

October 27, 2008

The Bank of Korea

Broadening of eligible collateral for open market operations

The Monetary Policy Committee of the Bank of Korea decided today to broaden the eligible collateral for open market operations to debentures issued by banking institutions and other special entities to shore up financial market stability by facilitating liquidity flows in the capital markets.

(The following is an English translation of the Monetary Policy Committee statement.)

1. Objectives

The recent filing for bankruptcy of Lehman Brothers heightened credit risk concerns in the financial markets both at home and abroad. This has led to a partial seize up in the credit markets which has pushed up market interest rates and destabilized flow of funds.

Consequently it has become necessary to diversify the normal liquidity provision channel and to ensure seamless flow of funds in the bond markets in order to secure financial stability.

In this context, the Bank of Korea has decided to include in its eligible collateral for Open Market Operations, debt securities that are not credit risk-free, such as bank financial debentures.

In addition, The Bank has taken into account the funding difficulties of MSE's, and the recent recession in the real estate/construction market by including government agency issued bonds pertaining to the relevant industries.

The announced measures should not be construed as a response to difficulties in the Korean commercial banking sector but rather as measures to restore the interplay of demand and supply in the debt securities markets. Commercial banks show robustness in their fund-raising as statistics show increased levels of time deposits.

2. Main points

The Monetary Policy Committee of the Bank of Korea decided today to broaden the eligible collateral for open market operations as follows:

- Debentures issued by banking institutions established by the Bank Act, Korea Development Bank, Industrial Bank of Korea, The National Agricultural Cooperative Federation, and The National Federation of Fisheries Cooperatives.
- Bonds issued by Korea Land Corporation, Korea National Housing Corporation, and Small Business Corporation.
- Mortgage Backed Securities issued by Korea Housing Finance Corporation.

The additional eligible collateral for open market operations, namely bank financial debentures and certain government agency issued bonds, will be mainly utilized as collateral for RP transactions between the Bank of Korea and its counterparties.

For risk management purposes, the Bank of Korea will set the margin ratios on debt securities whose credit risk is higher than that of government bonds, government guaranteed bonds, and monetary stabilization bonds.

3. Expected effects

Today's measures should have the following effects on the financial markets:

Firstly, it will improve credit standing of the debt securities additionally included as eligible collateral, leading to increased demand for them and an improvement in market conditions in the capital markets.

Secondly, it should help dissuade institutional investors such as securities firms from selling off bank debentures in response to their short-term funding needs.

Finally, it will also give some scope for institutional investors to purchase bank debentures using the funds raised by RP transactions involving bank debenture holdings as collateral.

4. Effective date : November 7, 2008

The securities that have been made additionally eligible as collateral will remain so for one year from the date of entry into effect.