Financial Services Commission

Press Release

April 20, 2020

PLANS FOR TEMPORARY EASING OF FINANCIAL REGULATIONS IN RESPONSE TO COVID-19

The financial authorities announced on April 17 a set of temporary deregulatory measures on financial institutions' capital adequacy, liquidity and asset quality requirements to help boost their financing capacity amid the COVID-19 crisis. The deregulatory measures are expected to pave the way for financial institutions to play a more active role in providing support to the real economy.

BACKGROUND

The international society including the G20 and the Basel Committee on Banking Supervision recognized the need for a more flexible application of financial regulations in response to COVID-19. The adoption of the Basel III standards in the aftermath of the 2007-2008 financial crisis has boosted the stability of financial institutions in crisis situations. But it also had an effect of constraining their ability to flexibly respond to crisis situations. Against this backdrop, the Financial Stability Board recently made a recommendation for more flexible application of regulations.

In response to COVID-19, the Korean government has made available more than KRW100 trillion in financing support via financial institutions. The financial institutions at the forefront of delivering this emergency support package to businesses have been requesting an easing of such regulations so that they can increase their financing capacity to help support the real economy.

TEMPORARY EASING OF FINANCIAL REGULATIONS

The deregulatory measures will be based on the four key principles—necessity, temporariness, promptness and effectiveness.

I. REGULATIONS ON CAPITAL ADEQUACY

► **CONTRIBUTION TO STOCK MARKET STABILIZATION FUND:** Banks, securities companies and insuance companies that are making contributions to the stock market stabilization fund will see lower risk weights for the amount of contribution they make.

(Banks) Under the current regulations, banks' investment in funds that have listed stocks as underlying assets should be assigned a 300 percent risk weight in principle. However, banks will be allowed to assign a 100 percent risk weight for the amount of contributions they make to the stock market stabilization fund.

(Insurance companies & securities companies) Due to the lower risks involved in the stock market stabilization fund, the contributions made by insuance companies and securities companies will see reductions in risk weights vis-à-vis their investment in general exchange-traded funds (from 8~12 percent to 6 percent for insurance companies and from 9~12 percent to 4.5~6 percent for securities companies).

► **EARLY ADOPTION OF BASEL III CREDIT RISK FRAMEWORK FOR BANKS:** Basel III contains measures to lower credit risk weights for SME loans[1] and loss given default (LGD) rates for business loans.[2] The early adoption of the Basel III credit risk framework in late June this year—more than one year and a half before the Basel Commiittee's recommendation—will increase domestic banks' average BIS ratio by 0.8 percentage point.

► **DESIGNATION OF D-SIBS:** Basel III requires domestic systemically important banks (D-SIBs) and their subsidiaries to maintain higher capital buffers of an additional 1 percentage point. Through revisions of rules and regulations in June, small-sized regional banks will be excluded from the list of D-SIBs and exempted from the 1 percentage point additional capital buffer rule.

► **POSTPONEMENT OF LARGE EXPOSURES FRAMEWORK:** Basel III recommended the implementation of the large exposures framework[3] by 2019 to prevent concentration of risks. The large exposures framework has been introduced in Korea through administrative guidance from March 2019. However, due to concerns about liquidity problems of businesses, the official introduction of large exposures framework through regulations will be postponed until after 2021.

► **NET CAPITAL RATIO FOR SECURITIES FIRMS:** The standards for calculating firms' net capital ratio will be temporarily eased for newly issued business loans until the end of September including extensions of existing loans. For loans to SMEs and start-ups up to a certain amount, the lowering of risk weights (from 100 percent to 0~32 percent) will be applied permanently.

► **CREDIT EXTENSION BETWEEN SUBSIDIARIES:** Under the Financial Holding Companies Act, credit extension between the subsidiaries of the same holding company is limited to 10 percent of equity capital. This cap on credit extension will be temporarily lifted to up to 20 percent of equity capital to a single subsidiary for a total of up to 30 percent.

