

NEW START FUND FOR SMALL MERCHANTS AND SELF-EMPLOYED BUSINESS OWNERS HIT BY COVID-19 TO BE LAUNCHED

A debt adjustment program, called '*New Start Fund*,' for small merchants and self-employed business owners hit by the Covid-19 crisis will be launched in October.¹ The New Start Fund is intended to ease their debt payment burden as they are struggling to repay their debt since they suffered unavoidable losses while cooperating with the government's quarantine measures such as social distancing policy and restrictions to business operations²

BACKGROUND

Over the past two and a half years, self-employed business owners and small merchants have suffered inescapable damages in the process of cooperating with the government's preventive measures, such as restrictions on business operation, in response to the COVID-19 crisis. As their businesses slowed down and financial conditions deteriorated, small businesses turned to debt and the size of their loans have grown significantly with increased burdens for principal and interest payments.

※ TRENDS IN SELF-EMPLOYED BUSINESS LOANS SINCE COVID-19 OUTBREAK (END-2019 TO END-JUNE 2022)

- a) Steep increase (up to KRW997 trillion) in individually owned enterprises (KRW653 trillion in business loans + KRW343 trillion in household loans)
- b) Loans for individually owned enterprises rose rapidly, twice faster than the pace of the growth in household loans: Up KRW303.9 trillion (*up 44%*)
- c) Loans from nonbank sectors rose more rapidly than loans from banks: Up KRW160.4 trillion (*up 71%*)
- d) Number of debtors with multiple debt accounts (borrowers from three or more lenders) increased more than fourfold: 80,000 → 330,000

Major institutions including the Bank of Korea evaluate the size of potential insolvency of self-employed business owners to be about 5 to 8 percent of their total loans. With the availability of COVID-19 support measures such as the loss compensation support, funding support through fiscal spending and the loan maturity extension and payment deferment program, the vulnerability of their debt situation had not surfaced yet. However, there are possibilities that their insolvency potential may build up and expand if there is another wave of COVID-19 or a worsening of the economic or financial conditions due to high levels of interest rates, prices and USD-to-KRW exchange rates.

¹ Tentative schedule

² Current administration's policy agenda I-1: "Support complete recovery and revitalization of small businesses"

Against this backdrop, the FSC has prepared a debt adjustment program (called “New Start Fund”) to help prevent an expansion in the insolvency potential of the pandemic-hit small businesses and to provide a chance of credit recovery and restart for debtors who have already turned insolvent. The debt adjustment program will help lower excessive payment burdens (high interest rate and short-term maturity) relative to their debt service capabilities while offering sufficient time to make business recovery. For insolvent debtors, the program intends to provide an opportunity to restart by offering the adjustment of existing debt according to their own payment capabilities through principal adjustment, etc.³

BORROWERS ELIGIBLE FOR DEBT ADJUSTMENT

The New Start Fund will target (a) debtors hit by the Covid-19 pandemic, (b) who are individually owned enterprises or small merchants; and (c) whose debt has been overdue for a long period (90 days or more); or has been considered at high risk of being long overdue. Whether potential applicants qualify for each of the criteria – (a), (b) and (c) - will be determined by the following factors.

- (a) **(COVID-19 DAMAGE)** Borrowers who have received the government-initiated emergency support fund (e.g. loss recovery fund targeting businesses), or loss compensation fund or those that have used the maturity extension and payment deferment program
 - All business types that have undertaken COVID-19 prevention measures such as business restrictions are included in the eligibility.
 - However, real estate leasing businesses, manufacturers of gambling and gaming machines, professional business areas such as legal, accounting and tax enterprises that have not been subject to the loss recovery fund provided by the MSS will be excluded.
- (b) **(INDIVIDUAL ENTERPRISE OR SMALL-SCALE CORPORATE ENTITIES)** Individually owned enterprises or corporate enterprises as prescribed under the Value Added Tax Act (only corporate enterprises that also qualify as “micro-enterprises” under the Framework Act on Micro-enterprises will be included)
 - Borrowers whose business closed down after the COVID-19 outbreak (April 2020 or thereafter) will also be included (incidental comment in supplementary budget).
- (c) **(VULNERABLE DEBTOR)** Borrowers who are insolvent or at risk of becoming insolvent, meeting one of the following criteria.

