



Press Release

December 14, 2015

POLICY DIRECTION FOR HOUSEHOLD DEBT MANAGEMENT

The FSC announced its policy direction for household debt management and a guideline to encourage banks to strengthen their mortgage application screening so that borrowers take out loans within their repayment ability and repay in installments from the beginning.

HOUSEHOLD DEBT GROWTH & POLICY DIRECTION

Korea's household debt grows fast to amount to KRW 1,166 trillion at the end of September 2015.¹ The rapid growth is attributable to a combination of several factors such as growing demand for loans amid low interest rates, eased restriction on lending for home buyers and housing market recovery.

The increase is mainly from mortgage lending by banks,² which is at lower interest rates and maintains soundness. In particular, group lending for apartment buyers has largely increased as markets for new apartments for sale and reconstruction recover.

(unit: trillion won)	2011	2012	2013	2014	Sept. 2015
group lending	102.4	104.0	100.6	101.5	104.6
intermediate payments	25.4	27.2	29.4	32.5	41.6
moving expenses	7.1	8.7	9.1	8.8	12.2

Since the government-backed program to improve mortgage debt structure was launched in March this year, shares of amortized and fixed-rate mortgages rose to 37.5% and 33.6% respectively out of the total mortgage lending by banks at the end of September 2015, compared to 6.4% and 0.5% at the end of 2010.

※ EVALUATION OF KOREA'S HOUSEHOLD DEBT BY OVERSEAS INSTITUTIONS

- ▷ The IMF said in February 2015 that "we do not see [Korea's household] debt levels as a near term threat to the macroeconomy....The structure of household debt could also be strengthened."
- ▷ Moody's noted in April 2015 that "the [Korean] government is proceeding with measures to reduce risks from the preponderance of variable rate, non-amortizing mortgages" and evaluated such measures are credit positive.

¹ Growth rate in household credit(% , yoy, BOK): 9.3% (average from 2005 to 2010), 8.7% (2011), 5.2% (2012), 5.7% (2013), 6.5% (2014), 10.4%(end-Sept. 2015)

² Increase in mortgage lending by banks(unit: trillion won): 21.2(2012), 21.4(2013), 36.7(2014), 64.0(Nov.2015)

As household debt grows faster than household income, the government is taking comprehensive measures to 1) increase household income to boost borrowers' repayment ability, 2) improve household debt structure; and 3) support low-income households. It is all the more important to improve structural soundness of household debt in response to potential risks such as the U.S. interest rate hikes.

Household debt management policy also requires a balanced approach which takes into account various factors such as private consumption, housing market conditions and regulatory effects on the real economy. Therefore, the government is working towards minimizing potential risks in household debt, consistently upholding the principle that household debt should be borrowed *within the borrower's repayment ability and paid back in installments from the beginning.*

「GUIDELINE ON BANKS' MORTGAGE LOAN SCREENING」 BY KFB³

The guideline is intended to encourage banks to establish a reinforced screening system that can more accurately assess and preemptively manage borrowers' credit risk.

▶ KEY POINTS

1. Use of more objective income references

Banks will use more objective references⁴ to figure out a borrower's income in order to more accurately assess the borrower's repayment ability.

2. More handlings of fully-amortized loans

Banks will recommend fully-amortized loans to borrowers seeking to take out large amount loans⁵ so that borrowers can repay their principal and interests from the beginning, which will prevent borrowers from facing excessive repayment burden at maturity.

3. Application of 'stress rate'

When newly lending floating-rate mortgages, banks will apply 'stress rate'⁶ in calculating the amount of loans that borrowers can afford in case of interest rate hikes in the future. If DTI exceeds 80% given the stress rate, banks will recommend fixed-rate loans or reduce the loan amount to lower DTI below 80%.

³ Please contact the Korea Federation of Banks(KFB) for further details about the Guideline

⁴ ① verifiable income(e.g. receipt of withholding tax, certificate of income amount, etc.), ② recognized income (e.g. national pension contribution, health insurance premium), ③ reported income(e.g. credit card expenditure, sales, lease income, etc.)

⁵ a) loans for first-time home buyers, b) loans with LTV or DTI exceeding 60%, c) in case the borrower has more than three collaterals held for mortgage

⁶ (The highest rate on household lending among weighted average interest rates during the past five years) – (weighted average of household loan interest rates released in November every year). ※ **2.7% stress rate applied as of December, 2015**

4. Introduction of Debt Service Ratio(DSR)

DSR will be introduced to comprehensively assess a borrower's debt servicing burden not only for a mortgage but also for other debts. If a borrower's DSR exceeds a certain level set by banks, the borrower will be under more stringent monitoring by banks to prevent default risk.

COMPARISON BETWEEN DTI AND DSR

DTI	DSR
$\frac{[(\text{principal and interest payments for a mortgage}) + (\text{interest payments for other debts})]}{[\text{annual income}]}$	$\frac{[(\text{repayment of principal and interests for a mortgage}) + (\text{principal and interest payments for other debts})]}{[\text{annual income}]}$

▶ EXCEPTIONS FOR IMPLEMENTATION

There are a few exceptions for implementing of the guideline to ensure the tighter standards should not excessively restrict household lending.

1. Group lending for apartment buyers will be exempted from the application of the guideline. It is difficult to uniformly apply the same standards as applied to general mortgages, given their different lending structure and the impact on pre-sale market for apartments.
2. The guideline will only be applied to newly extended mortgages after the guideline takes effect.
3. Among newly extended mortgages, exceptions will be permitted for small loans less than KRW 30 million or for loans for necessary expenses for a living such as medical or education expenses.

▶ IMPLEMENTATION SCHEDULE

The guideline will take into force from February 1, 2016 in Seoul and its metropolitan area, while it will be implemented from May 2, 2016 in provincial areas.

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