Financial Consumer Protection in the Household Lending Sector: An Assessment of the Korean Experience

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ABSTRACT

The objective of this paper is to offer a systematic review and assessment of the policy measures adopted to date for financial consumer protection (FCP) in the household lending sector in Korea. In so doing, we focus on the “software” aspects of the policies adopted so far in terms of four particular groups of consumer issues: (1) information provision (by service providers), (2) financial literacy programs, (3) sales practices, and (4) dispute resolution (rules and processes). We also attempt to relate the FCP policies to two broader goals of financial market regulations - financial stability and financial inclusion. Our analyses indicate that; the regulatory authorities in Korea initiated the FCP policies early on, which cover a fairly comprehensive set of policy measures with almost all sub-items of the aforementioned four dimensions being included; some of the FCP policies are driven in large part by the intent of stabilizing the housing and mortgage market rather than protecting financial consumers per se, for which the regulatory authorities should weigh the anticipated benefit in terms of financial stability against the unintended cost in financial inclusion; and the Korean FCP policies tend to focus on the residential mortgage lending sector, which should be extended to other consumer lending products (e.g., credit or non-collateralized lending, credit card receivables, and car loans). Though seemingly comprehensive, the FCP policies in Korea should be further refined and enhanced with respect to their effectiveness, for which we discuss a series of future research topics.

Keywords: Financial consumer protection, consumer mortgage lending, financial inclusion, financial market stability

1. Introduction

The reasons for government intervention to protect financial consumers are well-established. On the efficiency ground, information asymmetry between service providers (financial institutions (FIs) in particular) and financial consumers represents a classic case of market failure, implicating an under-provision of consumer credit due to moral hazard and adverse selection. (Campbell et al. (2011)) Search costs for, and infrequent transactions of, certain consumer financial products, e.g. mortgage loans for home acquisition, constitute additional sources of inefficiency in the markets for consumer financing. On the distributional ground, it is demonstrated that financial knowledge and household income tend to be positively correlated such that consumers with lower income are systematically ended up in the segments of financial markets where financial charges are higher. (Campbell (2006)) The recent literature also documents a pervasive lack of basic financial literacy among consumers in general (Lusardi and Mitchell (2007), Lusardi and Tufano (2009), Lusardi, Mitchell, and Curto (2010), and Tennyson (2016)), in response to which a rationale for govern-
ment-driven paternalism (or a “nudge”) through various forms of financial consumer protection (FCP) regulation is well-founded. (Thaler and Sunstein (2009))

The objective of this paper is to offer a systematic review and assessment of the policy measures adopted to date for FCP in the household lending sector in Korea. The country represents an interesting emerging-market case in that its consumer lending sector in general, and the residential mortgage credit in particular, has been rapidly evolving and expanding since the Asian Financial Crisis (AFC) in the late 1990s, and that the regulatory authorities have been actively instituting various FCP policy measures during the last decade.

In assessing FCP policies, one has to deal with the challenging issue of multi-dimensionality. The FCP policies should cover multiple consumer finance sectors (e.g. lending, insurance, investment, and so on) and each sector tends to have a unique set of FCP policy issues. In this study, we focus on the “software” aspects of the household lending sector in Korea by examining the rules, directives, and regulations governing four particular dimensions of FCP policy: (1) information provision (by service providers), (2) financial literacy programs, (3) sales practices, and (4) dispute resolution. Using the World Bank (2012) as a reference, which suggests 39 common good FCP practices, we first select those sub-items under each of four categories that are relevant to the household lending sector, and then survey and assess the Korean FCP policies by each selected sub-item. In the assessment, we also take a stance that FCP policy is a mean to an end and, as such, should contribute to such broader policy objectives as: preventing abusive or fraudulent lending-collection practices (by FIs, or their agents); inducing behavioral changes in demand-side or supply-side (or both) of the financial market in question such that the volatility of the lending sector is reduced; and enhancing financial inclusion of vulnerable consumer cohorts to the lending services.

Our analyses indicate that the regulatory authorities in Korea initiated the FCP policies early on, even before the Global Financial Crisis (GFC), and are covering a fairly comprehensive set of policy measures with almost all FCP items suggested by the World Bank (2012). To illustrate, the two main regulatory authorities - the Financial Services Commission (FSC) and the Financial Supervisory Service (FSS) - have instituted various FCP measures since 2007, including the summary statement (of the product chosen), the consumer handbook and checklist, the web-based “Mortgage Calculators,” e-mail and text notifications (whenever the lending rates and other loan terms change), the 14-day cooling-off period after signing contract (during which consumers can cancel the contract), and so on. In addition, the multi-layered consumer complaint mechanisms are in place (those run by FIs, by their professional associations, and by the regulators), and the abusive (or violent) debt collection practices have largely disappeared thanks to the special law enacted in 2009. Yet, some FCP measures are in a fairly early stage in terms of implementation (e.g. the financial literacy programs, and consumer access to the credit data and credit scores), for which a more elaborate and systematic policy design appears to be warranted. The next milestone expected in the Korean lending sector will be the passage of the special FCP law that was submitted to the Congress in 2017 by the two regulatory bodies, which is currently under deliberation for enactment.

As another overall assessment, it is fair to say that the rules and regulations in the consumer lending sector is tilted toward financial stability, more so than FCP per se or financial inclusion of marginal consumer cohorts. Although that is understandable given the large and rapidly-growing household debt of the country in the recent years, one should weigh the anticipated benefit in terms of financial stability against the unintended cost in financial inclusion in designing the policy scheme in the lending sector. As a case in point, the macro-prudential regulations employed - the maximum allowable loan-to-value (LTV) and debt-to-income (DTI) ratios work as constraints for FIs in underwriting loan applicants and, as such, inevitably steer low-income, low-wealth, and credit-impaired borrowers to a high-cost lending sector (e.g. about 5 percent lending rates by first-tier FIs such as the commercial banks vs. 24 percent interest rates by some of the tertiary FIs) or even exclude them from the financial service all together. As a related point, some FCP policy measures take a form of restriction in product offering (e.g., the quota in lending volumes of certain products such as fixed-rate or principal-amortizing mortgage loans).

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1 Chen (2018) categorizes the FCP issues into two groups - those related to “software” (relevant laws and rules, rationale and direction of FCP, and ex-ante and ex-post protection mechanisms) and others related to “hardware” (financial supervision organizations, deposit insurance corporations, and dispute settlement organizations).
or in underwriting conditions (e.g. the LTV • DTI caps). In instituting such policy measures, one should strike a balance between intended benefit in terms of FCP (or stabilizing financial market) and unintended cost in product affordability.

Up to now, the FCP policies in the consumer lending sector of Korea tend to focus on the residential mortgage lending sector, which should be extended to other consumer lending products (e.g. credit − or non-collateralized − lending, credit card receivables, and car loans). The sector takes roughly a half of the total consumer lending volume, yet receives a relatively high attention from the policy making circle as well as from general public due in large part to the importance of housing both as space consumption and as investment opportunity. But, both in terms the stability and in terms of the inclusion, the other half should receive an equal (at least) level of policy attention, as we believe that more resource-constrained borrowers and, hence, more vulnerable consumer cohorts at the time of economic shock would be concentrated in the non-mortgage sector. Finally, there is a host of future research issues for careful conceptual and empirical investigation going forward, as we discuss in Section V.

