

Establishing A New Government Sponsored Enterprise, Korea National Mortgage Corporation¹

by Seung-Dong You²

INTRODUCTION

The new Government Sponsored Enterprise (GSE), Korea National Mortgage Corporation (KNMC), is planning to launch in early 2004³. Its main business will be the issuance of Mortgage Backed Securities (MBS) and Student Loan Backed Securities (SLBS) and management and operations of the Housing Finance Credit Guarantee Fund (HFCGF)⁴.

Its creation was made necessary by fundamental changes in the Korean housing finance system (Blankenship, 2000). The establishment of KNMC was deemed necessary because the government concluded that the primary mortgage market could be exposed to systemic risk due to the expansion of short-term mortgages with a variable rate after the Korean financial crisis. The structural

change in the primary mortgage market has been led by commercial banks, and the formation of favorable market conditions for securitization in the secondary mortgage market that was introduced in 1999 is under progress.

This article provides information on Korean mortgage market conditions and a framework for the establishment of the new GSE in the housing finance market. First, it probes commercial banks' behavioral incentives for the market share increase in the primary mortgage market. Second, it presents current conditions of the secondary mortgage market and advances after its introduction in 1999. And finally, it discusses the process for the establishment of KNMC, introduces its new business, and then concludes.

STRUCTURAL CHANGES IN THE PRIMARY MORTGAGE MARKET

The 1997 financial crisis, a serious shock that financial institutions had never before experienced, has changed the shape of the banking industry in Korea. In the aftermath of the crisis, many commercial banks could not meet BIS ratios and were forced into bankruptcy. Many experts, such as Oh and Park (2003) claim that the heavy dependency on the poorly functioning banking system was the root cause of the economic crisis. From the crisis experience, commercial banks realized that they should focus on retail customers they had been ignoring during the period of rapid economic growth, focusing rather on corporate lending. As illustrated in Table 1, it is evident that after the crisis they have increased their lending significantly to the household sector, which can provide them

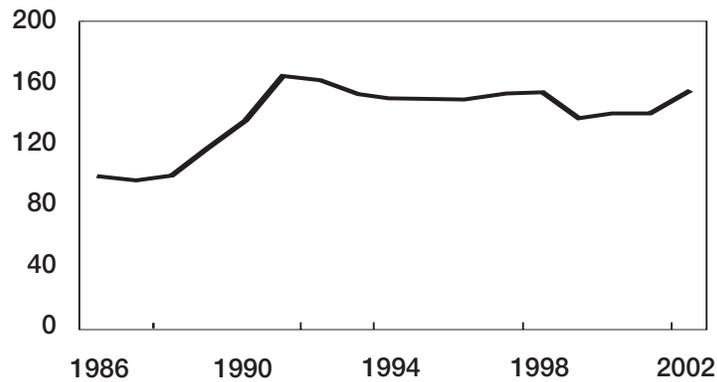
Table 1 Loans Generated by Banks

(Unit: Trillion Won, %)

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Household	22.8 22.2%	28.1 24.4%	36.8 27.1%	41.5 27.2%	50.2 28.3%	58.5 29.2%	55.5 27.7%	79.1 31.6%	108.9 35.1%	157.6 44.1%	222.3 47.1%
Industrial	79.9 77.8%	87.0 75.6%	99.0 72.9%	111.0 72.8%	127.0 71.7%	141.9 70.8%	144.8 72.3%	171.1 68.4%	201.9 64.9%	199.8 55.9%	249.4 52.9%
Total	102.8 100.0%	115.1 100.0%	135.9 100.0%	152.5 100.0%	177.2 100.0%	200.4 100.0%	200.3 100.0%	250.2 100.0%	310.8 100.0%	357.4 100.0%	471.7 100.0%

Source: Bank of Korea (BOK)

Chart 1 Trend in Real Estate Price Index (1986 =100)



Source: Kookmin Bank

with safe and sound collaterals, such as houses.

As commercial banks have been fascinated with mortgage products, most of them have jumped into hot competition in the mortgage market. Calling it a 'war', Lee (2003) says that the competition⁵ began in 1997, when the former Housing & Commercial Bank (H&CB) was privatized. This fierce competition between commercial banks has led to structural change in the primary mortgage market. Factoring companies that once shared 10% of the mortgage market in 1997, have lost market share due to high funding costs.

