

GOVERNMENT UNVEILS PLANS TO CREATE SPV TO SUPPORT CORPORATE BOND AND CP MARKETS

The government announced on May 20 specific plans to create a special purpose vehicle (SPV) aimed at supporting the corporate bond and commercial paper markets.

BACKGROUND

The conditions surrounding the corporate bond market hit by COVID-19 have improved somewhat recently with the government setting up a bond market stabilization fund (KRW20 trillion) and providing support for the issuance of primary collateralized bond obligations (KRW6.7 trillion) and corporate bonds (KRW4.1 trillion). As a result, the total amount of newly issued blue-chip corporate bonds rebounded in April.¹

However, the bond market still remains weak for lower rated corporate bonds with A or below ratings,² and there is stronger preference for short-term bonds.³ Against this backdrop, the government announced on April 22 its plans for creating an SPV to purchase lower-rated corporate bonds and commercial paper.

SPV MANAGEMENT

The government, the Bank of Korea and the Korea Development Bank will set up a KRW10 trillion SPV to help stabilize the corporate bond market, with the possibility of increasing its size up to KRW20 trillion.

(FUNDING SOURCES) KRW1 trillion (10%) equity capital from KDB,⁴ KRW1 trillion (10%) in subordinated loans from KDB and KRW8 trillion (80%) in primary loans from BOK

(PURCHASING TARGETS) AA to BB rated corporate bonds & A1 to A3 rated CP and short-term debt with maturity of up to 3 years

¹ New issuance of AA or above rated corporate bonds in 2020: KRW3.9 trillion (Jan) → KRW8.9 trillion (Feb) → KRW1.7 trillion (Mar) → KRW4.8 trillion (Apr)

² New issuance of A or below rated corporate bonds in 2020: KRW1.0 trillion (Jan) → KRW1.3 trillion (Feb) → KRW1.2 trillion (Mar) → KRW0.2 trillion (Apr)

³ Proportion of short-term (below 3 years) bond issuance: 18.2% (Mar 2019) → 19.9% (Mar 2020), 16.5% (Apr 2019) → 21.5% (Apr 2020)

⁴ Capital injection of KRW1 trillion by the government: KRW500 billion through 3rd supplementary budget and KRW500 billion through 2021 budget

The SPV purchasing program will mostly focus on A rated bonds but will also buy 'fallen angels,' junk-rated bonds which were downgraded from investment ratings due to Covid-19.

Companies with their interest coverage ratio of 100% or less for two consecutive years will be precluded from the purchasing program.

(PURCHASING LIMITS & PRICES) In order to fulfill the purpose of market stabilization, purchasing limits will be established within 2 to 3 percent of the total fund available from the SPV purchasing program for each individual company and business sector.

To encourage market-based capital raising efforts by businesses, the SPV will purchase bonds at a price slightly higher than market rates by applying additional fees.⁵.

(OPERATION PERIOD) For six months with possibility of extension based on market conditions

FURTHER PLANS

In order to expedite the provision of support, the KDB will begin purchasing low-rated corporate bonds and CP prior to the creation of SPV if deemed necessary.

Once the National Assembly passes the 3rd supplementary budget, which contains a provision of KRW500 billion investment for KDB, the SPV will be created with KDB's investment of KRW1 trillion. The BOK and the KDB will then issue primary loans (KRW8 trillion) and subordinated loans (KRW1 trillion), respectively, based on the purchase size of corporate bonds and CP.

An SPV operating committee composed of officials from the government, BOK and KDB will be set up to oversee decisions regarding the management of SPV. The decisions regarding whether to increase the availability of the fund to up to KRW20 trillion and to extend the operating period beyond the initial six months will be made depending on market conditions.

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⁵ Differential fee rates apply according to credit ratings within a 100 basis points range.