The rest of the paper consists of the following four sections: the current state and evolution of the Korean consumer lending sector along with the relevant FCP measures employed (Section 2); the international benchmarks and a survey of literature as a guidance for subsequent analyses (Section 3); the assessment of the FCP measures employed in Korea (Section 4); summary and concluding remarks (Section 5).

II. The Consumer Lending Sector in Korea

A. brief history and current state

Before the AFC in the late 1990s, the consumer lending sector was small and under-developed, and was not a high-priority segment in the public policy point of view: that is, the scarce financial resource was away from the sector but was directed toward the trading or export-generating industries. However, as a part of the post-AFC re-structuring, the consumer lending was liberalized to the commercial banks, the dominant players in the financial markets, and the lending volume has been steadily and fairly-strongly grown since the early 2000s. As shown in Figure 1, the total consumer credit rose by 7.2 percent per annum (based on a compounded annual growth rate, CAGR) between 2002 and 2017, which has accelerated in the recent years to 10.3 percent CAGR in 2014-2017. As of the 2nd quarter 2017, the total household debt takes about 85 percent of GDP, and about a half of that is the residential mortgage debt outstanding, MDO (hence, about 42 percent MDO-to-GDP ratio). The latter is relatively better documented and more closely monitored and has also been subjected to various regulations for the purpose of financial (and real estate) market stability.

In the early phase of the mortgage market development, the pre-dominant loan products were short-term (e.g. 3-year maturity bullet-paying (with no amortization of principal) adjustable-rate mortgage (ARM) contracts, due in large part to the deposit-based (rather than whole-sale) funding by the mortgage lenders. Concerned with a potential systemic risk posed by the predominant ARM contracts, the government promulgated the yearly quota in 2014 as to the shares of two particular loan types in MDO (of each commercial bank) - the fixed-rate mortgage (FRM) contracts and the principal-amortizing loans (see Table 1 for the plan). Thanks to this fairly-strong government push and to the securitizer of FRM - the Korea Housing Finance Corporation (KHFC) created in 2004, the share of FRM and that of the amortizing loans have been steeply rising in the recent years, and the 2016 goals for both loan types are also expected to be met.

Another feature of the sector to note is the macro-prudential regulations implemented since the early 2000s, LTV and DTI ratios. That is, the overall caps for these

<table>
<thead>
<tr>
<th>Loan type</th>
<th>2013 (observed)</th>
<th>Yearly target</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2015</td>
</tr>
<tr>
<td>FRM</td>
<td>15.9</td>
<td>20</td>
</tr>
<tr>
<td>Amortizing</td>
<td>18.7</td>
<td>20</td>
</tr>
</tbody>
</table>

Source: FSC (2014)

There were two specific de-regulation measures that helped the rapid influx of liquidity to the consumer lending markets - liberalizing the interest rates (both deposit and lending rates) and lifting the restrictions (for the commercial banks) to real estate backed loans. See Cho and Kim (2011) for more details on these regulatory changes.
lending ratios are set in a conservative level (70 percent for LTV and 40–60 percent for DTI), which are also location-varying, in that they get much lower in the spatially-designated speculative zones (e.g., the 30–40 percent LTV cap in some of the seemingly over-heated housing markets within Seoul and other primate cities). Relevant to the regulations, there are two additional measures that are being discussed in the context of a more prudent management of potentially vulnerable groups: that is, the planned implementation of the debt-service-ratio (DSR) - the back-end income ratio that includes all, not just one, debt obligations in computing DTI - and the definition of “marginal borrowers” - those whose DTIs exceed 40 percent AND whose financial liabilities exceed financial assets - defined for the purpose of a more close monitoring. At the same time, how to ensure proper level of financial service to the “real” mortgage demanders (e.g. first-time home buyers) given all these stability-driven regulations is the topic that is often being discussed in media as well as in academia.

1. The current state of the FCP policies

It was 2007 when the two main regulatory authorities - FSC and FSS - initiated the FCP policies in the form of the regulatory directives on the several measures related to information provision on the residential mortgage products. Since then, there have been the additional policy guides, and a special law was submitted to the Congress in May 2017 that is currently under a legislative deliberation. The proposed law encompasses a fairly comprehensive set of FCP measures in all dimensions of our analysis - (1) information provision, (2) consumer education, (3) sales practices, and (4) dispute resolution. As other notable features, the proposed law categorizes consumer products into four classes - depository, investment, insurance, and lending (or loan) products, and also identifies three types of service providers - direct sellers, delegated or intermediating sellers, and advisors. As other FCP measures to note, the authorities have implemented a product comparison system for typical contracts in each

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3 See Han, Hwang, and Cho (2016) for an empirical study on the effects of LTV regulations in Korea.
4 About 480tr KRW (about 35% of the total consumer credit) lent to self-employed borrowers and, among them, 42.8tr(696k households) being for “safety-net” loans. The cohort represents another important target for the consumer lending service in Korea.
product class, as depicted in Table 2, since January 2016. And, a tailor-made consumer education plan for different socio-economic groups (e.g. retirees, college students, credit-impaired, and so on) has been announced recently (on January 23, 2017). Other details of those proposed or implemented provisions will be discussed and assessed in the subsequent sections.

### III. Analytical Issues

#### A. Dimensions of the FCP policy in the lending sector

The subprime mortgage debacle, followed by the severe contractions in economic activities in various countries (e.g. the “Great Recession” in the U.S.), sparked a world-wide debate on FCP. The main lesson from the recent financial crisis, in particular from the residential mortgage lending sector, is that the policy effort should be geared toward both demand-side and supply-side, given that the anomalies are in fact observed from both sides – the excessive risk-taking and improper, even predatory, lending practices by the mortgage lenders combined with the speculation-driven mortgage demand propelled by a “permanent” housing price boom assumed. In response, there have been a number of FCP-related legislations, with the Dodd-Frank Act in the U.S. being a notable example. The multilateral international agencies also suggest a series of the good FCP practices, e.g. the OECD (2011), the World Bank (2012), and CFPB (2016). In particular, the World Bank (2012) put forth the 39 common good practices (or “principles”) around three themes: (1) providing appropriate information for financial consumers to make informed decisions, (2) protecting financial consumers from unfair or deceptive (lending) practices, and (3) ensuring them access to recourse mechanisms to resolve disputes. In our survey, a template of a desirable FCP policy measures in the case of consumer lending products is developed by selecting those good practices suggested in the World Bank (2012) that we believe as directly relevant to the sector. The selected measures are listed in the table below (see Appendix 1 for a more detailed description of each item). Using this template, we first collect the data to compile the current FCP policies adopted in Korea in all 13 dimensions - (a) through (m) in Table 3 - under the four categories.

