

January 02, 2014

The New Covered Bonds Act of Korea

A new legislative bill proposing the Covered Bonds Act (the “Act”) was passed by Korea’s National Assembly on December 19, 2013. This Act will come into full force and effect 3 months after its promulgation by the President, which is expected shortly.

Covered bonds are expected to reduce funding costs and serve as a stable method of funding in the event of financial crises for issuers. Covered bonds are also expected to improve the housing loan market by providing financial institutions with a stable funding source for long-term and fixed rate loans. Covered bonds can also be a solution to domestic or international investors who are looking for safe investments and solid returns, since covered bonds are often rated AA or above.

Covered bonds are debt securities of an issuer secured by cash-flow generated from an underlying investment pool of assets (a “cover pool”) - such as mortgage loans or public-sector loan receivables - that the issuer provides as collateral to the covered bondholders.

A cover pool must consist only of high-quality assets, such as mortgage loans satisfying certain criteria set out in the Act, government or public-sector bonds and such other assets as will be more particularly described in the Presidential Decree to the Act. The Act requires the total asset value of the cover pool to exceed 105% of the total outstanding amount of the covered bond.

The issuer must manage the cover pool separately from its other assets, preparing and maintaining separate books for the administration of the cover pool, and may appoint a covered bonds administrator to manage and administrate the cover pool assets as aforesaid for the benefit of the covered bondholders.

The issuer must also appoint a separate asset monitor to monitor whether the eligibility requirements of the cover pool assets are met and perform any act on behalf of the covered bondholders that is needed to manage, maintain and dispose of the cover pool assets in the event of default on the covered bonds. In the event of the issuer’s bankruptcy, covered bond investors have a preferential claim to the cover pool, in addition to a general unsecured claim on the issuer’s other assets.

To promote the covered bonds market and protect investors, the Act permits only “qualified issuers” to issue covered bonds, and only financial institutions with equity capital of at least KRW 100 Billion and a BIS ratio greater than 10% are eligible as “qualified issuers”, so as to ensure proper funding, operation and risk management.

An issuer of covered bonds must register an issuance plan and details of its proposed cover pool with the Financial Services Commission of Korea (the “FSC”). After registration, the issuer may issue covered bonds up to a principal amount not exceeding a ceiling greater than 8% of the issuer’s total assets as at the end of the previous fiscal year, to be set forth in the Presidential Decree. The FSC once announced that the ceiling would likely be set at 4% of the issuer’s total assets, but this remains to be seen until the Presidential Decree is enacted.

Should you have any questions regarding any of the foregoing, please feel free to contact us at any time.

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