³ For borrowers who have been diligently making debt payments on schedule, the availability of other types of diverse financial support measures has already been introduced (Please refer to the [press release](#) dated July 14, 2022 for the KRW125 trillion-plus measures to help stabilize people’s livelihoods).

	Qualification criteria (tentative)
Insolvent debtors	- Borrower with one or more loan accounts and have long-term overdue debt (3 months or more)
At-risk debtors	<ul style="list-style-type: none"> - Borrowers whose business closed down or whose business operation is suspended for 6 months or more (those reporting business closure or suspension) - Out of borrowers currently using the maturity extension and payment deferment program (as of August 29), (i) those who are not able to receive additional maturity extension from financial institutions (including borrowers who have been asked by lenders partial payments or increase in additional interest) or (ii) debtors whose interest payments are currently deferred - Borrowers who have become subject to credit information management due to failure to fulfill their tax payment duties (national and local taxes and customs duty) - Borrowers with low credit scores or those that have unintentionally accrued overdue debt for a considerable period of time⁴

- (d) **(EXCLUSION FROM SUPPORT)** Debt adjustment may be rejected for debtors who have intentionally accrued overdue debt to qualify for support under the program, those with high asset values applying for a small-scale reduction in debt, etc.
- To prevent moral hazard, a reasonable set of standards for rejecting debt adjustment will be prepared and a qualitative evaluation will be carried out on debt adjustment applications.
 - Upon finding submission of false documents or intentional accrual of overdue debt, debt adjustment will be immediately revoked and new application prohibited.

Whether applicants fit the eligibility criteria can be easily found at an online platform that is expected to open in October. As the online platform will be linked with the system of related government ministries such as the National Tax Service, Ministry of the Interior and Safety and Ministry of SMEs and Startups as well as credit information collection agencies, applicants can easily check their eligibility by simply entering borrower information such as their business registration numbers.⁵

TYPES OF LOANS ELIGIBLE FOR DEBT ADJUSTMENT

The debt adjustment program for self-employed business owners and small merchants will handle all outstanding loans⁶ held by financial institutions that have entered into a partnership for the New Start Fund scheme.⁷ As it is the first debt adjustment program intended exclusively to support the self-employed and small merchants, the program has been designed with particular financial traits and needs of small businesses in mind. The program makes available support for collateralized or guaranteed loans as small businesses tend to have less credit loans (13%) but more of collateralized (75%) and guaranteed (12%) loans. With regard to the self-employed, considering that it is difficult to draw a clear line between a business and an individual, the program will include support for household loans as well to assist their restart and recovery efforts in a more effective manner.⁸

⁴ Specific standards for determination are undisclosed for the purpose of preventing moral hazard of borrowers.

⁵ However, in certain cases that an automated eligibility check is not available through the system (e.g, when offering an additional loan maturity extension is difficult by financial institution), debtors should submit relevant documents to prove their eligibility.

⁶ Business loans and household loans / collateralized loans, guaranteed loans and unsecured loans

⁷ Partnership for "New Start Fund": About 6,500 financial institutions

⁸ Small merchants that are corporate entities have their legal personality and CEO separated, thus household

However, the program will not cover the following loans that are irrelevant to COVID-19 damage, given their characteristics, or that are considered to be difficult for debt adjustment under the New Start Fund scheme:

- (a) Loans related to property lease or sale, household loans for purchasing a home or other personal asset accumulation purpose, guaranteed loans for jeonse, etc.
 - However, home or other real estate-backed business loans, commercial auto loans for trucks or heavy equipment can be eligible for debt adjustment as these loans are for business purposes.
- (b) Discount notes, trade finances, loans from special purpose companies (SPCs), deposit-backed loans, other types of loans with restrictions for disposal, loans subject to a judicial recovery process, etc.
- (c) Person-to-person debt obligation or debt owed to non-signatory institutions to the “New Start Fund “ partnership such as overdue payments of national and local taxes and customs duty
- (d) New loans held by at-risk borrowers,⁹ which have been issued within past six months
 - This is aimed at preventing cases in which debtors intentionally increase the size of their debt prior to applying for debt adjustment support, so that it helps to prevent potential moral hazard problems.