#### B. FCP vs. financial stability vs. financial inclusion

In this study, we take a stance that a good FCP policy should contribute to achieving two conventional policy objectives in financial markets - financial stability and financial inclusion. As a case in point, an enhanced consumer capability for product selection via an effective education program along with an appropriate (i.e. risk-based and non-predatory) sales practice by the lenders can lead to a counter-cyclical lending pattern, which in turn will reduce a chance of a systemic risk driven by

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**Table 2. Product Comparison and Public Announcement**

<table>
<thead>
<tr>
<th>Channel</th>
<th>Product</th>
<th>Segment</th>
<th>Key information to provide</th>
</tr>
</thead>
<tbody>
<tr>
<td>FSS-consolidated comparison &amp; public announcement (CPA)</td>
<td>Deposit</td>
<td>(1)Banks, (2) Savings Banks</td>
<td>Interest rates (IR) by maturity, conditions</td>
</tr>
<tr>
<td>Installment saving</td>
<td></td>
<td></td>
<td>Allotment conditions, IR by maturity</td>
</tr>
<tr>
<td>Loan</td>
<td>Housing</td>
<td>(1), (2), (3) Insurance C., &amp; (4) Capitals</td>
<td>IR band, prepay penalty, loan limit</td>
</tr>
<tr>
<td></td>
<td>Chosie</td>
<td></td>
<td>Above &amp; repayment method</td>
</tr>
<tr>
<td></td>
<td>Credit</td>
<td></td>
<td>IR by credit rating, average IR</td>
</tr>
<tr>
<td>Saving, pension</td>
<td>(1), (3), &amp; (5) Investment C.</td>
<td>Minimum freq., yield, expected payment</td>
<td></td>
</tr>
<tr>
<td>Retirement pension</td>
<td></td>
<td>Minimum freq., yield</td>
<td></td>
</tr>
<tr>
<td>Association-driven CPA</td>
<td>Fund</td>
<td>(5)</td>
<td>Yield, risk grade, minimum investment</td>
</tr>
<tr>
<td>Insurance, indemnity</td>
<td></td>
<td>(3)</td>
<td>Eligible age, premium by subscription condition, collateral</td>
</tr>
</tbody>
</table>

Source: FSC & FSS (2015)
### Table 3. Relevant FCP Measures Suggested (for the Consumer Lending Sector)

<table>
<thead>
<tr>
<th>FCP measure suggested</th>
<th>Description</th>
</tr>
</thead>
</table>
| **A. Information provision** | Summary statement: A short one or two page summary statement on the product (Principle 8)  
Qualification of FI staff: Adequate training for FI staff on products & services (Principle 14)  
Change in lending terms: Individual & immediate notification in writing of changes in products (Principle 16)  
Consumer credit data: Ready and free access to their credit reports from credit registers, and provides procedures for correcting mistakes in credit reports (Principle 20) |
| **B. Financial literacy** | Programs for financial literacy: Developing and implementing the financial literacy programs by a wide range of organizations (Principle 33)  
Monitoring financial literacy: Measurement of financial literacy of consumers through broad-based household surveys (Principle 36)  
Financial advisor: On forward and reverse mortgage contracts; For low-income, low-wealth, and less creditworthy borrowers |
| **C. Sales practices** | Cooling-off period: A period during which the consumer may cancel the contract without penalty (Principle 11)  
Code of Conduct: A principles-based code of conduct that is devised by (by all banks, by all non-bank credit institutions, or by their associations) (Sector-specific Principle)  
Affordability of product: Product recommended being in line with the need of the consumer; Consumer’s credit worthiness being properly assessed (Sector-specific Principle) |
| **D. Dispute resolution** | Collection practice; & Debt Recovery: Prohibition of abusive collection or debt recovery practices (Principle 19); & as a Sector-specific Principle  
Consumer complaint; & Ombudsman and other conflict resolution mechanisms: Designated contact point with clear procedures for handling customer complaints; Up-to-date records of all complaints received (Principle 25); Access to an affordable, efficient, respected, professionally qualified and adequately resourced mechanism for dispute resolution (Principle 26)  
Foreclosure of mortgaged or charged property: Informing in writing in advance of the procedures involved, and of the legal remedies and options available (Sector-specific Principle) |


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**Figure 2. FCP vs. Financial Stability vs. Financial Inclusion**

A. Financial stability vs. financial inclusion: Housing boom & pro-cyclical lending → demand for leverage ↑ (by consumers) → excessive risk-taking & predatory lending (by FIs) → bad news (e.g. asset price bust & NPL ↑) → liquidity trap → contraction in real economy (C ↓ & I ↓)

B. FCP vs. financial stability: Financial literacy (of consumers) ↑ → sound loan selection & leverage ↑ → risk-taking & predatory lending (by FIs) ↓ → (sector-driven) systemic risk ↓

C. FCP vs. financial inclusion: Information provision & “sound” lending practices ↑ → credit risk ↓ & better loan matching → more prudent risk management → “serving more underserved” (or extending the service to more “marginal” borrowers)
the lending sector, the linkage B in Figure 2. Also, a prudent (or efficient) risk management by FIs backed by real data and historical evidences can lead to a better matching between lending products and borrower cohorts, which will result in an extended financial services to more marginal (or underserved) consumers in the lending system, the linkage C in Figure 2.

Since the global financial crisis, there has been a rising volume of the academic studies on various topics related to the housing-driven systemic risk, e.g. those on the pro-cyclical mortgage lending patterns (Geanakoplos (2010) and Brunnermeier and Oehmke (2014)), on the wealth effects of housing and mortgage market boom-busts (Iacoviello and Pavan (2013), Mian and Sufi (2011), Carroll, Otsuka, and Slacalek (2011), Case, Quigley, and Shiller (2011), and Mian, Rao, and Sufi (2013)), and on the micro- and macro-prudential regulations to help prevent a similar event from happening again (Crowe et al. (2011) and Wachter, Cho, and Tcha (2014)).

Though challenging, the effectiveness of FCP policies should be judged, as we argue, with respect to whether or not, and to what extent, they contribute to stabilizing the consumer lending sector by changing behaviors of both service providers (FIs and their agents) and consumers such that the systemic risk (or a contagious lending cycle) is better contained.

At the same time, a good FCP policy is also about an inclusive financial intermediation: that is, relating financial consumers of diverse socio-economic characteristics in terms of income, wealth, and demographics to optimal (or welfare-maximizing) financial products and services; and, in so doing, serving more underserved households (i.e. extending financial inclusion) in a prudent fashion. To this end, a series of studies has documented various policy issues in the context of making the residential mortgage lending sector more complete and inclusive (Miles (2003) and (2004), Mercer Oliver Wyman (2005), and Kim and Cho (2014)).

In this study, our effort to assess the FCP measures adopted in the lending sector in Korea will largely be conceptual, rather than empirical, given the lack of proper micro data set. As such, this study should be viewed as an initial effort to set the stage for more full-blown empirical tests of different elements of good FCP policies as to how effective they are in achieving those two policy objectives discussed in this section in the contexts of Korea and other countries.