From the perspective of banks, mortgage loans have lower credit risk compared to other household loans. As the value of collateral, real estate seldom goes down as shown by Chart 1 and Table 2 below, the mortgage, which holds the collateral with 1st or 2nd priority, is sound and safe for the

bank. Although the steep rise of real estate prices halted in the early 1990s, the slow and steady increase of housing prices has not ceased. For instance, from 1991 to 2002 the average annual growth rate of housing price index was 1.04%⁶. In Seoul, which has more than 20%⁷ of Korea's households, it is around 1.97%.

Average loan to value (LTV) ratios are about 30%, as illustrated in Table 3. LTV ratios in Korea are lower than those of other countries as shown in Table 3 and Table 4. The lower this ratio, the greater the protection the lender has if the applicant defaults and it becomes necessary to repossess and sell the property (Fabozzi and Modigliani, 1999, p.42). With sound collateral whose value seldom goes down, the lender does not always need to use very strict underwriting criteria because it can benefit from extra charges from default loans or late payments. In addition, although some of the mortgage products

offered by commercial banks and other private sector lenders include LTV of up to 100% of the appraised price (Blankenship, 2000), an appraised price often is not a market price, but a conservative price that is lower than the market price.

Banks have seldom maintained high LTV ratios, because they, by law, have lower reimbursement priorities of defaulted loans to Chonseil⁸ tenants who deposit the small amount of up-front deposit ranging from 14 million won to 40 million won per room⁹.

Nonetheless, as from June 3 2002, Financial Supervisory Services (FSS) recommended that lending institutions not originate mortgages with more than 50% LTV ratios, and commercial banks set up new underwriting standards for newly originated mortgages (see Table 5).

Most banks with high deposit balances are transferring interest risks to mortgagors

Table 2 Percent Change of Housing Price Index

(Unit:%)

Year	Average	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	
House Price Index	Nation	1.04	-0.5	-5.0	-2.9	-0.1	-0.2	1.5	2.0	-12.4	3.4	0.4	9.9	16.4
	Seoul	1.97	-2.1	-5.4	-3.2	0.5	-0.6	1.5	2.0	-13.2	5.6	3.1	12.9	22.5
APT Price Index	Nation	2.81	-1.8	-5.0	-2.7	0.7	0.7	3.5	4.7	-13.6	8.5	1.4	14.5	22.8
	Seoul	4.27	-4.5	-4.3	-2.8	1.2	0.0	4.2	5.2	-14.6	12.5	4.2	19.3	30.8

Source: Kookmin Bank

Table 3 Average LTV ratio

1997	1998	1999	2000	2001	2002
28.4%	33.2%	30.4%	28.5%	31.6%	32.1%

Source: Kookmin Bank

Table 4 International LTV ratios¹⁾ (in 1999)

Belgium	Germany	France	Italy	Netherlands	Sweden	Spain	UK	Hong Kong
80%-85%	60%-80%	67%	50%	75%	50% - 70%	80%	75%-85%	64%

Note: 1) Typical or average LTV ratios.

Source: Merrill Lynch

Table 5 New LTV Standards for Mortgage Loans as of June 11, 2003

Banks	LTV
Kookmin Bank	45%(mortgagor with low credit: 40%)
Korea Exchange Bank, Woori Bank, Hana Bank, Korea First Bank, Shinhan Bank, KorAm Bank	50%
Chohung Bank, Industrial Bank of Korea	50%(mortgagor with low credit: 45%)

through variable rate products. To solve the maturity gap problem¹⁰, commercial banks that finance through short-term savings are providing the retail customers with short-term mortgages. When the government owned Housing and Commercial Bank (H&CB) led the housing finance market, it supplied long-term mortgages. But, after the privatization of H&CB, whose major business is housing finance including

mortgages and construction financings, Kookmin Bank (a merger of H&CB)¹¹, like other banks, increased short-term mortgage loans as in Table 6.

Around 86% of loans generated by commercial banks in 2001 were short term maturity variable rate loans, as seen in Table 7. Commercial banks supply few fixed rate mortgage products and the spread

difference between variable rate mortgages and fixed rate mortgages is not small.¹² Due to high financing costs of fixed rate funding with long-term maturity, banks sell mortgages mostly with a variable rate. Borrowers choose variable rate mortgage loans¹³ due to a high spread difference between a variable and fixed rate products.

