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KOREA: CAPITAL & REGULATION · JAPAN & KOREA ALLOCATOR INTELLIGENCE #004

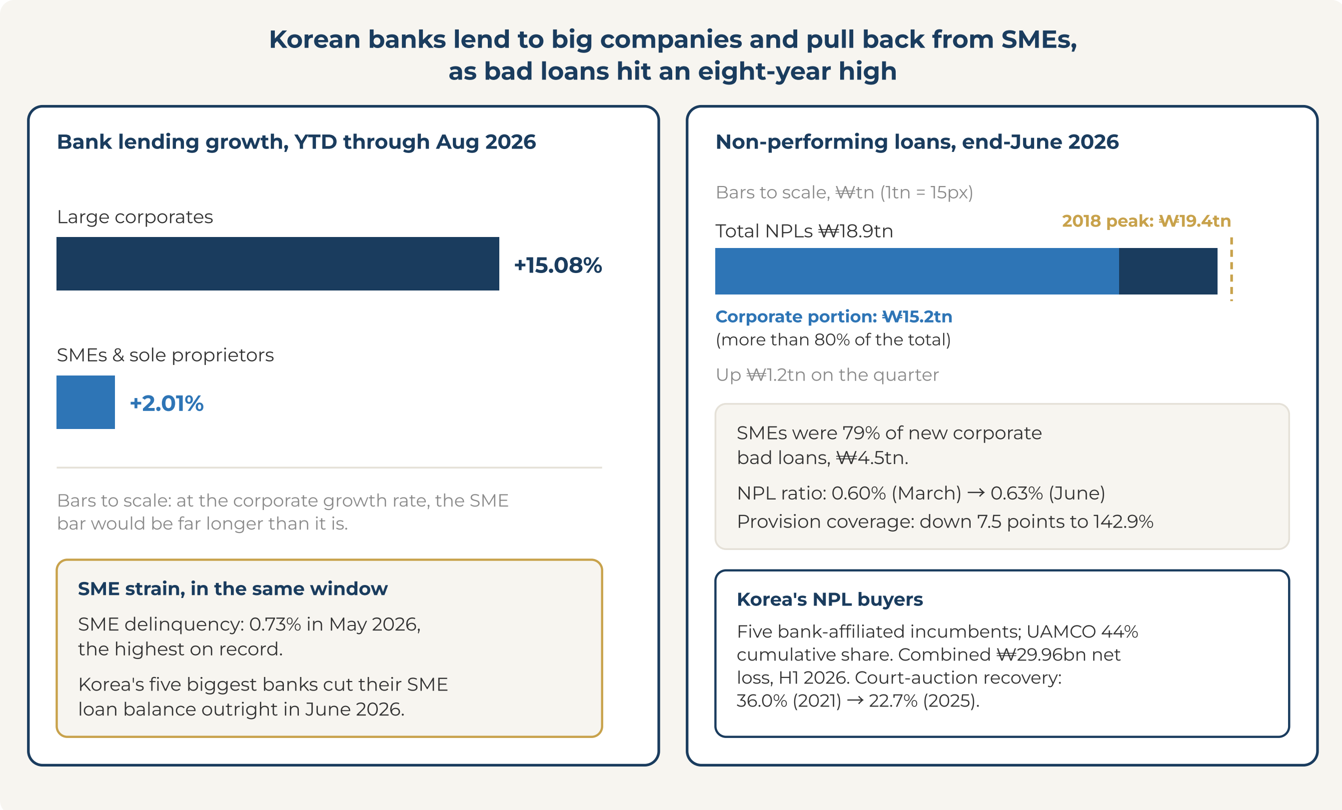
Korea's Bank NPLs Hit an Eight-Year High — a Real SME Lending Gap Opens

Korean banks are retreating from SME lending because it no longer pays them, not because a rival lender undercut them. That is a supply gap, and the one Korean story this week that is a direct-lending opportunity rather than a constraint.