IV. Assessing the Korean System

A. Information provision

1. Current state and the FCP measures adopted

Given the fact that the ARMs were the dominant mortgage contracts and the growth of MDO was surprisingly fast in the early 2000s, the regulatory authorities formed a task force (TF) in 2004 to review and highlight potential risks associated with the mortgage lending sector. Out of the TF deliberation, a series of policy measures was introduced, in a large part for stabilizing the mortgage market and the macroeconomy rather than for protecting financial consumers. The specific measures promulgated were along the same line of argument put forth by Miles (2004) in UK: that is, in their choices among competing mortgage products, consumers tended to be myopic in that they prefer variable-rate mortgages (over fixed-rate loans) and bullet mortgages (over amortizing loans) due in large part to lower payment burdens in initial years of loan lives, without much considering a potential risk of payment shock in later phases of loan terms. The phenomenon is also labeled as “the present-(time)-bias” by Campbell et al. (2011).

The regulatory intent embedded in the first FCP measure was to have borrowers realize the risks associated with the certain mortgage products by issuing several guidelines for the lenders. First, upon signing a variable-rate mortgage

6 The team was composed of bankers, policy makers, and academics and focused on a development of practical guidelines for mortgage originators.

7 What is interesting was the fact the Korean consumers indicated their preferences that were opposite to their actual product choices. In particular, You (2006) reported that more than 70 per cent of future home buyers who planned to take out a mortgage loan in 2005 showed their preference for fixed-rate mortgages. In the same year, however, the market share of fixed-rate mortgages was less than 15 per cent. They also wanted to obtain amortizing mortgages, the market share of which was less than 30 percent, even though more than 70 percent mortgages were (short-term) bullet loans.
contract, lenders (or underwriters) were asked to expressly and openly state risks of rising interest rates and to have them sign on the parts of the contract to verify that the borrowers acknowledged and understood the risks. Second, borrowers should be given the information (in the so-called “passbook”) based on which they could track their monthly interest rates and interest payments. Related to the second guideline, FSC released an interesting survey in 2007, showing that, while most borrowers who received an email message to alert an interest rate change did not tend to read the message (only 30 percent even checked the message), those who received a mobile text were more likely to read the alert. Based on this finding, all lenders were required to have both methods of the alert, for which borrowers could choose one or both. Third, FSS required financial institutions to provide a mortgage calculator on their website by launching a standard system of its own (Figure 3). These calculators are quite similar to those in other websites provided by the Money Advisor Service in UK and the Financial Consumer Agency of Canada.

One important policy measure introduced by the authorities in April 2007 was the requirement to provide a summary statement on the mortgage loan to be issued, whose length was limited to two pages at the maximum. Since then, its contents have been updated several times with the current version containing a fairly detailed set of basic facts and descriptions of terms on the mortgage contracts – an overview of the product, the amount of the mortgage loan, types of interest rates, other fees or costs, maturity and amortizing information, prepayment or late payment penalty, tax deduction for qualified borrowers, the lender’s contact information, the borrower’s income, the value of the collateral, and spreads for borrowers with low credit scores as well as effective interest rates (along with its calculation methods) and both prepayment and delinquent penalties. The updates were done in response to consumers’ comments and complaints. In addition, the summary statement includes examples for loan and delinquent penalties, legal ceiling of penalty and official stamp tax, reasons for why interest rates for FRMs being generally higher than those of ARMs.

In 2015, FSC and FSS jointly proposed announced that from Apr 2016 financial institutions should not request more than eight documents at the time of mortgage origination, a fairly significant reduction from around 20 documents collected at that time as some of them were deemed to be redundant or trivial, and that some loan information

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Figure 3. Mortgage Financial Offered by FSC and Commercial Banks

Note: the English translations were added by the authors.
should be included to the summary statement.

As one more policy measure adopted in the recent years, the regulatory authorities issued the standard terms and conditions of the credit business that contains a borrower’s right to seek a loan modification such as a reduction in interest rate when her financial conditions improve after loan origination. However, most borrowers do not know about this, and lenders are generally passive in informing them on this provision by arguing that they do not have specific guidelines for “improved financial conditions.” Furthermore, the right was limited to consumer loans excluding mortgages. In Apr 2014, as a result, the FSS asked banks to provide the detailed guidelines, and to provide borrowers information on the right by sending text messages. From Jan 2017, all the lenders are required to explain a borrower’s option to negotiate loan terms when her financial conditions have improved upon loan origination.

2. Assessment and Policy Implications

Although the regulatory authorities in Korea have initiated the information provision part of FCP policies early on in a fairly comprehensive fashion, there are several areas of further strengthening with this respect. First, it appears that training of the staff in financial institutions should be more systematically and specifically designed for different consumer lending products. Given that actual communication to consumers on risk-return profiles of different financial products is generally done by FI staff, we believe that capability to convey accurate, unbiased, and professional product information by them is crucial, for which a systematic training program is necessary. Currently, FI staff members have a general training on consumer lending, designed by individual institution or by their professional association. We believe that it is more desirable to have such training program to be product-specific given that the mortgage products (due to their long-term maturities and other special product attributes) tend to be different from our consumer lending products (e.g., credit card receivables and other non-collateralized lending). As a case in point, while the performance of non-collateralized credit lending is mainly influenced by future income streams (or human capital) of borrowers, that of the residential mortgage loans is closely correlated with housing price cycles, which represents an unique systematic risk factor that should be considered in the underwriting and should be explained clearly its prospective borrowers.

Second, given its importance in helping consumers understand products’ risk-return profiles, the “optimal” contents of summary statement should be properly designed and should also be empirically tested as to its effectiveness. The Korean experience shows that, though it originally starts as a short synopsis (with two pages maximum), the current version contains a lot more, probably too much, data points, which are difficult to be comprehended by most households who do not have professional knowledge about mortgage terms and transactions. Hence, it appears to be necessary to conduct a further research in determining what set of loan characteristics along with how much descriptions thereof are clear and concise, yet detailed, enough to assist consumers’ comprehension and their efficient loan selections.

Third, financial consumers should have an easy and efficient way to check their creditworthiness and to modify their loan terms if that is feasible. One information issue in that regard is the checking of consumer credit information: that is, there is little guidelines or laws that specify obligations that lenders need to provide their consumers with updated credit information and resulting credit score. Consumers should be able to check changes in credit information along with other loan characteristics (e.g., interest rates) easily and should have a efficient medium to reflect them in their scheduled repayments.

B. Financial literacy

1. Current state and the FCP measures adopted

After the FCP policy measures were initiated in 2007, the banking association in Korea (KFB) developed and published a consumer handbook and a check list for mortgage borrowers as a consumer education tool. The handbook contains various mortgage-related information such as the determination of an adequate mortgage loan amount, the selection of mortgage products, and types and risks of mortgage products. The information also includes mortgage terms, fees and penalties, available market information, and strategies for managing unexpected incidences. The checklist enables borrowers to compare different mortgage products from several institutions and to help them reach an optimal choice among the products. The handbook book
and the check list have been being distributed through government organizations, websites and branches of banks, and that of KFB.