Table 6 Maturity of Mortgage Loan¹⁾: Case of Kookmin Bank

	1998	1999	2000	2001	2002 ²⁾
3 years or less	4.1	55.4	62.6	70.8	75.6
3 years or less than 10 years	12.7	19.5	20.5	12.4	9.3
10 years or less than 20 years	9.1	3.7	4.4	4.9	1.7
30 years or more	74.1	21.5	12.5	11.8	13.4
Total	100	100	100	100	100

Note: 1) Newly Originated Loans

2) From January to August

Source: Kookmin Bank and Lee (2003)

The commercial banks have increased the deposit-mortgage spread rather than the deposit-the other household loan spread. The deposit-mortgage spread increased by 65 bps from 2.17% in December 2001 to 2.82% in December 2002. During the same period, however, the deposit-loan spread decreased by 25 bps from 2.93% to 2.68%. In fact, although mortgage rates are determined by the prime rate or CD plus spreads, banks raises required funds from deposits at a much lower interest rate than the prime rate or CD. Transferring risks to mortgagors, the commercial bank has generated higher incomes from mortgage loans than those from other loans.

THE IMMATURE SECONDARY MORTGAGE MARKET

Although a MBS vehicle¹⁴ has become an effective instrument in the housing finance market during a very short period of time, the amount of MBS issuance has not increased substantially, due to unfavorable market conditions¹⁵. However, a MBS system has been evaluated to contribute to the advance of Korean financial markets, including the long-term bond market, and to the reduction of financial risks in the primary mortgage market.

The amount of MBS issuance is much smaller than that of Asset Backed Security (ABS) issuance. In 2002, the amount of MBS issuance was 951.5 billion won, 2.45% of the amount of ABS issuance. As of December 2003, the amount of KoMoCo's MBS issuance is 326.6 billion won.

Since the majority of MBS are composed of senior tranches, economy of MBS securitization, rather than ABS securitization, is high. For example, whereas 93.8% (2,971.0 billion won/3,168.3 billion won) of MBS issued till 2002 are senior, 82.8% of ABS are.¹⁶ A high percentage of senior bonds means lower potential risks of loss from underlying assets as losses from underlying assets are absorbed by junior tranches. The main characteristics of MBS issued from 2000 to 2003 in the Korean secondary mortgage market are illustrated in Tables 10 and 11.

Table 7 Interest Rate Types of Loans originated by Commercial Banks

(Unit: %)

	1998.3	1999.12	2000.12	2001.6
Prime Variable Rate	76.3	72.2	53.1	52.5
Market Variable Rate	9.6	14.2	33.5	34.1
Others	14.1	13.6	13.4	13.4
Total	100	100	100	100

Note: outstanding balance of eight leading commercial banks

Source: BOK

Table 8 Weighted Average Interest Rate of Commercial Banks

(Unit: %)

	2001.12	2002.12
Interest Rate of Deposit	3.98	3.97
Interest Rate of Loan	6.91(2.93)	6.65(2.68)
Interest Rate of Household Loan	7.26(3.28)	7.31(3.34)
Interest Rate of Mortgage	6.15(2.17)	6.79(2.82)

Note: figures in parenthesis represent deposit-loan spread

Source: BOK

Table 9 ABS and MBS Issuance

(Unit: Billion Won)

	1999	2000	2001	2002
ABS ¹⁾ (A)	6,770.9	48,004.4	50,096.2	38,875.9
MBS (B)	-	1,378.8	838.0	951.5
B/A*100	-	2.87%	1.67%	2.45%

Note: 1) The amount of MBS issued under the ABS Act is excluded.

Source: FSS

In the long-term bond market, MBS are recognized as being very attractive products by institutional investors. Also, in the Korean bond market, where bonds with maturity of above five years are considered long-term bonds, the issuance of MBS with a 15-year maturity has greatly influenced the formation of the long-term bond market because of most products in the bond market with the maturity of less than 5 years. A total of 59% of KoMoCo MBS are long-term securities with a maturity of more than five years, and 78% are those with a maturity of more than three years. In the

case of ABS having a structure similar to MBS, most are short-term securities. In addition, the percentage of ABS with maturity of more than five years greatly decreased from 5.6% in 1999 to 1.2% in 2002.

