

FSC ANNOUNCES MEASURES TO SUPPORT COVERED BOND MARKET TO FACILITATE SUPPLY OF LONG-TERM, FIXED RATE MORTGAGES

- The FSC introduces plans to promote commercial banks' issuance of covered bonds with aims to build foundations that will help to boost the supply of long-term, fixed interest rate mortgage loans.
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The Financial Services Commission announced that an agreement signing event was held between Korea Housing Finance Corporation (HF) and five major commercial banks to facilitate payment guarantees on covered bonds on May 27. In accordance with this agreement, HF will begin to provide payment guarantee service on covered bonds issued by banks starting from May 27. This is part of the broader set of government plans intended to support the covered bond market with aims to increase the supply of long-term, fixed interest rate mortgage products by commercial banks.

Through HF's payment guarantee service, commercial banks are able to issue covered bonds at lower interest rates and investors are able to invest in safe, long-term assets, which require relatively little capital costs.

For instance, with HF's payment guarantee service, covered bonds issued by banks with an "AAA" rating will have 5 to 21 basis points lower interest rates for issuance, when compared to typical bank bonds with same maturities. Therefore, if banks are incentivized in this way to reduce funding costs, this will encourage them to provide more long-term, fixed interest rate mortgage products at lower interest rates.

HF also plans to seek re-securitization of covered bonds. Under this program, HF will purchase 10-yr covered bonds issued by banks, for instance, and through a settlor-trustee trust, issue asset-backed securities and sell them. This program will facilitate the issuance and purchase of long-term covered bonds in the market, and the supply of long-term funds raised this way can be put to use in providing long-term, fixed interest rate mortgages for houses valued more than KRW600 million, which is currently unavailable under the policy mortgage loan program.

In line with the introduction of HF's payment guarantee service, there will be other types of incentives for banks and financial institutions. First, when issuing covered bonds with 10-yr or longer maturities, banks will be allowed to use (within one percent of deposits in KRW) the funds raised through covered bond issuance for extending loans to customers by offering an incentive in calculating their loan-to-deposit ratio (in KRW). Second, within this year, an electronic filing and disclosure system will be established at DART (data analysis, retrieval and transfer system operated by the Financial Supervisory Service) to boost convenience and enable electronic management of covered bond issuance and disclosure services.

In addition, there will be incentives from the perspective of investors, such as pension funds and insurers that wish to invest in long-term, safe assets. First, the FSC plans to coordinate with related authorities to enable recognition of covered bonds as eligible collateral by the Bank of Korea. This will enable financial institutions to make greater use of covered bonds as collateral. Second, under the current capital requirements, banks or insurance companies holding covered bonds that are backed by HF will not be required to set aside additional capital, since the risk weight on covered bonds guaranteed by HF remains at zero. This will encourage them to invest more in covered bonds. Third, the Korea Financial Investment Association and bond ratings agencies will begin to publish benchmark yields on covered bonds starting from the end of June to help remove uncertainties concerning covered bonds investment.

At today's event, FSC Vice Chairman Kim Soyoung said that increasing the supply of long-term, fixed interest rate mortgage products should be considered as a persistent and ongoing policy task, regardless of the direction in the movement of interest rates. With the introduction of various measures intended to bolster demand for covered bonds and lower their issuance rates, Vice Chairman Kim said that it will be possible to provide fixed interest rate mortgages offering competitive rates even in times when interest rates are declining.

The FSC plans to keep close tabs on the issuance and circulation of covered bonds along the way and seek additional measures and improvements to support the covered bond market.

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