In January 2017, the government announced an overall plan to beef up the financial education for consumers, the details of which will have to be refined in coming years. The plan was based on two previous tasks that the regulatory authorities undertook in this vein, one in 2013 and another in 2015; the former proposed surveys of financial literacy and the latter designed consumer education programs based on the survey results. The survey exhibits that consumers of different age-cohorts tend to have different appetites for financial products and, using that as an evidence, the supervisory authorities proposed the education programs by age cohort in 2017. Nonetheless, the programs are still in an infant stage in the sense that the government put together the existing programs designed by government agencies, public associations, consumer advocate groups, and banking or non-bank financial institution organizations, and there should be more specific standards or industry-wide norms for an effective consumer education program.

Financial advisors are generally not common for the consumer lending products unlike the insurance or investment products. Nonetheless, for some complicated consumer loans such as the reverse annuity mortgage (RAM), it is mandatory for consumers to take a counseling session from the advisors who are specialized with the product. To that end, the KHFC issued the handbook for RAM borrowers, similar to the one in the U.S. for the Home Equity Conversion Mortgage (HECM) borrowers. RAM applicants are required to consult financial advisors employed by KHFC and the advisors should take training programs to acquire their qualification.

2. Assessment and Policy Implications

The handbook and the checklist developed in 2007 are mainly for consumers of residential mortgage loans, even though they take slightly more than a half of total household debt. Although it is likely that borrowers for other consumer loans face the same information issues, only limited educational materials (e.g. brochures) are available for credit card receivables and automobile loans. Hence, the programs to enhance financial literacy should become more broad-based by covering those non-mortgage lending sectors as well.

Although FSC and FSS announced several consumer education programs by age cohorts in 2017, their implementation is still in a very early stage. It appears to be necessary for the regulatory authorities to take a more active role in designing the best practice education modules that are tailored for different age-product combinations. To this end, the government recently announced that they plan to establish the Council for Financial Education and Financial Education Council (for Youth), which is mandated to develop and implement financial literacy programs. In sum, the regulatory bodies will have to lead or coordinate the education programs provided by a wide range of financial organizations more effectively and efficiently.

As to the advisors, financial consumers in Korea are generally not advised to get counseling from them. However, there always exist vulnerable groups in the consumer lending sector, for whom a professional counseling will lead to a welfare-enhancing loan choice. To this end, some of the international benchmarks will have to be examined, such as the consumer counseling program administered by the Federal Housing Administration (FHA) in the U.S.

C. Sales practices

1. Current state and the FCP measures adopted

Since 2016, those qualified borrowers in Korea are allowed to cancel loan contracts within 14 calendar days after signing. The Word Bank (2012) suggests that instituting this cooling-off period is one of the suggested good FCP practices. Nonetheless, the length of the period varies across the countries - 14 days in France and Germany but 3 days in the U.S. In order to exercise this option, the qualified borrowers in Korea need to notify the intention through mail, email, online banking account, or visiting to bank branch. During the cooling-off period, the borrowers do not pay prepayment penalty. However, the original loan contract agreement is not treated as being null or void because the borrowers must reimburse costs incurred by their lender such as stamp tax, appraisal

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9 Delinquent or default rates for other consumer debt are higher than those for mortgage debt. In August 2017, for example, the delinquent rate for consumer loans was 0.28 per cent, even though the delinquent rate for mortgage loans 0.19 per cent.
fee, and legal fee for registration. In addition, the borrowers are not allowed to exercise the option more than three times within a year from the same lender or only once per a month for all the lenders.

The World Bank (2011) reports that the sector-specific “principle-based” codes of conduct in the banking sector, which are available in some countries such as Australia. In Korea, however, there doesn’t seem to be such codes of conduct, although each bank as well as the KFB has a general code of ethics. For financial brokers, however, a code of conduct was implemented in 2010, which was devised by financial brokers in consultation with the FSC.10

In Korea, financial supervisory bodies have been proposing underwriting guidelines that financial institution should follow. For example, they have instituted the LTV limit since 2002 and the DTI cap since 2005, based on which the mortgage lenders are supposed to originate the loans. One critical issue that should be examined carefully is the fact that those guidelines have been changing frequently according to housing market conditions or sometimes to public opinion as reported in media, which makes it difficult for borrowers as well as lenders to predict affordable loan products in different locations and time periods.

In 2011, financial supervisory bodies set the quota (or the minimum market shares to achieve) for FRM and for the amortizing mortgage loans, as 30 percent for each loan type. One point to make in this vein is that the definition of FRM (or “amortizing” to that matter) is not crystal clear as lenders can combine those product features to create various hybrid loan products. For example, Fernández de Lis et al. (2013) classify a mortgage loan into three categories: fixed-rate mortgage, initial period fixed-rate mortgage, and variable mortgage; an initial period fixed-rate mortgage includes a rollover mortgage, interest rate of which is renegotiable and a hybrid mortgage, interest rate of which is fixed for a year after origination. In practice, the Korean lenders developed a hybrid mortgage, interest rate of which is fixed for initial five years and is variable after the years, and financial supervisory bodies also acknowledged the hybrid mortgage as a fixed-rate mortgage. According to the Bank of Korea, the market share of the hybrid mortgage reached 43.8 per cent in 2015.

2. Assessment and Policy Implications

The cooling-off period is a cost factor for lenders. Hence, the commercial banks in Korea have generally been hesitant in providing the consumers with an option to cancel a loan contract. Furthermore, the option is given only to a very limited group of qualified borrowers, e.g. those who have a contract of mortgage loan with the amount not exceeding 200 million KRW or a contract of non-mortgage loan with the amount less than 40 million KRW.11 Even worse, a borrower who cancels a loan contract needs to reimburse the most costs incurred, which should be re-examined with various alternative options that are less costly to both parties of loan transaction (e.g. a shorter cooling off period such as 3 days without any penalty or costs borne by the consumers).

There should be a sector-specific principle-based code of conduct as articulated by the World Bank (2012), for which the Australian case can serve as a benchmark. In Australia, there are two different industry professional bodies - Mortgage and Finance Association of Australia (MFAA) and Finance Brokers Association of Australia (FBAA) - which treat mortgage brokers differently from general financial brokers.

As to the product offering, we argue that the mortgage lenders in Korea should have a more leeway in terms of product development and risk assessment via underwriting and other loss-mitigation activities. Currently, the regulatory bodies take a hands-on approach by directly limiting the product offering through the LTV • DTI caps and other lending restrictions. That should be relaxed over time so that FIs should be geared to develop and institute their own products and risk assessment matrices under broad guidelines by the supervisory organizations.

D. Dispute resolution and debt recovery

1. Current state and the FCP measures adopted

In Korea, the abusive or violent debt collection practices

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10 The FSS articulated that the code of conduct could prevent illegal behaviors for financial brokers such as releasing information on customers, misleading or false advertising, or charging illegal fees.