Nonetheless, in 2003 the amount of MBS issuance is 2.84% (951.5 billion won/ 33,491.9 billion won) of that of Korean Treasury bonds issuance and 0.4%(951.5 billion won/ 241,460.1 billion won) of Korean securities issuance. Although the creation of the MBS market could be highly

Table 10 Key Characteristics of KoMoCo MBS

		MBS'00-1	MBS'00-2	MBS'00-3	MBS'01-1	MBS'01-2
Date		4/7/'00	9/1/'00	12/8/'00	5/28/'01	9/20/'01
Amount (B won)		397.6	500.0	381.3	237.7	505.0
Underlying Assets		National Housing Fund (NHF)'s Mortgage Loans				
		82,196	103,528	58,367	15,633	44,750
Avg. Balance of Underlying Assets (M won)		4.81	4.82	6.53	15.20	11.27
Structure	Maturity	6mos – 6yrs	6mos – 7.5yrs	6mos – 10yrs	6mos – 10yrs	1yr – 14yrs
	Senior					
	Amount (B won)	369.0	479.0	368.0	228.0	500.0
	Interest Rate	8.15 – 10.04%	7.38 – 9.00%	6.82 – 8.60%	6.24 – 7.99%	4.90 – 6.92%
	Junior					
	Maturity	6 – 7yrs	8 – 9yrs	11.5yrs	12yrs	15yrs
		MBS'02-1	MBS'02-2	MBS'03-1	MBS'03-2	-
Date		1/23/'02	2/21/'02	4/2/'03	8/4/03	-
Amount (B won)		17.97	510.2	310.0	16.61	-
Underlying Assets		Samsung ¹⁾		NHF	NACF ²⁾	-
		610	44,399	27,471	578	-
Avg. Balance of Underlying Assets (M won)		29.90	11.49	11.00	29.00	-
Structure	Maturity	1yr – 7.5 yrs	6mos – 14yrs	6mos – 12yrs	3 yrs – 15yrs	-
	Senior					
	Amount (B won)	17.5	492.0	309.0	16.10	-
	Interest Rate	5.65 – 7.50%	4.86 – 7.65%	5.20 – 6.11%	5.18 – 6.03%	-
	Junior					
Maturity	15 yrs	15 yrs	16 yrs	15yrs	-	
Amount (B won)		0.47	18.20	1.00	0.01	-

Note: 1) Samsung Life Insurance Company's Mortgage Loans
2) National Agricultural Cooperative Federation's Mortgage Loans

Source: KoMoCo

Table 11 Key Characteristics of Other Financial Companies' MBS

	MBS	Senior	Underlying Assets
New Issue:	9 times ('00-'02)	Maturity: 1yr - 11yrs	Originator: New State Capital
State Capital	Amount: 166.5 B won	Int. Rate: 6.75% - 12.00%	Priority: 1st or 2nd
	Senior: 89.2% - 74.0%	Rate: AAA - BBB- (KIS)	
Woori Factoring Company	Issue: 1 time ('00) Amount: 41.0 B won Senior: 80.5%	Maturity: 5 yrs Rate: AAA (KIS)	Originator: Woori Factoring Company. Priority: 1st or 2nd
Samsung Life Ins. Co.	Issue: 1 time (2002) Amount: 410.0 B won Senior: 88.6%	Int. Rate: 3 months LIBOR + 86 bps Rate: Aaa (Moody's)	Originator: Samsung Life Insurance Company Priority: 1st or 2nd

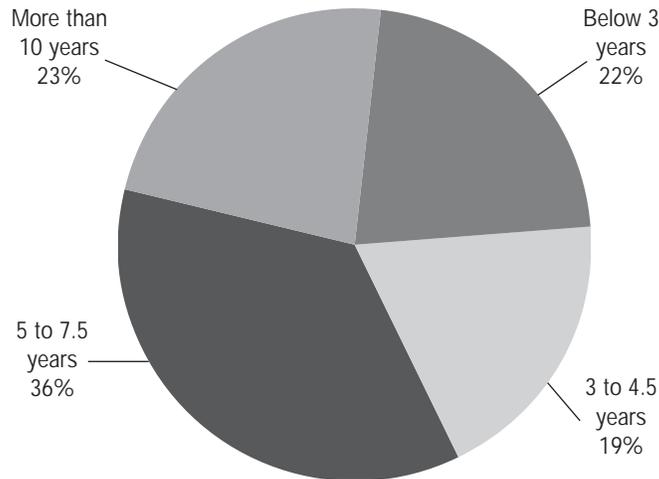
Source: Korea Investors Service, FSS, Moody's

beneficial for the Korean long-term bond market, its current market size leaves little doubt that MBS is not yet considered as one of the leading financial instruments.