II. REGULATIONS ON LIQUIDITY

► **LIQUIDITY COVERAGE RATIO FOR BANKS:** Under the supervision of banking business regulation, the FSC may change liquidity coverage ratios for a period of less than

[1] From 100% to 85%
[2] LGD rates on unsecured loans (45% → 40%), LGD rates on real estate collateral loans (35% → 20%)
[3] Sets a limit to large exposures at 25% of Tier 1 capital

six months provided that significant changes in economic conditions have taken place or that changes in LCR are necessary to bring stability to the real economy. In this regard, the FSC will work to lower the foreign currency LCR from 80 percent to 70 percent by the end of September. Similarly, the FSC will work to bring down the total LCR from 100 percent to 85 percent by the end of September in order to encourage banks to make use of high liquidity assets amid the COVID-19 crisis.

► **LOAN-TO-DEPOSIT RATIO:** Banks may face increasing difficulties in complying with the LTD regulations as they continue to issue business loans to small merchants and self-employed business owners due to heavier risk weights applied to the small merchants vis-à-vis SMEs.

In this regard, banks will be exempted from sanctions for violating the LTD ratio requirement within a 5 percentage point range until the end of June 2021. Also, the risk weight of commercial loans issued to self-employed small merchants in this year will be lowered from 100 percent to 85 percent.

► **NET STABLE FUNDING RATIO:** Korea Development Bank issues industrial finance bonds to raise funds for the government's COVID-19 emergency support package. Due to the relatively low risk weight assigned to these bonds, KDB's net stable funding ratio is expected to drop after the bond issuance.

As such, there will be no penalties imposed on KDB for violating the net stable funding ratio rule within a 10 percentage point range until the end of June 2021.

► **REPURCHASE AGREEMENTS FOR INSURANCE COMPANIES:** The Insurance Business Act allows repurchase agreements (repos) for insurance companies for the purpose of satisfying the financial soundness standards or maintaining an appropriate liquidity level. Until now, it remained unclear whether an insurance company participating in the bond market stabilization fund and/or stock market stabilization fund can raise short-term cash through repos. In this regard, insurance companies' participation in the market stabilization facilities are not considered to be geared toward profit-generating but instead for the purpose of bringing stability to the markets on a temporary basis. Thus, it fits the purpose of maintaining liquidity.

► **INSURANCE COMPANIES' RISK ASSESSMENT:** Insurance companies' liquidity ratios are evaluated as part of their risk assessment application system (RAAS). Given the effects of COVID-19 and insurance companies' participation in the market stabilization facilities, it is necessary to temporarily ease their liquidity assessment standards.

As such, the liquidity assessment indexes of insurance companies will be upgraded from the current 2 to 4 (and 5 ratings in certain cases) to 1 to 4 ratings as part of their RAAS until the end of September.

► **LIQUIDIRY RATIO REQUIREMENTS FOR CREDIT FINANCE COMPANIES & SAVINGS BANKS:** Due to a rise in the volume of loan extensions and deferment of payment to the SMEs and small merchants hit by COVID-19, specialized credit finance companies and savings banks also face the risk of violating the liquidity ratio requirements.

In this regard, specialized credit finance companies and savings banks will not be sanctioned for violating the liquidity ratio rules within a 10 percentage point range until the end of June 2021.

► **LOAN-TO-DEPOSIT RATIO FOR SAVINGS BANKS & MUTUAL FINANCE COMPANIES:** Administrative sanctions for violating the LTD ratio rules for savings banks (110 percent in 2020 and 100 percent in 2021) and mutual finance companies (80~100 percent) will be lifted temporarily within a 10 percentage point range untile the end of June 2021.

III. ASSET QUALITY STANDARDS

► **CLASSIFICATION STANDARDS:** Across all financial sectors, concerns have been raised over degradation of asset quality and accounting of accrued interest due to heavy volumes of loan extensions and deferment of payment extended to commercial entities.

In this regard, all financial institutions can apply the existing asset quality standards without the need to raise additional capital reserves and consider accrued interest as interest revenue for accounting purposes.

