

GOVERNMENT ANNOUNCES HOUSEHOLD DEBT MANAGEMENT PLAN FOR 2021-2023

The government announced the household debt management plan for 2021-2023 on April 29. The plan is aimed at (i) managing the growth rate of gross household debt at stable levels for the mid- to long-term and (ii) establishing lending practices based on individual borrowers' repayment capability.

BACKGROUND

Household debt growth remained stable from 2017 to 2019 as the government was able to implement a consistent policy for household debt management. However, due to expansionary fiscal and monetary policies put in place in response to the COVID-19 pandemic, the household debt growth rate accelerated in 2020.¹ In this year, the growth rate has slowed down somewhat since the government announced a series of policy measures to tighten mortgage regulations and boost housing supply. However, the household debt level still remains high even though credit loans which was a dominant factor in the last year's household debt growth in the second half appears to have come down to a stable level.²

Korea's household debt has been regarded as one of the potential sources of financial risk, given its relatively high ratio against GDP and fast pace of growth compared with major economies. However, the increase in private sector debt in response to COVID-19, which is a common phenomenon, has been inevitable to some extent. In addition, due to the government's efforts at improving the structural soundness of household debt, it is unlikely that household debt turns into a systemic risk in the short-term. Against this backdrop, the government intends to preemptively manage household debt from a macroprudential perspective to prevent it from turning into potential risk factors.

Regulatory adjustments at a micro level are also needed to ensure that a tightening of mortgage regulations do not curtail first-time homebuyers' access to mortgages. The current regulation of loan-to-value (LTV) ratio, uniformly applied across all homebuyers, has limited opportunities for first-time homebuyers. Moreover, regulatory disparities existing in terms of restriction areas, type of housing and type of lenders have created regulatory loopholes and problems of bypassing regulations. As

¹ Household credit growth: 11.6%(2016), 8.1%(2017), 5.9%(2018), 4.1%(2019), 7.9%(2020)

² Overall household loan growth (in trillion won): +12.6(monthly average, H2 2020), +10.4(Jan 2021), +9.7(Feb 2021), +9.1(Mar 2021)

Credit loan growth (in trillion won): +4.5(monthly average, H2 2020), +3.1(Jan 2021), +0.7(Feb 2021), +0.9(Mar 2021)

such, regulatory adjustments are needed to remove regulatory loopholes and provide support to first-time homebuyers in actual need of housing.

KEY MEASURES

The household debt management plan for 2021-2023 aims to (a) manage household debt growth at stable levels to prevent the pandemic-induced growth in household debt from putting downward pressure on the economy and (b) introduce regulatory measures to ensure household loans are extended based on borrowers' ability to repay. In specific, the measures include (i) strengthening measures to manage the gross household debt level, (ii) introducing debt service ratio (DSR) rules tailored to individual borrowers' debt servicing capabilities, (iii) tightening oversight over nonbank loans and non-housing mortgages and (iv) enhancing financial access of first-time homebuyers to strengthen the housing ladder.

I. IMPROVING MACROPRUDENTIAL OVERSIGHT ON HOUSEHOLD DEBT

- **MANAGE HOUSEHOLD DEBT GROWTH LEVEL:** With a mid- to long-term target of bringing down the growth rate back to the pre-pandemic level of around 4 percent, the government will resume the growth target management that was temporarily suspended in 2020 due to the COVID-19. Considering the continuing COVID-19 situation, the growth target for this year will be within 5 to 6 percent with targeted risk management measures to prevent concentration on credit loans, etc. The authorities will regularly check household debt trends from banks and nonbanks on a monthly basis and take appropriate measures when necessary.
- **INTRODUCE COUNTERCYCLICAL CAPITAL BUFFER FOR HOUSEHOLD LOANS IN BANKS:** Household debt increase during economic booms builds up default risks, which tends to materialize in an event of economic downturn; therefore, countercyclical capital buffer will be introduced to help banks preempt such risks. Banks will be required to set aside additional capital of up to 2.5 percent in proportion of their household lending to total lending. (H2 2021~)
- **DIFFERENTIATE DEPOSIT INSURANCE PREMIUM RATES:** Financial institutions will be subject to differentiated deposit insurance premium rates within 10 percentage points, according to their risk levels in household lending and household loan growth rate. (Jan 2022~)
- **STRENGTHEN RISK MANAGEMENT FOR NONBANKS' CREDIT OFFERING WITH PREDETERMINED LIMIT:** Banks and insurers are currently subject to the rules that require them to set aside provisions for credit extended with predetermined limit, which are calculated toward their BIS capital adequacy ratios. The authorities will introduce the same requirement for savings banks, specialized credit finance companies and mutual finance companies for their credit offering with predetermined limit. (Jan 2022~)

II. APPLYING DSR ON INDIVIDUAL BORROWERS

- **GRADUALLY EXPAND DSR RULES ON INDIVIDUAL BORROWERS:** The government will expand DSR rules, currently applied at the level of financial institutions, on the level of individual borrowers in three phases with the goal of completing the transition by July 2023. The current DSR rules applied on financial institutions may be discontinued depending on the progress of the shift in DSR rules toward individual borrowers. (Jul 2021~)

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

	As is	1st phase (Jul 2021~)	2nd phase (Jul 2022~)	3rd phase (Jul 2023~)
Home mortgages	Houses in 'speculative' or 'overheated speculative' areas with property value of KRW900 mil. or more	(a) Houses priced over KRW600 million in all regulated areas	- Total borrowed amount over KRW200 million	- Total borrowed amount over KRW100 million
Credit loans	Annual income exceeding KRW80 mil. & KRW100 mil.	(b) Over KRW100 million	- Maintain rules (a)+(b)	- Discontinue rules (a)+(b)

The borrower-level DSR rules will not apply on jeonse loans, savings-secured loans and insurance-secured loans, as well as government-backed microloans and other lending support initiated through government policies. Applying the DSR rules on individual borrowers will help improve the financial soundness of lending institutions and contribute to financial consumer protection in the long run.