The laws and regulatory framework for the housing finance market have been improved after the establishment of the MBS market. The MBS Company Act was amended to extend the payment guarantee limit to 30 times (from 20 times) equity capital in 2002. In accordance with the Tax Preference Act, lower taxation applies to interest and dividends from MBS. In addition, acquisition and registration taxes are exempted until registration after securitization of MBS. Also, interest on long-term mortgage loans of more than 10 years is tax deductible. Furthermore, 20% of the BIS weighted risk factor applies to MBS issued based on the MBS Company Act.

But, the foundation of KNMC is a stage in the take off of the housing finance market. Although the government's National Housing Fund (NHF) is the largest shareholder of KoMoCo, the sole MBS securitization company established under the MBS Company Act, it was a majority privately owned company. Government policy makers have concluded that a company owned by the government could develop and advance the entire housing finance market fast and effectively, rather than maximizing the interests of specific

Chart 2 KoMoCo's MBS Maturity Structure as of December 20, 2003



Source: KoMoCo

parties. Also, establishing a new corporation, the government would like to expand the secondary mortgage market dramatically¹⁷ and reduce financial burdens of mortgagors through low financing costs of a new entity and tax deduction on mortgage interest for prospective homebuyers. In addition, some have insisted that, via the securitization system, it may reduce the systemic risk in the housing finance market generated by the expansion of short-term mortgages with a variable rate.

ESTABLISHMENT OF KOREA NATIONAL MORTGAGE CORPORATION

The Korean secondary mortgage market is expected to go through a fundamental systemic change. To foster the secondary mortgage market as well as to reduce financial risks in the primary mortgage market, the Korean government enacted the Korea National Corporation Act¹⁸ on December 23, 2003.¹⁹

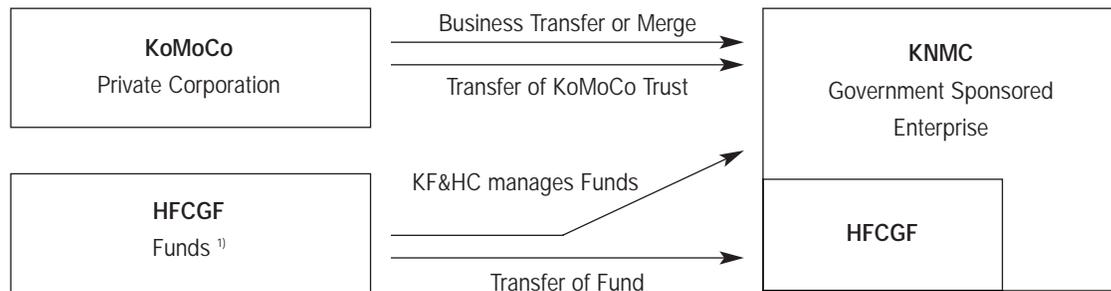
KNMC will manage HFCGF pursuant to the provisions of the Credit Guarantee Fund Act

from March 2004, and right after its establishment, it is planning to merge with an MBS company pursuant to the MBS Company Act as shown in Chart 3. The MBS business structure of the new GSE is not different from that of KoMoCo, except for the credit guarantee business in the primary mortgage market as seen in Chart 4. The Ministry of Finance and Economy

(MoFE) has handled duties related to the preparation for the establishment of the GSE²⁰ and appointed establishment committee members. The GSE has one president, one vice-president, up to four directors, two outside directors and one auditor. Also, six committee members shall include the president of a new GSE, one government officer appointed by the