APPLICATION AVAILABILITY AND MAXIMUM AMOUNT OF DEBT ADJUSTMENT

Within the available period, application for debt adjustment can be submitted only once in order to restrict cases where applicants intentionally and repeatedly submit their applications multiple times. However, for at-risk borrowers using the debt adjustment program, if the debtor is unable to fulfill the debt adjustment plan for 90 days or more, it is possible to move from an “at-risk debtor” track to an “insolvent debtor” track.

The maximum amount available for debt adjustment is KRW1.5 billion in total with KRW1 billion in collateralized debt and KRW500 million in unsecured debt. These limits are the same level as the maximum debt adjustment amounts provided by the Credit Counseling and Recovery Service (CCRS) for individual debtors. Considering that the average amount of debt held by self-employed business owners is KRW120 million (according to Statistics Korea), it is expected that most self-employed business owners in debt will qualify for the program.

DEBT ADJUSTMENT DETAILS AND DISADVANTAGE TO CREDIT STANDING

Self-employed business owners and small merchants will be supported through customized debt adjustment plans according to their individual credit conditions and types of loans.

loans issued to CEOs will not be supported by the program.

⁹ At-risk borrowers who have taken out a new loan within past six months in the amount of more than 30% of their total outstanding debt cannot apply for debt adjustment support.

	Guaranteed loans	Unsecured loans	Collateralized loans
Insolvent debtors	Track 1 (after payment by subrogation)	Track 1	Track 2
At-risk debtors	Track 2	Track 2	Track 2

[Track 1] When an insolvent debtor applies for debt adjustment of guaranteed or unsecured loans

When insolvent debtors apply for debt adjustment of guaranteed or unsecured loans, the loan principal and the payment schedule will be adjusted to the level where debtors are able to make repayments based on his or her own capabilities.

(PRINCIPAL ADJUSTMENT) Support principal adjustment on 60 to 80% of net debt (amount of debt in excess of asset value) following a rigorous assessment

- As there will be differential reduction rates applied on net asset (debt minus asset value) between 60 to 80%, the actual principal reduction rate in relation to total debt will also vary between 0¹⁰ to 80% depending on the size of assets in holding.
- The reduction rate will be decided based on the proportion of net debt relative to income, potential period of being economically active, payment period, etc.

※ Considering the unavoidable nature of COVID-19 damage to businesses, the below debt reduction rates show somewhat increased levels of debt reduction compared with the current debt adjustment system.

	Reduction Rate relative to total debt	Average reduction rate
CCRS	0 to 70% (~90% for vulnerable groups)	44% (61% for bad debt)
New Start Fund	0 to 80% (~90% for vulnerable groups)	-
Bankruptcy Court	No limit	60 to 70%

(INTEREST RATE REDUCTION) Interest on principal and overdue payments will be reduced (when debt is greater than asset value).

(INSTALLMENT PAYMENT) Regardless of the previous payment method (bullet payment or installment payment), the payment method for all loans will be switched to installment payment and debtors will need to make payments in installment a little by little consistently.

(PAYMENT PERIOD) Debtors can choose the deferred payment and debt service periods according to individual financial situations.

- The deferment period for installment payments can be chosen from 0 to 12 months and the installment payment period can be chosen from 1 to 10 years.

⇒ Provision of debt adjustment will be revoked immediately if concealed assets are found through regular inquiry into debtors' assets, etc.

¹⁰ There is no principal adjustment provided when the value of assets in holding exceed the total debt amount.

