



# DEBT SERVICE RATIO (DSR) TO BE INTRODUCED AS HOUSEHOLD DEBT MANAGEMENT STANDARD

## **BACKGROUND**

Korea's household debt growth has slowed down in recent years.<sup>1</sup> It is unlikely that household debt would pose a systemic risk to the Korean economy in the near future; however, the government needs to stay alert from a longer-term perspective. The sheer size of household debt would continue to grow, and its growth pace still remains high. In the mid-to-long term, the government aims to keep household debt growth rate at a level close to nominal GDP growth rate. The FSC expects the introduction of debt service ratio (DSR) rules in conjunction with other lending standards will help reduce household indebtedness and curb rapid growth of household debt.

## **DEBT SERVICE RATIO (DSR) RULES**

The DSR was introduced on a trial basis first with banks last March and subsequently across the financial sector.<sup>2</sup> Based on the test operation with banks for the past six months, DSR rules will be officially introduced as standards for banks to manage their household loans starting from October 31, 2018.

Banks will be required to **manage “high-risk” loans below a certain percentage of their total loans**. To define high-risk loans, the FSC set **two-tier DSR standards**: loans with a DSR exceeding 70% will be considered as “risky”; and those with a DSR of 90% or above as “highly risky.” Currently, commercial banks are better positioned than local banks and specialized banks to cut back on the proportion of high DSR loans. Loans with a DSR exceeding 100% take up 14.3% of total loans in commercial banks, compared to 30.1% in local banks and 27.9% in specialized banks. The average of DSR is also different: 52% with commercial banks, 123% with local banks, and 128% with specialized banks. Considering the gaps in compliance burden, **different levels of targets will apply**:

- ▶ **Commercial banks** will be required to manage the proportion of loans with a DSR exceeding 70% (hereinafter ‘risky loans’) below 15%; and those with a DSR exceeding 90% (hereinafter ‘highly risky loans’) below 10% of total loans.

<sup>1</sup> Household credit growth rate (% , Bank of Korea): 10.9%('15), 11.6%('16), 8.1%('17), 7.6%('18)

<sup>2</sup> mutual finance institutions in July, insurers in September, and savings banks & specialized credit business in October

- ▶ **Local banks** will be required to keep the percentage of ‘risky’ and ‘highly risky’ loans below 30% and 25% respectively.
- ▶ **Specialized banks** will be required to meet a target of 25% for ‘risky’ loans and 20% for ‘highly risky’ loans.

Banks will also have to meet **targets for the average of DSR by the end of 2021: 40% for commercial banks, 80% for local banks, and below 80% for specialized banks.**

| TARGETS<br>OF DSR RULES  | percentage of<br>“risky” loans<br>(70% DSR or above) | percentage of “highly<br>risky” loans<br>(90% DSR or above) | average of DSR<br>by 2021 |
|--------------------------|--|---|---------------------------|
| <b>Commercial banks</b>  | 15%  | 10%   | 40%                       |
| <b>Local banks</b>       | 30%  | 25%   | 80%                       |
| <b>Specialized banks</b> | 25%  | 20%   | below 80%                 |

DSR rules will **apply to new loans starting from October 31, 2018**. Government-backed loans for low-income borrowers – e.g. microloans, small credit loans – will be exempted from DSR rules in order to protect them from tighter credit conditions.

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