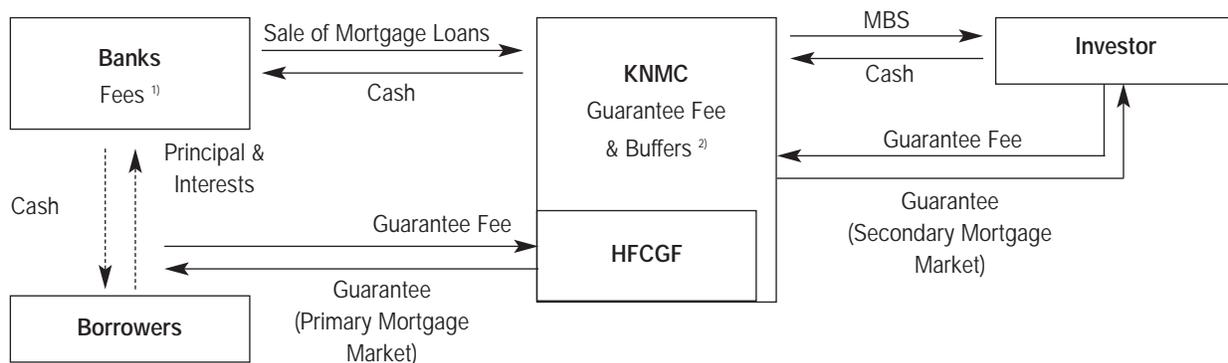
minister of MoFE, one government officer appointed by the minister of the Ministry of Construction and Transportation (MoCT), one housing finance professional entrusted by the minister of MoFE, and two professionals, each of who are recommended by the minister of MoFE and the governor of BOK and entrusted by the minister of MoFE.

Chart 3 Flow Chart for the Establishment of KNMC



Note: 1) Funds are raised through contributions made mainly by the government and approved lenders
Source: MoFE

Chart 4 The Structure of KNMC MBS



Note:
1) Origination and servicing fees. Originators become servicers after sales of mortgages.
2) Buffers are types of fees that KNMC generates.

To create a higher level of public confidence, the new GSE is chartered by the more favorable Act than the MBS Company Act. First, the government and Bank of Korea (BOK) wholly finances the capital fund of the company.²¹ Second, the account of the KNMC is kept separately from that of HFCGF. Third, losses resulting from the settlement of accounts shall be covered by the reserve amount. When the reserves are insufficient, it shall be covered by the government. Also, the policy of putting MBS on the list of RP transaction between the central bank and financial institutions is expected to be adopted soon.

KNMC is equipped with various favorable policy instruments to promote the secondary mortgage market²². First, the scope of underlying assets for MBS is broadened. A mortgage loan classified as a general loan can be securitized. Second, the 'buy and hold' business is introduced for the reduction of originators' financial

burdens. Third, the new GSE is allowed to choose the optimal time for securitization; holding mortgage loans is possible for a period of time. Fourth, the guarantee limit of the new company is expanded to 50 times of the equity capital.²³ Fifth, with respect to mortgage loans purchased by the new GSE, when attempting to register itself as the authorized holder, it is regarded as a governmental office. In addition, the transfer procedure of Keun-mortgage²⁴ is improved.

As aforementioned, the GSE's business includes credit guarantee in the primary mortgage market and SLBS issuance, a new business in Korea. HFCGF provides two main guarantee services to promote housing affordability and a decent housing environment through the effective supply of housing funds. Its main service is for individuals who obtain mortgages for a purchase, rental or renovation from approved lenders in the primary mortgage market, and the other is for house builders

and employers who take loans for the construction of a residential community.²⁵ HFCGF's guarantee services have become strictly conservative due to increased accumulated losses after the Korean financial crisis. In 2002, 78.5% of guarantees for individuals have the outstanding guarantee volume of less than 20 million won and 96.4% of guarantees for house builders have the outstanding guarantee volume of less than 5 billion won. Also, the outstanding guarantee balance for housing builders is only 18.57% of that for individuals. HFCGF has cut off risky business and has made underwriting criteria very strict. In addition, it stopped the additional issuance of guarantee certificates for homebuilders as of May 25, 2001. Performance of HFCGF after its establishment for individuals who obtain mortgages for a purchase, rental or renovation is summarized in Table 12.

Table 12 HFCGF Performance of Individual Guarantee Service

(Unit: thousand, billion won)

