the issuer provides as collateral. In the event of the issuer's bankruptcy, investors have a preferential claim to the cover pool and are guaranteed dual recourse to the issuer's other assets as well.

2. Eligible issuers of covered bonds

In order for a financial institution to issue covered bonds, it should satisfy both institutional and eligibility requirements.

- **(institutional requirement)** banks, Korea Housing Finance Corporation, Korea Finance Corporation, and other equivalent institutions designated by Presidential Decree

- **(eligibility requirement)** a financial institution with equity capital of more than KRW 100 billion and a BIS ratio of more than 10 %, capable of ensuring proper funding, operation and risk management.

3. Cover pool

A cover pool is composed of cover assets, liquid assets and other assets with a minimum coverage ratio of collateral more than 105%.

[1] As of end-June, 2012, 33 countries have introduced some legislation for covered bonds; and in the U.S., the enactment of Covered Bond Act is now in progress.

- **(cover assets)** mortgage loans, debts issued by governments and public institutions, government bonds
- **(liquid assets)** cash, certificates of deposit issued by other banks with a maturity of less than 100 days
- **(other assets)** recovery from cover assets, property earned through management, operation, and sale of assets, derivative contracts for hedging against currency and interest rate risks

4. Registration and issuance

An issuer should register its issuance plan and details about its cover pool to the FSC.

- **(issuance plan)** issuer, issuance terms such as interest rate, maturity, date, volume
- **(cover pool)** type of assets, total values, collateral ratio, management of cover pool, trustees, supervisors

The issuer who completed registration may issue covered bonds with a ceiling set by Presidential Decree within the range of 8% of the issuer's total assets at the end of previous fiscal year.

5. Management of cover pool

The issuer should manage a cover pool of assets separately from other assets and keep a separate balance sheet. The issuer should maintain a collateral ratio and eligibility of a cover pool by adding and replacing assets and select an auditor to ensure independent audit and supervision of a cover pool.

6. Preferential rights

Covered bond investors have a preferential claim to a cover pool in the event of the issuer's bankruptcy. If they could not exercise their preferential rights to a cover pool, they are granted an equal standing with unsecured unsubordinated creditors.

7. Public disclosure and supervision

The issuer should establish a risk management system for issuance and repayment of covered bonds, and present value of a cover pool at least once on a quarterly basis and post the results on its website.

For the purpose of investor protection, the FSC can require issuers to submit covered bond-related materials, conduct investigation and order corrective measures.

UPCOMING SCHEDULE

The draft bill on the Covered Bond Act will be submitted for parliamentary approval by December, 2012 after a 40-day notice period from October 24 to December 3, 2012 and a review by the Ministry of Government Legislation.

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