11 Note that a median price for medium-size condominiums (62.8 m²-95.9m²) is KRW 336 million as of Sep 2017 according to the KB Kookmin Bank.
by banks or their agents - such actions as threats, uses of physical power, repeated visits toward debtors or their related parties - are prohibited by the Fair Debt Collection Practices Act of 2009. In addition, other related activities that can be construed as misrepresentation, unfair conduct, and divulgence of personal information are also prohibited. If any party is found guilty on any illegal debt collection practice as specified by the law, both the person who conducted such action as well as the legal representative of his company will be penalized according to the joint penalty provision specified in the law. While there were some abusive practices existed before the enactment of the law (that received a fair amount of public attention), they are largely disappeared thanks to the 2009 law as well as the enforced civil penalties since then.

As to the dispute resolution mechanisms, the financial consumers in Korea can raise the issue through three main channels: (1) the complaint systems run by individual FIs, (2) those run by the professional associations of FIs (e.g. the KFB), and (3) e-Consumer Complaint Center jointly run by FSC and FSS. In general, the complaints are filed through the first channel, and, if not resolved there, then they tend to go to the next channels. But, in case that there is a dispute between FI and consumer, the case most likely goes to the third channel because the consumer tends to believe that a direct consultation with FIs will not solve such case. If either party (FI or consumer) is not satisfied with the arbitration by e-Consumer Complaint Center, then the case can be resolved via a lawsuit. The statistics on consumer complaints are currently compiled by both FIs and the regulators (FSS), and are released to public periodically.

For the mortgage loans, lenders can liquidate the collaterals (housing or other property) to recover unpaid loan principal at the time of consumer default, mostly through the public auction administered by the court. In this case, the FI notifies the consumer about the procedure to be initiated for the liquidation. Given the fact that most consumer loans in Korea have the recourse provisions, the lender can still recover a deficiency after the collateral sale through a legal procedure. On this issue, the consumer can demand a loan modification either before (called as “a pre-workout deal”) or during the delinquency (called as “an individual work-out deal”). However, this seemingly more efficient resolution method is rarely used due to the low LTV level and, hence, a low probability of positive credit loss after the collateral sale.

In the case of non-collateral lending, if a loan is under a less than three months’ delinquency, the consumer can apply for the pre-workout deal to FIs or to a special council, the Credit Counseling and Recovery Service (which is established under the law to assist financial service for low-income households). In the case that FIs conduct sale or transfer of consumer loans, they should notify and get agreement from the borrowers.

2. Assessment and Policy Implications

Given that the abusive and violent debt collection practices are largely disappeared since the 2009 Act, the legislation appears to be effective. There have been some subtle ways through which the agents attempted to threat borrowers to collect debt, but the law was amended over time to prohibit additional practices as illegal.

As to the consumer complaint and dispute resolution mechanisms, most FIs in Korea have their own contact point with clear procedures for handling consumer complaints; the related statistics are updated and released in a transparent fashion. There are also multiple layers of dispute resolution, all the way to e-Consumer Complaint Center before a lawsuit. However, the current use of the mechanisms doesn’t appear to be efficient in that, when there is a dispute, the case tends to go directly to the regulators’ channel rather than first utilizing the FIs or the associations’ systems. That is mainly caused by the fact that the first two resolution mechanisms do not have a power for binding arbitration, which is currently being debated as a part of the pending FCP law.

Finally, the pre-foreclosure workout options can be utilized more as they can offer more efficient (or less costly) ways to resolve borrowers’ defaults. As mentioned earlier, due to the low LTV levels and the recourse provision, the lenders in Korea are generally reluctant to use the workout routes. But given the time length of a full-blown foreclosure as well as the financial and psychological burden put on the consumer involved, a more active utilization of the workout options will be welfare-enhancing, for which the regulatory authorities in cooperation with other market participants may develop and implement an industry-wide standard procedure.
<table>
<thead>
<tr>
<th>A. Information provision</th>
<th>B. Financial literacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. (Summary statement)</td>
<td>e. (Programs for financial literacy)</td>
</tr>
<tr>
<td>A short one or two page summary statement on the product (Principle 8)</td>
<td>Developing and implementing the financial literacy programs by a wide range of organizations (Principle 33)</td>
</tr>
<tr>
<td>b. (Qualification of FI staff)</td>
<td>f. (Monitoring financial literacy)</td>
</tr>
<tr>
<td>Adequate training for FI staff on products &amp; services (Principle 14)</td>
<td>Measurement of financial literacy of consumers through broad-based household surveys (Principle 36)</td>
</tr>
<tr>
<td>c. (Change in lending terms)</td>
<td>g. (Financial advisor)</td>
</tr>
<tr>
<td>Individual immediate notification in writing of changes in products (Principle 16)</td>
<td>On forward and reverse mortgage contracts, and for low-income, low-wealth, and less creditworthy borrowers</td>
</tr>
<tr>
<td>d. (Consumer credit data)</td>
<td></td>
</tr>
<tr>
<td>Ready and free access to their credit reports from credit registers, and provides procedures for correcting mistakes in credit reports (Principle 20)</td>
<td></td>
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</tbody>
</table>

**Assessment**

The FCP measures being adopted early on, even before the Global Financial Crisis (GFC), driven in large part by the intent to stabilize the mortgage market rather than to protect financial consumers per se. How effective those policies employed are should be a topic of careful investigation (e.g., Are the current contents of the summary statement too detailed or reasonably easy to understand to consumers?) Non-mortgage (residential) consumer lending sectors should have their own FCP measures as well.

General training for FI staff on consumer lending being offered by individual FIs (to our knowledge, no particular policy directive on this) A more systematic training program (for FI staff) should be devised, either by regulatory authority or by FI association; a sector-specific training program (e.g. mortgage loans vs. non-collateralized loans) appears to be preferable.

An e-mail and/or text notification to borrowers for changes in the lending rates or other loan terms being required by the policy directive (in 2007) A proper notification system, which reflects the consumer preference, appears to be in place; how effective the system is (i.e. whether or not borrowers actually request the modifications in their lending terms to benefit from "improved financial conditions") should be periodically monitored.

No specific guidance currently being in place in this regard, although the consumer credit data (along with the 10-digit credit scores) being utilized more and more A ready and easy access to check consumer credit history along with his/her credit score should be developed; the role of FI and the credit data compiler (the Korea Credit Bureau and others) should be clearly specified. The mechanism of compiling the credit score (the CB ratings) should be shared more to promote appropriate research and enhancement.

The consumer handbook and the check list being issued by individual FIs or by their professional associations since in 2007 An industry-wide norm for education programs for financial literacy should be developed, under a partnership among parties involved (FIs, regulators, consumer groups, academia, and so on) The programs, including the consumer handbooks and check lists, should be developed and updated for both mortgage-lending and other sectors of consumer finance (e.g. credit card loans, auto loans, micro credits) should be a topic of careful investigation (e.g., How effective those policies employed are and others) should be clearly specified.

Two consumer surveys being done in the recent years - the survey of financial literacy (in 2013) and the survey of consumer education programs (in 2015) The designs and findings of, and future plans for, the two surveys conducted should be share with general public, so that more research for future enhancement can be conducted.