	Purchase			Rental			Total		
	Case (A)	Amount (B)	B/A	Case (C)	Amount (D)	D/C	Case (E)	Amount (F)	F/E
1988	25	50	1.97	1	5	5.07	26	55	2.08
1989	30	135	4.38	14	96	6.70	45	232	5.12
1990	31	288	9.20	19	136	6.90	51	425	8.31
1991	47	827	17.58	5	50	8.63	52	878	16.59
1992	62	1,215	19.30	5	42	8.44	68	1,258	18.40
1993	72	1,459	20.06	7	72	9.41	80	1,532	19.04
1994	59	1,176	19.92	17	177	9.90	76	1,354	17.59
1995	54	945	17.51	24	250	10.04	79	1,196	15.14
1996	54	995	18.21	30	314	10.45	84	1,309	15.45
1997	73	131	15.46	58	624	10.66	131	1,756	13.33
1998	201	4,413	21.85	43	447	10.20	245	4,861	19.04
1999	166	4,723	28.36	136	1,670	12.23	303	6,393	21.09
2000	185	4,845	26.19	238	3,101	13.02	423	7,947	18.78
2001	227	5,247	23.08	190	2,338	12.26	418	7,585	18.14
2002	280	7,351	32.33	170	2,657	15.54	451	10,008	22.17
Total	1,573	34,805	22.13	996	11,988	12.41	2,539	46,794	18.43

Source: HFCGF

Table 13 Trend in Interest Rates on Subsidized Student Loans

(Unit: %)

	1998	1999	2000	2001	2002
Interest Rate	11.5	10.5	10.5	10.5	9.5
Governmental Subsidy	4.75	4.75	4.75	4.75	4.75
Net Interest Rate	6.75	5.75	5.75	5.75	5.25

Source: MoE

Table 14 Market Size of Subsidized Student Loans

(Unit: Billion Won)

	1998	1999	2000	2001	2002
Balance of Newly Generated Loans	65.5	165.1	457.4	484.2	685.0

Source: MoE

In addition, KNMC is planning to issue SLBS (Student Loan Backed Securities). Student loans are divided into two separate categories in Korea: subsidized and unsubsidized. The government began to subsidize college students in 1985. The Ministry of Education and Human Resources Development (MoE) pays half of the interest on behalf of students and parents who can obtain a guarantee certificate from Seoul Guarantee Insurance Company²⁶. From 11 commercial banks, students can finance the cost of education of the maximum amount of 15 million won at a 5.25% interest rate with 4.75% interest rate subsidy from the government as seen in Table 13. As the market size has increased, as illustrated in Table 14, MoE's subsidy for students has increased. For unsubsidized loans, factoring companies lend college tuition and living expenses of the maximum amount of 5 million won per semester at 12% to 14% interest rates.

The structure of SLBS is very similar to that of MBS. By issuing SLBS, KNMC will supply students and parents with costs of education through the capital market. Nonetheless, unlike mortgage loans, student loans have no collateral and they have high credit risks. In addition, the infrastructure for and experiences of the issuance of SLBS are not well equipped for new GSE business.

CONCLUSION

The government has announced that KNMC will issue MBS in the amount of 5 to 10 trillion won (approximately \$4.16 billion to \$8.33 billion) in 2004 and 70 trillion won (approximately \$58.33 billion) until 2008. It expects that the long-term bond market will be nurtured by the increase of the amount of MBS issuance. In addition, KNMC will construct the infrastructure for the sound and stable housing finance market, such as construction of housing finance IT systems and execution of research and accumulation of industry data.

Nonetheless, there are several challenges for the successful launching and operation of a new GSE ahead. Most commercial banks with high deposit balances that generate big spreads by holding mortgage loans in their investment portfolios will not to sell mortgage loans to the secondary mortgage market through KNMC. KNMC needs to develop an IT system for integration of two different business sectors and that between KNMC and banks. In addition, it requires the early development of advanced underwriting criteria as well as servicing guidelines.

REFERENCES

- Blankenship, Jackie (2000) "Recent Trends in the Korean Housing Finance Market", Housing Finance International
- Fabozzi, Frankly and Modigliani, Franco (1999), *Mortgage & Mortgage-Backed Securities Markets*, Harvard Business School Press, 1999
- Lee, Joong-hee(2003), "Mortgage Securitization in Korea", *Housing Finance International*, pp. 23 -30
- Oh, Gytug and Park, Jae-Ha (2003), "Developing the Asian Bond markets using Securitization and Credit Guarantees", *Financial Economics Working Paper Series No. 2003-14*, Korea Institute of Finance.

NOTES

- ¹ This paper provides information beginning January 1, 2004. The company's name is not fixed officially.
- ² SEUNG-DONG YOU is working at Korea Mortgage Corporation. Email: peter@securitization.co.kr
- ³ The Korea National Mortgage Corporation Act was enacted on December 23, 2003.

