Financial Services Commission

Press Release

October 26, 2021

GOVERNMENT UNVEILS ADDITIONAL MEASURES FOR HOUSEHOLD DEBT MANAGEMENT

The government announced additional measures to strengthen household debt management at the 47th Meeting of Central Economic Response Headquarters held on October 26. The measures are aimed at preemptively managing household debt-related risks and resolving financial imbalances while ensuring the availability of loans to individuals in actual need. Some of the key measures include improving the effectiveness of DSR rules applied on individual borrowers, strengthening targeted management in the nonbank sector and promoting more installment payments on both housing and personal credit-based loans. These are supplementary measures to the initial household debt management plan announced on April 29, 2021.[1]

BACKGROUND

(RECENT TRENDS) The household debt growth has shown a downward trend in recent years after reaching an 11.6 percent growth in 2016. However, it has spiked up again in 2020 due to the pandemic-related policies and rise in asset prices.[2] For this year, the government had previously set the goal of containing the growth of household debt to five to six percent as it sought to control debt levels while continuing to make financing available for first time homebuyers, renters, etc. Along this line, the government introduced the measures to curb credit-based loans[3] and expand the application of the debt service ratio (DSR) rules on individual borrowers in April this year. At the same time, the loan-to-value (LTV) ratio has been eased with the support for rent deposit (including jeonse) made available for young adults, newly married couples, etc.[4]

However, household debt levels spiked in the first half of this year due to instability in the housing market and resurgence in the coronavirus infection cases. The growth in credit loans and personal mortgages that led the surge in total debt levels at the end of 2020 stabilized. But loans for rent deposits, collective lending and government-backed housing mortgages all continued to rise with a spillover effect into the nonbank sector. The growth trend has slowed down somewhat in September this year as the authorities strengthened their guidance from after July and the Bank of Korea raised its base rate in August. However, the downward pressure on household

[1] Please click here to see the press release dated April 29, 2021.
[2] Household debt growth (y-o-y): 11.6% (2016), 8.1% (2017), 5.9% (2018), 4.1% (2019), 7.9% (2020), 10.3% (Q2 2021)
[3] Please click here to see the press release dated November 13, 2020.
[4] Please click here to see the press release dated May 31, 2021.
Jeonse: A lump sum payment for housing deposit with no monthly rent usually for a two-year contract

debt continues to exist in the fourth quarter of this year amid the fall moving season and with rises in housing sales and rental prices.

(ISSUES FOR CONSIDERATION) The household debt to GDP as well as the pace of its increase has grown to an alarming level, which poses the biggest potential risk to the Korean economy. There are three issues to consider. First, in 2020, the household debt to GDP ratio has exceeded one hundred percent, which limits the creation of aggregate demand and has the potential to harm macroprudential soundness when asset prices enter adjustment. Second, the growth pace of household debt to GDP ratio is faster in Korea than in other major economies. Left unattended, this pace of growth may lead to deepening financial imbalances in Korea with worsening credit standing abroad. Third, when interest rates rise in the future, the payment burden may be overwhelming especially on vulnerable debtors with multiple debts. As such, in the event of an external shock, such as an abrupt economic downturn or asset price adjustment, borrowers may experience economic difficulties due to their exposure to the spike in household debt. Maintaining strong efforts to control household debt is necessary to minimize potential harm to borrowers in crisis situations.

Household debt stands at a manageable level at present. However, the need for early action is growing to preempt financial risks associated with asset price hikes. It is now time for preemptive and strong response through application of timely and appropriate measures to bolster management of household debt. Against this backdrop, the financial authorities have prepared the following measures for strengthening household debt management.

OVERVIEW

I. Preemptively and effectively manage household debt-related risks to establish lending practice based on a borrower's repayment capabilities ("Three Tasks")
- Improve the effectiveness of the DSR rules
- Strengthen targeted management in the nonbank sector
- Improve the qualitative soundness of household debt structure by expanding installment payment requirements

II. Pursue a more systematic and consistent household debt management scheme and work to minimize negative impact on lower income and other vulnerable groups ("Two Groundworks")
- Strengthen risk management and establish a culture of responsible lending through financial institutions' own internal household debt management programs
- Draw up various measures to minimize the impact of credit shortfall on lower income earners and other vulnerable groups

III. Establish an alternative plan (Plan B) for managing the level of household debt growth if the upward trend persists in the future ("Plan B")
- Announce the possibility of adopting stronger measures as a way to boost the predictability

<u>KEY DETAILS: "THREE TASKS" ON HOUSEHOLD DEBT MANAGEMENT</u>

I. PROMOTE AND ESTABLISH LENDING PRACTICE BASED ON A BORROWER'S REPAYMENT CAPABILITY BY IMPROVING EFFECTIVENESS OF DSR RULES