► **COMMERCIAL LOANS TO CLOSED BUSINESSES:** The current rules stipulate that commercial loans to owners of closed businesses be classified as ‘sub-standard.’ As such, a business owner with no prior record of overdue payments who has sufficient capacity to service debt is automatically categorized as ‘sub-standard’ if s/he has gone out of business.

In this regard, commercial loans to closed businesses can be considered as above ‘risky’ assets provided that the owner of the business demonstrates sufficient capacity to meet principal and interest payments in the future.

IV. EXEMPTION FROM SANCTIONS & OTHER DEREGULATORY MEASURES

► **MISCONDUCT IN FINANCIAL SERVICES:** In order to ensure that financial services workers are exempted from sanctions for minor misconduct while providing the COVID-19 emergency support package, the financial regulators began to implement a reasonable and transparent set of revised rules on exemption from sanctions for misconduct in financial services on April 16.[4]

► **RULES ON DISCLOSURE, REPORTING, ETC.:** Due to COVID-19 related issues, financial institutions may find it difficult to meet deadlines for disclosure, business reporting, etc. In this regard, there will be no penalties or administrative sanctions for failing to meet disclosure or business report deadlines.

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[4] For details, please refer to the press release, “Plans to Improve Rules on Exemption for Misconduct in Financial Services” (April 8, 2020).

► **MAXIMUM LEVERAGE RATIO FOR CREDIT FINANCE COMPANIES:** In order to facilitate smooth operation of credit card companies amid the COVID-19 pandemic, the maximum leverage ratio will be increased from the current six times to eight times the total assets minus on-lending loans over equity capital. In order to strengthen the management and supervision of credit card companies' liquidity risks, when credit card companies' leverage ratios reach seven times or higher of their total assets minus on-lending loans over equity capital, they will be prohibited from shaving off equity capital.

Also, differential risk weights will apply for household loans (115 percent) and commercial loans (85 percent) across all credit finance companies in order to mitigate excessive rise in household debt.

► **INSURANCE TELEMARKETING RULES:** Under the Insurance Business Act, insurance agents should meet their clients at least once face-to-face to give detailed explanation on the products and receive a signed subscription form from the client. In the wake of the COVID-19 crisis, social distancing has become widespread and face-to-face sales opportunities have diminished significantly.

When the COVID-19 alert level is at 'serious' or 'warning,' an untact recording of telephone conversations will be permitted in place of the face-to-face explanation and handwritten signature requirements. Close examination of telephone recordings and an extension of cooling off period (+45 days) will be in place to prevent misselling.

► **CREDIT EXTENSION REQUIREMENTS FOR SAVINGS BANKS:** Savings banks are required to maintain certain levels of credit extension to local SMEs and self-employed business owners within the districts in which they operate.[5] Due to a growing volume of loan extensions offered to commercial entities outside of their districts for more than six months, savings banks may find it difficult to keep up with these requirements.

As such, savings banks will be exempted from sanctions for violating these requirements within a 5 percentage point range until the end of June 2021.

► **INCENTIVES FOR STATE-BACKED FINANCIAL INSTITUTIONS:** State-backed financial institutions have expanded the availability of funding to help businesses and individuals and also to stabilize markets. By doing so, policy banks have risked unfavorable assessment results for their annual performance reviews, especially in terms of budget implementation and revenue management.

In this regard, the financial authorities will take into account special circumstances surrounding their business operation amid the COVID-19 crisis and prioritize their perfomance of providing the COVID-19 emergency support package when carrying out performance reviews on policy banks this year.

[5] Seoul metropolitan area (50%) and other regions (40%)

EXPECTATION

The temporary deregulations are expected to boost financial institutions’ capacity to provide additional financing by KRW206 trillion to KRW394 trillion.