(CREDIT PENALTY) When entering into a debt adjustment contract, previous record on long-term debt overdue will be cancelled, but instead, a record for using the debt adjustment program will be registered at the Korea Credit Information Services and will be shared with all financial sectors and credit bureaus (CBs) for two years. During this period, debtors under the program will be effectively restricted in further credit-based transactions such as receiving new loans or using/applying for credit cards. However, after two years, the publicly registered data will be removed and depending on debtors' individual efforts, improving one's credit score is made possible which will serve as the basis of credit recovery.

[Track 2] When an at-risk debtor applies for debt adjustment of collateralized, guaranteed or unsecured loans, or when an insolvent debtor applies for debt adjustment of collateralized loans

The loan structure will be switched to a long-term maturity, low interest rate and installment payment based loan to allow debtors to make payments according to the pace of individual business recovery.

(PRINCIPAL ADJUSTMENT) Principal will not be subject to adjustments.

(INTEREST RATE REDUCTION) Support for interest rate reduction will be provided differentially based on the period of overdue payment of individual borrowers

- **(OVERDUE FOR UP TO 30 DAYS)** Keep the existing interest rate stated under the loan contract but bring interest rates down to 9% for those with above 9% interest rates¹¹
- **(OVERDUE FOR MORE THAN 30 DAYS)** Adjust to a single interest rate within the payment period as borrowers will begin to see a substantial fall in credit scores

※ Specific levels of interest rates to be decided based on banks' loan rates, financing rates for "New Start Fund," etc. However, as lower adjusted rates are provided for shorter payment periods, there is more advantage in making repayments faster.

* e.g. (Payment period of 3 years or less) upper 3%, (3 to 5 years) mid-4%, (5 years or more) upper 4%
→ The rates above are examples only and decisions will be made based on prevailing conditions at the end of September 2022

(INSTALLMENT PAYMENT) Regardless of the previous payment method (bullet payment or installment payment), the payment method for all loans will be switched to installment payment and debtors will need to make payments in installment a little by little consistently.

(PAYMENT PERIOD) Debtors can choose the interest-only and debt service periods according to individual financial situations.

- The deferment period for interest-only payments¹² can be chosen from 0 to 12 months (0 to 36 months for mortgage-backed loans), and the installment payment

¹¹ Considering low impact on credit scores, the focus will be on maturity extension and partial easing of interest rate burden.

¹² Interest rate stated under the existing loan contract will apply during the interest-only period.

period can be chosen from 1 to 10 years (1 to 20 years for mortgage-backed loans).

- During the deferment period, interest payments can be deferred for up to 1 year.

(CREDIT PENALTY) Although information about at-risk debtors will not be registered as public data, there may be restrictions to engaging in new credit-based transactions due to credit score downgrading following a record of short-term debt overdue.¹³

APPLICATION FOR DEBT ADJUSTMENT

(WHERE TO APPLY) Self-employed business owners and small merchants can apply for debt adjustment through an online platform which will become available in October or through on-site channels (50 microfinance support centers and 26 KAMCO offices). Also, a call center will be available in September to provide support with detailed information and consultation about how to use the debt adjustment program.¹⁴

(WHEN IT BECOMES AVAILABLE) Application for debt adjustment will be available in October after going through a preparation period of revising relevant law, forming a partnership agreement in financial sectors (about 6,500 entities) and establishing a data system (one to two months expected).¹⁵ Beginning in October 2022, debt adjustment applications will be accepted for one year initially, and when it becomes necessary, the program will be operated up to three years based on the COVID-19 situation, economic conditions and trends in the insolvency potential of the self-employed and small merchants.

(DEBT ADJUSTMENT) When an application is filed for debt adjustment, a debt adjustment plan will be prepared within about two weeks and a contract for debt adjustment will be signed within two months after purchasing bond, etc. Debtors thereafter will make debt payments according to the grace period and payment schedule that they have selected previously.

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For press inquiry, please contact Foreign Media Relations at fsc_media@korea.kr.

¹³ For insolvent debtors, credit penalty is the same as the Track 1.

¹⁴ Availability of online platform and call center to be announced through release of promotional material.

¹⁵ Exact date of availability will be announced later once preparation is finished.