- **MOVE UP DSR IMPLEMENTATION SCHEDULE ON INDIVIDUAL BORROWERS:** The second and third phases of the previously announced DSR rules on individual borrowers will be implemented early from January 2022 as shown in the table below. The original implementation schedule for the second and third phases was from July 2022 and July 2023, respectively, under the initial plan that was announced in April 2021. *(From Jan 2022)*

<Plan for Gradual Expansion of DSR Rules on Individual Borrowers>

<table>
<tr><th></th><th>Before July 2021</th><th>1st phase
(Currently in place)</th><th>2nd phase
(Implementation schedule moved up from July 2022 to January 2022)</th><th>3rd phase
(Implementation schedule moved up from July 2023 to July 2022)</th></tr>
<tr><td>Home mortgages</td><td>Houses in 'speculative' or 'overheated speculative' areas with property value of KRW900 mil. or more</td><td>(a) Houses priced over KRW600 million in all regulated areas</td><td rowspan="2">- Total borrowed amount over KRW200 million

- Maintain rules (a)+(b)</td><td rowspan="2">- Total borrowed amount over KRW100 million

- Discontinue rules (a)+(b)</td></tr>
<tr><td>Credit loans</td><td>Annual income exceeding KRW80 mil. & KRW100 mil.</td><td>(b) Over KRW100 million</td></tr>
<tr><td>Application</td><td>8.8% of newly issued home mortgages</td><td>12.4% of newly issued home mortgages</td><td>13.2% of all borrowers
51.8% of all loans</td><td>29.8% of all borrowers
77.2% of all loans</td></tr>
</table>

- **STRENGTHEN DSR RULES IN NONBANK SECTOR:** The current level of DSR applied on individual borrowers (60%) in the nonbank sector will be lowered to 50 percent with the average institution-level DSRs also being adjusted to strengthen control in particular sectors with high levels of growth in lending. *(From Jan 2022)*

<Application of Adjusted Average DSR Rules in Nonbank Sectors>

Average DSR	Bank	Insurance	Mutual Finance	Credit card	Capital	Savings bank
Current DSR rule	40%	70%	160%	60%	90%	90%
Current DSR level	38.3%	51.9%	124.6%	55.7%	70.5%	71.5%
Adjusted DSR rule	40%	50%	110%	50%	65%	65%

- **APPLY STRICT RULES ON DSR CALCULATION:** For the purpose of calculating DSR, the current application of maximum loan maturity will be changed to the application of average loan maturity, which will reflect more realistic standards. *(From Jan 2022)*

II. STRENGTHEN TARGETED MANAGEMENT IN THE NONBANK SECTOR

- **ADJUST RULES ON LTD RATIO IN MUTUAL FINANCE SECTOR:** The household debt growth in the mutual finance sector has been expanding recently among borrowers who maintain a quasi-member (nonmember) status. For the purpose of calculating a mutual finance company's loan-to-deposit (LTD) ratio, loans issued to quasi-members and nonmembers will be weighted more heavily than loans issued to members. *(From Jul 2022)*

- **IMPROVE RULES IN CREDIT CARD SECTOR:** Credit card loans issued by specialized credit finance companies are currently not calculated toward the DSR of individual borrowers. As such, credit card loans will also be included in DSR calculation. In addition, a best practice guideline will be drawn up to more effectively control the issue of delinquency and prevent excessive borrowing by delinquent debtors. *(From Jan 2022)*

III. IMPROVE THE QUALITATIVE SOUNDNESS OF HOUSEHOLD DEBT STRUCTURE

- **REVISE UP TARGETS FOR HOME MORTGAGE INSTALLMENT PAYMENTS:** The proportion of installment payments on home mortgage loans in Korea remains lower compared to other major economies,[5] largely due to jeonse loans and credit loans. As such, the authorities will seek to revise up targets for total home mortgage installment payments and newly create goals for individual home mortgage installment payments. *(From Jan 2022)*

- **PROVIDE INCENTIVES TO PROMOTE MORE INSTALLMENT PAYMENTS ON JEONSE LOANS:** Financial institutions will be given an incentive to promote more installment payments on jeonse loans from borrowers. Financial institutions with an outstanding record in receiving installment payments on jeonse loans will be given a preference when allocating government-sponsored mortgage products. *(From Jan 2022)*

- **CONTINUE TO ENCOURAGE INSTALLMENT PAYMENTS ON CREDIT LOANS:** For DSR calculation, the real maturity on a credit loan will be applied when debt is being paid back in installment to encourage the use of installment payment on credit loans. *(From Jan 2022)*

KEY DETAILS: "TWO GROUNDWORKS" ON HOUSEHOLD DEBT MANAGEMENT

I. BOLSTER FINANCIAL INSTITUTIONS' OWN HOUSEHOLD DEBT MANAGEMENT SCHEME

- **IMPROVE MANAGEMENT OF ANNUAL PLANS FILED BY FINANCIAL INSTITUTIONS:** At the beginning of every year, financial institutions submit their yearly plan for household loans to the authority. When submitting their annual plan, financial institutions will be required to report to CEOs and relevant boards about their plan and ensure that the supply plan reflects a proportional distribution throughout the year. *(From Nov 2021)*