A mandatory advisory service being required for borrowers of the RAMs Financial advisory (or counseling) services for more diverse groups of vulnerable consumers should be designed and implemented (e.g. for those borrowers of the government-supported loan programs)
<table>
<thead>
<tr>
<th>C. Sales practices</th>
<th>FCP measure suggested</th>
<th>FCP policies being employed</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>h. (Cooling-off period) A period during which the</td>
<td>For qualified mortgage borrowers (in terms of loan amount, size of collateral, and so</td>
<td>The qualification conditions should be relaxed or even be abolished, for which the period itself</td>
<td>The costs to be reimbursed by the borrowers (at the time of cancelation) should be re-examined to</td>
</tr>
<tr>
<td>consumer may cancel the contract without penalty</td>
<td>on), a 14 calendar days cooling period being given since 2016;</td>
<td>can shortened (as in Germany and other countries)</td>
<td>judge their appropriateness as to consumers’ (rather than lenders’) costs</td>
</tr>
<tr>
<td>(Principle 11)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I. (Code of Conduct) A principles-based code of</td>
<td>Individual FIs having their own codes of conduct, mostly designed for general (rather</td>
<td>A systematic review, and a guidance if needed, should be done to explore any area of improvement</td>
<td></td>
</tr>
<tr>
<td>conduct that is devised by (by all banks, by all non-</td>
<td>than sector-specific) consumer lending</td>
<td></td>
<td></td>
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<tr>
<td>bank credit institutions, or by their associations)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>(Sector-specific Principle)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>j. (Affordability of product) Product recommended</td>
<td>As a part of the macro-prudential regulations, an industry-wide restrictions on the</td>
<td>Those prudential regulations should be weighed against the issue of financial exclusion as well,</td>
<td></td>
</tr>
<tr>
<td>in line with the need of the consumer; consumer’s</td>
<td>maximum LTV and DTI being in place (that are quite restrictive in some locations with</td>
<td>in that less credit worthy borrowers are inevitably steered to a high-cost lending sector (e.g.</td>
<td></td>
</tr>
<tr>
<td>creditworthiness being properly assessed (Sector-specific Principle)</td>
<td>the max LTV of 40 percent)</td>
<td>about 5 percent lending rates by first-tier FIs such as the commercial banks vs. 24 percent</td>
<td></td>
</tr>
<tr>
<td>Principle)</td>
<td>The above regulations working as constraints for FIs in their underwriting of mortgage</td>
<td>interest rates by some of the tertiary FIs)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>applications</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D. Dispute resolution</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>k. (Collection practice) Prohibition of abusive</td>
<td>Abusive (or violent) debt collection practices being prohibited by the Fair Debt</td>
<td>The law appears to be effective in that the abusive practices have been declining in number and</td>
<td>The FIs’ dispute resolution systems are less frequently used by the consumers, which can be</td>
</tr>
<tr>
<td>collection or debt recovery practices</td>
<td>Collection Practices Act of 2009</td>
<td>being monitored closely by the regulatory authorities</td>
<td>ameliorated by an independent dispute resolution mechanism inside FIs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>A binding arbitration power to be given to “alternative” dispute resolution body</td>
</tr>
<tr>
<td>l. (Consumer complaint) Designated contact point</td>
<td>The system to process consumer complaints being operated in both FI-level and the FSS-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>with clear procedures for handling customer complaints;</td>
<td>level; statistics on consumer complaints being periodically updated and released</td>
<td></td>
<td></td>
</tr>
<tr>
<td>up-to-date records of all complaints received</td>
<td>Through e-Consumer Complaint Center, jointly-run by FSC and FSS, a binding arbitration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Principle 25); &amp; (Ombudsman and other conflict</td>
<td>on consumer complaint being possible; if not satisfactory, consumer can file a lawsuit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>resolution mechanisms) Access to an affordable,</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>efficient, respected, professionally qualified and</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>adequately resourced mechanism for dispute resolution</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Principle 26)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>m. (Foreclosure of mortgaged or charged property)</td>
<td>A clear and objective procedure of liquidating collateral (at the time of borrower’s</td>
<td>The FIs are in general reluctant (or passive) in using the pre-foreclosure workout options; a</td>
<td></td>
</tr>
<tr>
<td>Informing in writing in advance of the procedures</td>
<td>default) being in place, which is notified to the borrower before initiating the</td>
<td>more standardized workout procedure should be devised so as for FIs to be incentivized to use the</td>
<td></td>
</tr>
<tr>
<td>involved, and of the legal remedies and options</td>
<td>procedure Options for pre-foreclosure workout (via loan modification) being available,</td>
<td>the options more actively and to avoid the costly full-blown foreclosure procedures</td>
<td></td>
</tr>
<tr>
<td>available (Sector-specific Principle)</td>
<td>either before or during mortgage delinquency; Consumers can consult with lenders (FIs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>or with the Credit Restoration Committee on those options</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
V. Summary and Concluding Remarks

In this study, we attempt to survey and assess the FCP measures adopted in the household lending sector in Korea, out of which we report several key findings: first, the FCP policies in the sector are fairly comprehensive in that they cover almost all good practices suggested in the literature, although some measures are in a fairly early stage, the financial literacy programs in particular; second, the rules and regulations in the consumer lending (e.g. various macro-prudential regulations employed) tend to focus more on the issue of financial stability, and one should weigh the anticipated benefit in that regard against the unintended cost in financial inclusion; third, the FCP policies in the consumer lending sector of Korea tend to focus on the residential mortgage lending sector, which should be extended to other consumer lending products (e.g. credit – or non-collateralized – lending, credit card receivables, and car loans).

In addition, there is a host of implementation and monitoring issues, some of which we list below as the topics of future research:

- The summary statement ~ Does it contain too much information and details? Do they actually help the understanding of consumers on the product in question?
- The financial literacy programs ~ Are they effective in that they help consumers make a more informed decision? Should an industry-wide norm for the programs be developed?
- The training programs for FI staff ~ Do they have to be sector-specific such that they provide a meaningful help for consumers of different lending sectors?
- The rules and procedures to check the consumer credit data ~ Are they ready and easy enough for consumers? Are enough details being shared on the widely-used consumer credit scores (as to their input data and methodologies) such that future research for enhancement can be fostered?
- The cooling-off period after contract signing ~ Are the qualification conditions and the costs involved appropriate given the practices in other countries (e.g. Germany, and the U.S.)?
- The financial advisory (or counseling) services ~ Do they cover diverse-enough groups of vulnerable consumers (e.g. for those borrowers of the government-supported loan programs)?
- The dispute resolution mechanisms (by FIs and by the regulators) ~ Are they working effectively as a pre-lawsuit conflict resolution mechanism? Are the pre-foreclosure workout options being utilized enough both by FIs and by the consumers?

We also want to reiterate the importance of a timely passage of the special FCP law in the Congress, which will put various FCP issues in the lending sector, both the software aspects (rules and procedures) and the hardware dimensions (governance structure), into a more firm ground.