Korean banks' non-performing loans (NPLs) hit ₩18.9tn at end-June 2026, the most since ₩19.4tn at end-June 2018, up ₩1.2tn on the quarter; the ratio rose to 0.63% from 0.60%. Corporate credit drove it: ₩15.2tn of the total, more than 80%. Within that, small and mid-sized enterprises (SMEs) accounted for 79% of new corporate bad loans, ₩4.5tn, and SME corporations deteriorated faster (1.08% NPL ratio) than sole proprietors (0.67%). Loan-loss provision coverage fell 7.5 percentage points to 142.9% even as the provision balance grew — banks are recognising problems faster than they can reserve against them.

This is a real credit contraction, not relabelling. Korea's five biggest banks cut their SME loan balance outright in June 2026, the first drop in six months, while large-corporate lending grew for a sixth straight month. Through August the gap widened: large-corporate loans up 15.08% year-to-date, SME-and-sole-proprietor loans up 2.01%. Banks attribute the shift to a weak domestic economy and asset-quality discipline, not a one-off slump; SME delinquency hit 0.73% in May 2026, a record.

On the ratio measure, 0.63% just exceeded the 0.60% hit in March, itself a five-year high. That reads as acceleration, not noise. It is still a normalisation from an unusually low base, not yet a crisis on the scale of Korea's post-Asian-crisis credit cycles.



Large-corporate lending is up 15.08% year-to-date through August 2026; SME and sole-proprietor lending is up only 2.01%. Total bank NPLs hit ₩18.9tn at end-June 2026 — the most since ₩19.4tn at end-June 2018 — with SMEs driving most of the new corporate bad loans, and Korea's dominant NPL buyers themselves losing money on what they already hold.

Korea's domestic secondary NPL market, where banks sell soured loans, is dominated by five bank-affiliated incumbents, led by UAMCO at 44% cumulative share. Those incumbents are themselves loss-making: a combined ₩29.96bn net loss in H1 2026, as court-auction recovery rates fell from 36.0% in 2021 to 22.7% in 2025. One precedent exists for a foreign entrant. SC Lowy secured an ADIA-backed Korea real-estate private-credit mandate in 2024, though this week's opening is corporate and SME credit, not real estate.

Market Entry Implication: In Japan a rising domestic yield raises the bar for offshore credit. Korea's story is different: a supply gap. Banks are pulling back from a segment they can no longer serve profitably, not competing with it on price. The pitch that wins is framed against this specific 2018–2026 Korean corporate cycle, not a generic global direct-lending story. It needs an honest answer to "who else is already here": five domestic, currently unprofitable specialists, not foreign direct lenders.

Which GPs Have Opportunities:

GP profile	Why this fits	What they'd need
Asia-dedicated direct-lending platforms already raising for the region	Korea SME/mid-corporate direct lending is a natural adjacent sleeve for existing Asia underwriting infrastructure	A Korea-specific origination team or local partner, and a loss-history narrative built on this exact cycle, not a generic pitch

GP profile	Why this fits	What they'd need
Special-situations / distressed-for-control managers with real restructuring capability	The opening is concentrated in SME corporations specifically — a workout problem, not plain-vanilla lending — and incumbent buyers are currently loss-making	Korean insolvency-process capability and patience for the recovery-period problem currently hurting incumbents
Real-estate-adjacent private credit managers	SC Lowy's ADIA-backed strategy is a visible precedent for foreign LPs and GPs getting comfortable with Korea-specific private credit	Explicit positioning as corporate cash-flow-based underwriting, not collateral-based, to avoid being mistaken for a real-estate play

Sources: note 6.

Sources

[6] Korea's Bank NPLs Hit an Eight-Year High — a Real SME Lending Gap Opens.
- Korea bank bad loans hit ₩18.9tn, an eight-year high on corporate credit — Businesskorea
- Korean bank bad loans hit 18.9 trillion won, highest in 8 years — Seoul Economic Daily

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