<Extra Funding Capacity by Institution Types>

(KRW, trillion)

Types	Deregulatory measures	Extra funding capacity
Banks	- Temporary easing of LTD ratio (5%p) - Early adoption of Basel III credit risk framework	71.6 ~ 259
Securities firms	- Temporary reduction of risk weights on corporate debts	8.6
Credit card companies	- Increasing maximum leverage ratio from 6x to 8x	54.4
Savings banks	- Temporary easing of LTD ratio (10%p)	6.6
Mutual finance	- Temporary easing of LTD ratio (10%p)	65.1
Total		206.3 ~ 393.7

In addition, the five major financial holding companies will be able to extend KRW12.9 trillion worth of extra credit to their subsidiaries due to increased caps on credit extension rules between subsidiaries.

FURTHER PLANS

The financial authorities will ensure that the deregulatory measures requiring no revisions to the existing laws go into effective immediately via regulatory interpretations and no-action letters.

For deregulations with specific timelines, such as liquidity coverage ratios and loan-to-deposit ratios, the authorities will review the need for an extension beyond the initial schedule as well as the need for any supplemental actions prior to the expiry dates, while providing stakeholders with sufficient time to adjust.

Meanwhile, the government will closely monitor the financial soundness of regulated entities and take necessary steps to bolster supervision when deemed necessary.

SCHEDULE

	Deregulatory measures	Required actions	In effect
I. Capital adequacy			
All	Reducing capital burdens for participation in stock market stabilization fund	(Banks) Regulatory interpretation in April	–
		(Insurance & securities firms) Revision of enforcement rules in April	–
Banks	Early implementation of Basel III	Revision of enforcement rules in April	–
Banks	Excluding small sized regional banks from D-SIBs	Revision of rules and regulations in June	–
Banks	Postponement of large exposures framework	–	–
Securities firms	Lowering financial investment firms’ risk weights on corporate loans	Revision of enforcement rules in April	Until Sep. 2020
	Lowering securities firms’ risk weights on commercial loans	Revision of regulations and FSC approval in April	Until Sep. 2020

	Lowering securities firms' risk weights on commercial loans to medium-sized businesses	Revision of regulations in June	–
Financial holding companies	Increasing cap on credit extensions between the subsidiaries of the same financial holding company	Revision of regulations and FSC approval in May	–
II. Liquidity			
Banks	Temporary lowering of foreign currency LCR	FSC approval on April 16	Until Sep. 2020
	Temporary lowering of total LCR	FSC approval on April 16	Until Sep. 2020
Banks	Temporary lifting of LTD ratio	Regulatory interpretation and no-action letter issued in April	Until Jun. 2021
	Lowering risk weights on business loans to self-employed small merchants	Revision of regulations in May	Until Dec. 2020
KDB	Temporary lifting of NSFR	No-action letter issued in April	Until Jun. 2021
Insurance firms	Allow repos for market stabilization funds	Regulatory interpretation issued in April	–
Insurance firms	Temporary easing of liquidity standards	–	Until Sep. 2020
Credit finance & savings banks	Temporary lifting of liquidity ratio	No-action letter issued in April	Until Jun. 2021
Savings banks & mutual finance	Temporary lifting of LTD ratio	No-action letter issued in April	Until Jun. 2021
III. Asset quality			
All	Application of existing asset quality standards on loan extensions	Regulatory interpretation issued in April	–
Credit finance	Improving asset quality on commercial loans to closed businesses	Revision of regulations in May	–
IV. Exemption from sanctions & other deregulatory measures			
All	Granting more exemptions from sanctions for financial services workers	Revision of regulations on April 16	–
All	Lifting sanctions for missing disclosure and reporting deadlines	No-action letter issued in April	–
Insurance firms	Permitting telemarketing procedures for insurance salespersons	No-action letter issued in April	–
Credit finance	Increasing maximum leverage ratio for credit card companies	Revision of regulations in July	–
Savings banks	Temporary lifting of credit extension requirements for savings banks	No-action letter issued in April	Until Jun. 2021
Policy banks	Giving incentives for active provision of COVID-19 emergency financing support	Revision of guidlines in April	–

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