[5] Korea (52.6%), UK (92.1%), Germany (89.0%), Canada (89.1%), Netherlands (81.3%), Belgium (93.6%)

- **ENSURE APPLICATION OF SUITABILITY AND ADEQUACY PRINCIPLES UNDER THE FINANCIAL CONSUMER PROTECTION ACT:** With the implementation of the Financial Consumer Protection Act from March 2021, financial institutions are required to check borrower's financial status, credit background, repayment capability, etc. As such, the application of suitability and adequacy principles will be closely monitored with the possibility of imposing a fine for violating the rules. *(From Jan 2022)*

- **ENHANCE INSPECTION ON VARIOUS HOME MORTGAGE LOAN AND OTHER RELEVANT RULES:** The authorities will continue to conduct biannual inspection on financial institutions to check compliance with various home mortgage loan and other related rules. *(Biannually)*

II. DRAW UP MEASURES TO MINIMIZE IMPACT OF CREDIT SHORTFALL ON LOWER INCOME AND OTHER VULNERABLE GROUPS

- **ENSURE SUPPLY OF JEONSE LOANS IN Q4 2021:** The authorities have already announced their plans to exclude jeonse loans issued in the fourth quarter of this year from the total household debt management goal for this year.[6] Credit evaluation for jeonse loans will be strengthened to make sure that the supply of jeonse loans is targeted at lower income groups and those with an urgent need. For instance, when renewing a jeonse contract, the amount of jeonse loan allowed will be determined by the increased amount for jeonse deposit, and homeowners will be restricted from applying for jeonse loans via contactless channels. *(Q4 2021)*

- **WORK FOR UNINTERRUPTED SUPPLY OF COLLECTIVE LENDING TO PROSPECTIVE HOMEOWNERS IN Q4 2021:** The authorities have already announced the plan to ensure the availability of loans for prospective homeowners who are scheduled to move into new homes in the fourth quarter and are required to make balance payments. The lenders will strengthen loan application review to ensure that the newly issued loans to prospective homeowners are not in excess of the amount they actually need. *(Q4 2021)*

- **PERMIT EXEMPTIONS ON STRICT LENDING RULES:** The authorities will allow exceptional cases where borrowers can take out personal credit-based loans in excess of one's annual income level. The exceptional cases will include having a wedding, funeral, surgery, etc. *(From Nov 2021)*

- **EXPAND SUPPLY OF MID-RANGE INTEREST RATE LOANS AND MICROLOAN OPPORTUNITIES:** The authorities will continue to expand the supply of mid-range interest rate loans to those with mid-to-low credit standings and increase the availability of microloan opportunities for lower income groups. *(Ongoing)*

KEY DETAILS: ALTERNATIVE PLAN ("PLAN B") IF RISKS PERSIST IN THE FUTURE

The authorities may introduce following measures in the case that the household debt growth continues to pose risks in the future despite implementation of the

[6] Please click here to see the press release dated October 14, 2021.

supplemental measures.

I. FURTHER STRENGTHENING OF DSR RULES: The authorities may introduce additional adjustments on financial institutions' average DSR, high DSR, individual borrower level DSR while lowering the maximum loan amount for which the individual borrower level DSR rule begins to apply.

II. MANAGING JEONSE LOAN GROWTH: The authorities may begin to (a) take into account jeonse loan principal when calculating DSR if a jeonse loan borrower attempts to apply for an additional loan, (b) require proof of repayment capability, such as income, when calculating maximum guarantee for jeonse loan and (c) lower guarantee coverage for jeonse loans.

III. STRESS DTI AND STRESS DSR: The authorities may apply more stringent rules on stress DTI ratios and introduce stress DSR rules to control lending limits and encourage more fixed rate loans as a way to help absorb shocks from eventual interest rate hikes in the future.

HOUSEHOLD DEBT GROWTH MANAGEMENT TARGET FOR 2022

The government's household debt management plan for 2022 will be aimed at a gradual normalization back to the pre-pandemic level. In 2020, the difference (the "gap") between the household debt growth rate (7.95%) and the nominal GDP growth rate (0.45%) was largest ever (7.5%p). The authorities plan to gradually reduce this "gap" in 2021-2022 with a goal of scaling back the pandemic-era average "gap" to a pre-pandemic average level.

Through seamless implementation of the household debt management measures, the government will work to contain the growth of household debt to 4 to 5 percent in 2022. Based on developments in the real economy, changes in asset markets and trends in financial markets, the authorities will continue to fine-tune the management target and work to minimize impact and inconvenience for those in actual need.

The supplemental measures announced today to control the growth of household debt are aimed at promoting a more systematic and consistent management. In this regard, the authorities along with the industry groups will begin to operate a joint taskforce on household debt management from November this year, which will support the implementation of specific measures and come up with necessary improvements.

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