- **CHANGE DSR CALCULATION RULES ON CREDIT LOANS:** Unlike home mortgages, credit loans' maturity is currently calculated as 10 years when evaluating DSR for borrowers. This uniform application of the 10-year maturity will be changed to 7-year maturity in July 2021 and 5-year maturity in July 2022 to help reflect the actual maturity of credit loans which is 52 months on average. (July 2021~)

- **IMPROVE BORROWERS' INCOME CALCULATION METHODS:** Aside from the current income tax data or national pension and health insurance payment data available for calculating a borrower's income level, the authorities will adopt more flexible criteria for the types of recognized income data to reflect a diverse source of data in income calculation.

III. TIGHTENING REGULATORY OVERSIGHT IN VULNERABLE SECTORS

- **IMPROVE RULES ON NON-HOUSING MORTGAGES:** The authorities will apply the loan-to-value (LTV) ratio of up to 70 percent on non-housing mortgage loans from all financial sectors from May 17, 2021. From July 2021, the LTV ratio of 40 percent will be applied to the issuance of new non-housing mortgage loans for land buyers in the 'land transaction permitted areas,' except for those engaged in the agriculture or fisheries sectors who are in actual need of the land. On non-housing mortgage loans, the authorities will also work to prepare for the application of

individual DSR rules from July 2023.

- **IMPROVE MUTUAL FINANCE COMPANIES' HANDLING OF NON-HOUSING MORTGAGES:** The authorities will thoroughly and regularly inspect areas for improvements with regard to the mutual finance companies' handling of non-housing mortgage products. The relevant authorities and industry groups will hold consultative meetings on a regular basis to help improve the soundness of the mutual finance sector.

IV. EXPANDING FINANCIAL ACCESS FOR LOWER INCOME GROUPS & YOUNG ADULTS

- **INTRODUCE FLEXIBLE METHOD OF DSR CALCULATION TO REFLECT LIFETIME INCOME CYCLE:** The authorities will introduce a more flexible method of DSR calculation that takes into account an individual's lifetime income cycle, especially the future income growth prospects of young adults. The relevant industry groups will draw up best practice guidelines and provide other relevant statistics to be used in each sector. For young adults wishing to take out a long-term home mortgage loan, this measure will help expand their maximum mortgage limit. (Jul 2021~)
- **INTRODUCE 40-YEAR HOME MORTGAGE:** In order to help relieve financial burdens of purchasing a home, the authorities will introduce a 40-year home mortgage loan for young adults aged 39 or less and newly married couples who have been married for 7 years or less.³ (H2 2021~)

The authorities will work on providing additional support for lower income earners and first-time homebuyers, such as preferential rates on LTV and DTI and eased income requirements, etc.

³ For instance, for KRW300 million mortgage loan with an interest rate of 2.75%, monthly payment burden becomes 15.1% less with a 40-year mortgage than with a 30-year mortgage (KRW1.22 million to KRW1.04 million).

SCHEDULE

	Key tasks	Measures	Schedule
<i>IMPROVING MACROPRUDENTIAL OVERSIGHT ON HOUSEHOLD DEBT</i>			
1)	Manage household debt growth level	-	Ongoing
2)	Introduce countercyclical capital buffer for household loans	Through Revision to supervisory regulation	H2 2021
3)	Introduce a graded deposit insurance premium system	-	Jan 2022
4)	Strengthen risk management for nonbanks' credit offering with predetermined limit	Through Revision to supervisory regulation	Jan 2022
<i>APPLYING DSR ON INDIVIDUAL BORROWERS</i>			
5)	Gradually expand DSR rules on individual borrowers	Through Revision to supervisory regulation	Jul 2021 (1 st phase)
6)	Change DSR calculation rules on credit loans	Through Revision to supervisory regulation	Jul 2021
7)	Improve borrowers' income calculation methods	Through Revision to supervisory regulation	Ongoing
<i>TIGHTENING REGULATORY OVERSIGHT IN VULNERABLE SECTORS</i>			
8)	Improve rules on non-housing mortgages	Through Revision to supervisory regulation	May 2021
9)	Improve mutual finance companies' handling of non-housing mortgages	-	Ongoing
<i>EXPANDING FINANCIAL ACCESS FOR LOWER INCOME GROUPS & YOUNG ADULTS</i>			
10)	Introduce flexible DSR calculation measure fit for lifetime income cycle	Through guidelines	Jul 2021
11)	Introduce 40-year home mortgage	-	H2 2021

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