Financial Services Commission

Press Release

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FOR IMMEDIATE RELEASE

COMPREHENSIVE MEASURES FOR HOUSEHOLD DEBT MANAGEMENT

The government announced a comprehensive scheme to manage household debt in an effort to reduce financial risks in the short-term; and strengthen macroeconomic soundness, boost household income and repayment ability in the mid-to-long term.

I. BACKGROUND: ASSESSMENT OF THE CURRENT CONDITION

South Korea's household debt is unlikely to cause a systemic risk:

- Household debt repayment ability is sufficient enough to keep default risks limited.
  - ✓ Households' net assets continue to increase as their property assets grow with mortgages
  - ✓ The top 20 % of income earners owns 70% of household debt.

- The soundness of household debt has improved as the proportion of fixed-rate and amortized loans increased.

- Financial institutions have sufficient capacity to absorb unexpected losses, if any.
  - ✓ Delinquency rates on household loans are kept low.
  - ✓ Banks' BIS ratio is 15.4% as of end-June 2017, exceeding the BIS requirement of 9.125%.

- The pace of household debt growth began to slow as tighter screening standards for household loan applications apply across all the financial sectors.

- The OECD and credit rating agency S&P also evaluated that South Korea's household debt is unlikely to pose a systemic risk, citing improvement in the quality of household debt with a growing share of fixed-rate and amortizing mortgages out of total household loans.

However, some groups of borrowers, particularly whose debt repayment ability is highly limited, remain vulnerable to possible rate hikes.

Based on the assessment, the government came up with comprehensive measures to (i) better protect those vulnerable households with tailored and targeted policy responses, and (ii) curb the fast growth of household debt from a macroeconomic perspective.

II. KEY POLICY MEASURES

<u>POLICY REPSONESE TAILORED FOR CHARACTERISTICS OF BORROWERS</u>

The government will provide tailored assistance for each grouping of borrowers according to their debt repayment capability.

- **(Group A) Borrowers with sufficient debt repayment ability**
  - Policy focus will be on boosting household income and managing financial soundness

- **(Group B) Borrowers who pay their debt on schedule but feel financially distressed**
  - Policy responses will be focused on preventing delinquencies by restructuring their debt in a pre-emptive manner, reducing their debt repayment burden, and providing government-backed micro loans.

- **(Group C) Borrowers who are delinquent on their loans**
  - The government will reduce their extra burden of overdue interest and support their recovery of credit ratings.

- **(Group D) Borrowers with no repayment ability**
  - Policy focus will be on writing off small and long-overdue debt and assisting borrowers to file for personal rehabilitation or bankruptcy

  ※ *Debt relief will be provided based on a thorough review of borrowers' repayment ability to prevent moral hazard.*

MACROECONOMIC RISK MANAGEMENT

The government will properly manage risks in terms of total volume of household debt to prevent the debt growth from hampering consumption and economic growth.

- **'Soft landing' for household debt growth**
  - The government will manage household debt growth rate over the next five years below an average of 8.2 for the past 10 years; and continue to increase the proportion of fixed-rate, amortizing loans in banks' mortgages[1], to improve the soundness of household debt structure.

- **Adjustment to calculation of debt-to-income (DTI) ratio**
  - The government will amend the way banks calculate a borrower's debt-to-income(DTI) to more accurately evaluate the borrower's debt repayment ability.
  - For borrowers who have multiple mortgages, banks currently count the principal and interest payments on a new mortgage and only interest payments for previous loans as 'debt'. However, under the new calculating rule, banks will count as 'debt' both the principal and interest payments on the existing ones as well.
  - In calculating a borrower's income, the banks will check the borrower's income records for the recent two years, up from the current requirement of one-year record. Income items hard to prove – e.g. estimated incomes from pension payments or card expenditures – will be scaled down in calculating a borrower's income.
  - To protect non-speculative homebuyers from tighter lending conditions, some exemptions will be given to those who have temporarily own two mortgages for a new home, the newly-weds and young workers who don't have any property.
  - The new DTI rule will apply from January 2018 to new mortgages in the areas where the current rule applies. Whether to expand the new DTI rule nationwide will be reviewed later.

- **Introduction of Debt Service Ratio (DSR)**
  - The Debt Service Ratio will be introduced to evaluate borrower's overall repayment ability. The ratio will measure borrowers' overall debt service burden – the sum of principal and interest payments on all outstanding debt against their annual income.
  - The DSR will be first introduced to banks starting from the second half of 2018 and gradually expanded to the non-banking sector.

[1] % of fixed-rate loans: 14.2%(end-2012) → 44.2% (end-June, 2017) → 45.0% (end-2017)
% of amortizing loans: 13.9% (end-2012) → 47.8% (end-June, 2017) → 55.0% (end-2017)

Targeted Measures for Vulnerable Sectors

The government will take targeted measures for household borrowings in the non-banking sector, ‘collective lending’ by homebuyers in groups, and lending for the self-employed, which are particularly vulnerable to household debt risks.

- **Refinancing of mortgages from the non-banking sector**
  - The government will launch a mortgage refinancing program of KRW 500billion in December 2017 to help borrowers from the non-banking sector to switch their outstanding mortgages into fixed-rate and amortizing ones with a longer maturity.

- **Stricter conditions for ‘collective lending’ for home buyers**
  - The government will tighten the upper limits and ratios of government-backed guarantees for home buyers’ collective loans for middle payments.

- **Risk management for lending to self-employed business owners**
  - Financial institutions will be encouraged to strengthen their risk management in lending to self-employed business owners to prevent loans from excessively concentrating toward certain categories of businesses.

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