Two particular issues are worth mentioning as our conclusion remarks. First, we believe that a sound FCP policy is almost all about a proper matching between various loan products and different consumer segments, which should in turn consider to two particular dimensions – product affordability and risk management. To illustrate, one can lay out a baseline consumer segmentation in terms of income and lifecycle stage as follows:

<table>
<thead>
<tr>
<th>Income level</th>
<th>20s &amp; 30s</th>
<th>40s &amp; 50s</th>
<th>60s &amp; 70s</th>
<th>Over 70s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very low</td>
<td>C_{11}</td>
<td>-</td>
<td>-</td>
<td>C_{41}</td>
</tr>
<tr>
<td>Low</td>
<td>-</td>
<td>C_{22}</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Moderate</td>
<td>-</td>
<td>-</td>
<td>C_{33}</td>
<td></td>
</tr>
<tr>
<td>High</td>
<td>C_{44}</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

An initial question to pose is, for each cell in Table 3, C_{ij}, which product - whether it is collateralized or not - will be affordable and welfare-maximizing in the demand-side and, at the same time, will that be in-scope in terms of a risk management capability in the supply-side? As to the residential mortgage lending, there has been a fairly long history of research on consumer choice on mortgage products, between FRM vs. ARM (numerous early studies plus Campbel and Cocco (2003), Miles (2004)), and between the prime vs. sub-prime mortgage contacts (to be quoted). Although it is difficult to pinpoint which product is most welfare-enhancing for a particular consumer segment (say, C_{ij} in the table) based on those studies, a good FCP policy, as we claim, should enhance consumer capability for product selection via effective education programs and other means and should also induce risk-based lending via a proper regulatory
and monitoring scheme.

However, a real-world consumer segmentation tends to be more complicated as it should encompass various other dimensions, e.g. loan purpose (those primary residence vs. those for investment in the case of residential mortgage), demographic factors of importance (first-time home buyers, family size, marital status, and so on), consumer credit ratings (FICO scores in the U.S. and the CB ratings in Korea), and other underwriting conditions (LTV • DTI caps, default insurance, and so on). In the supply-side, there are also various differentiating factors in developing and intermediating the products, e.g. lending channels (direct lending vs. third-party lending vs. on-line lending), product attributes (maturities, interest variability, principal amortization, and prepayment penalty), and funding method (deposit-based vs. whole-sale based). It is documented in the literature that financial consumers are in general not that informed about risk profiles of available financial products (Miles (2004) for the UK case, Agawal et al. (2010) for the U.S. case), and that the various education programs to enhance financial literacy for consumers tend to be ineffective (Tennyson (2016)). Hence, a more micro, or segment-specific, approach is warranted in designing an FCP policy to better match loan products to various consumer cohorts, which consider both dimensions of product affordability and of prudent risk management.

Another issue to comment on is reflecting a process view in designing the FCP policies. That is, the consumer lending business takes multiple steps – from loan application, to underwriting, contracting, servicing, and all the way to loan termination; and different FCP and risk management issues usually come about and may have to be subjects to a policy consideration. We believe that this process-driven view can make the FCP policies in the sector more relevant and realistic, and expect to see careful analyses both from academia and policy circle to be done going forward to make the policy regime in the country more complete and effective.

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Appendix 1. Good FCP practices (selected from the World Bank (2012))

A. (Mandatory) information provision

a. (Summary statement) For all financial products or services, consumers receive a short one or two page summary statement (or electronic equivalent), presented in a legible font and written in plain language, describing the key terms and conditions, including recourse mechanisms, applicable to the financial product or service (Principle 8)

b. (Qualification of FI staff) Staff of financial institutions who deal directly with consumers receive adequate training, suitable for the complexity of the products or services they sell. In particular, financial intermediaries are qualified as appropriate for the complexity of the financial product or service they sell (Principle 14)

c. (Change in lending terms) As early as possible, customers are individually notified in writing (or by electronic means) of changes in interest rates, fees, and charges or other key terms and conditions of their financial products or services (Principle 16)

d. (Consumer credit data) For credit registries, the law specifies the extent and timeliness of the updating of customer information, gives customers ready and free access to their credit reports from credit registers (at least once a year), and provides procedures for correcting mistakes in credit reports (Principle 20)

B. Financial literacy

e. (Programs for financial literacy) A wide range of organizations (including government, state agencies and non-governmental organization) are involved in developing and implementing the financial literacy program. The government appoints a ministry (e.g. the Ministry of Finance), the central bank or a financial regulator to lead and coordinate the development and implementation of the program (Principle 33)

f. (Monitoring financial literacy) The financial literacy of consumers and the impact of consumer empowerment measures are measured through broad-based household surveys that are repeated from time to time to see if the current policies are having the desired impact on the financial marketplace (Principle 36)

g. (Financial advisor) An independent financial advisor is needed, especially for vulnerable groups (low-income, low-wealth, and less creditworthy borrower cohorts) or for particularly complex mortgage contracts, e.g. Reverse Annuity Mortgage (Refer the UK and other cases)

C. Sales practices

h. (Cooling-off period) Except for securities and derivatives, financial products or services with a long-term savings component—or those subject to high-pressure sales practices—have a “cooling-off” period, during which the consumer may cancel the contract without penalty (Principle 11)

i. (Code of Conduct) There should be a principles-based code of conduct that is devised by (by all banks, by all non-bank credit institutions, or by their associations) in consultation with the financial supervisory agency and consumer associations, if possible. Monitored by a statutory agency or an effective self-regulatory agency, this code should be formally adhered to by all sector-specific institutions (Sector-specific Principle)

j. (Affordability of product) When a bank makes a recommendation regarding a product or service to a consumer, the product or service it offers to that consumer should be in line with the need of the consumer; The consumer should be given a range of options to choose from to meet his or her requirements; When offering a new credit product or service significantly increasing the amount of debt assumed by the consumer, the consumer’s credit worthiness should be properly assessed (Sector-specific Principle)

D. Dispute resolution

k. (Collection practice) Financial institutions are prohibited from employing abusive collection or debt recovery practices against their customers (Principle 19)
l. (Consumer complaint) Every financial institution has a designated contact point with clear procedures for handling customer complaints, including complaints submitted verbally. Financial institutions also maintain up-to-date records of all complaints they receive and develop internal dispute resolution policies and practices, including processing time deadlines, complaint response, and customer access (Principle 25)

m. (Ombudsman and other conflict resolution mechanisms) Consumers have access to an affordable, efficient, respected, professionally qualified and adequately resourced mechanism for dispute resolution, such as an independent financial ombudsman or equivalent institution with effective enforcement capacity (Principle 26)

n. (Debt Recovery) A bank, agent of a bank and any third party should be prohibited from employing any abusive debt collection practice against any customer of the bank, including the use of any false statement, any unfair practice or the giving of false credit information to others (Sector-specific Principle)

o. (Foreclosure of mortgaged or charged property) In the event that a bank exercises its right to foreclose on a property that serves as collateral for a loan, the bank should inform the consumer in writing in advance of the procedures involved, and the process to be employed by the bank to foreclose on the property it holds as collateral and the consequences thereof to the consumer; At the same time, the bank should inform the consumer of the legal remedies and options available to him or her in respect of the foreclosure process (Sector-specific Principle)