- ⁴ The Korean government introduced a public guarantee system in accordance with the provisions of the Workers' Residential Life Stabilization and Worker's Asset Formation Act (WRLS Act) in 1998.
- ⁵ Since the late 1990's, credit loan salespersons have distributed mortgage-advertising leaflets on the street.
- ⁶ Except 1998, the year right after the financial crisis, the average annual growth rate of housing price index increased to 2.26% from 1991 to 2002.
- ⁷ Based on 2000 Population and Housing Census, 3,085,936 households among 14,311,807 households in Korea are in Seoul.
- ⁸ Chonseil has been a major form of housing tenure in Korea, accounting for about 37% of the housing stock. Chonseil contracts generally require an up-front deposit amounting approximately to 50% of the house price. Landlords benefited during prosperous times by investing the deposits that generated a good return. Renters also benefited by not having to make monthly payments for the duration of the contract (Blankenship, 2000).
- ⁹ It differs from provinces.
- ¹⁰ The mismatch problem has existed in the United State during most of the postwar period, because mortgages – very long-term assets – have been financed by institutions that obtained their funds primarily, if not entirely, through deposits of a short-term nature. These institutions were engaging in the highly speculative activity of borrowing short and lending very long (Fabozzi and Modigliani, 1999, p.99).
- ¹¹ The Korea Housing Bank (KHB) was initially set up by the government in 1967 to provide a stable source of funds for housing. KHB was privatized under the new name of Housing & Commercial Bank (H&CB). In November 2001, H&CB and Kookmin Bank (the largest consumer bank in Korea) merged to create the new Kookmin Bank (Blankenship, 2000).
- ¹² As of October 14, 2002. Kookmin Bank's spread between the 1-year term variable rate mortgages and 3-month term variable rate mortgages was 188 bps., and Woori Bank's spread was 92 bps.
- ¹³ Based on a survey conducted on September 2003, 82.3% respondents prefer fixed rate mortgages with more than 10 years of maturity.
- ¹⁴ There are two laws that govern mortgage securitization in Korea: The Asset-Backed Securitization Act (ABS Act), and the Mortgage-Backed Securitization Company Act (MBS Company Act). Whereas the ABS Act was established in September 1998 to promote the restructuring of firms and financial companies, the MBS company Act was enacted in January 1999 under the judgments that mortgage loans could be more effectively securitized by a reliable permanent entity rather than by a SPV with a limited life. Lee (2003)
- ¹⁵ Lee (2003) studies in depth issues for promoting mortgage securitization.
- ¹⁶ Whereas 96.2% of KoMoCo MBS are seniors, 83.7% of MBS issued by other companies are seniors.
- ¹⁷ Announcing the establishment of a KNMC, the MoFE (Ministry of Finance and Economy) announced a plan that around 50% of mortgage loans would be securitized,
- ¹⁸ The KNMC Act states that the mission of KNMC is to contribute to the development of the national economy and to promote the housing welfare through the long-term and stable supply of housing funds through securitizations such as mortgage-backed securities and credit guarantee business.
- ¹⁹ A new GSE model after Canadian Mortgage and Housing Corporation (CMHC), a company that plays important roles in both primary and secondary mortgage markets, including consulting and research on the housing finance market in Canada. CMHC began its credit guarantee business in the primary mortgage market in 1954 and launched the MBS payment guarantee business in the secondary mortgage market in 1987.
- ²⁰ The MoCT is consulted with respect to the formulation of the establishment committee.
- ²¹ Although legal capital funds shall amount to two trillion won, the initial paid-in capital is expected to be 450 billion won.
- ²² Most policy proposals made by Lee (2003) are adopted to the new GSE Act.
- ²³ The guarantee limit of the MBS Company is 30 times the equity capital
- ²⁴ The Keun mortgage, which is widely used in Korea, is the mortgage that serves, up to a predetermined amount, as a collateral for several uncompleted obligations that will be created and extinguished in the course of continuous transactions and whose remaining balance will be fixed at the settlement of accounts (Lee, 2003)
- ²⁵ Guarantee fee rates for individual home ownership, rental or renovation loans are 0.4% ~ 0.9% per annum and those for loans for housing builders and employers are 0.5% ~ 1.0% per annum.
- ²⁶ Merger of Korea Fidelity & Surety Company, established in 1969 and Hankuk Fidelity & Surety Company, established in 1989