



Finansinspektionen  
Box 7821  
103 97 Stockholm

SVERIGES RIKSBANK  
SE-103 37 Stockholm  
(Brunkebergstorg 11)

Tel +46 8 787 00 00  
Fax +46 8 21 05 31  
registratorn@riksbank.se  
www.riksbank.se

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## Consultation response to proposed new regulations requiring the amortisation of new mortgages

*The Riksbank welcomes Finansinspektionen's proposal for new regulations requiring the amortisation of new mortgages and considers that this is a step in the right direction towards managing the risks associated with household debt.*

*The Riksbank considers that household indebtedness is high, in both historical terms and in an international comparison, and poses risks to the Swedish economy. The Riksbank therefore believes that indebtedness should be reduced. It is thus important to take measures that effectively limit the risk of debts continuing to increase more rapidly than incomes. This applies not least given that Finansinspektionen's proposals for regulations on amortisation requirements offer the possibility of reassessing the value of housing every fifth year.*

*In the case of the reassessment of housing due to a substantial change in value, the Riksbank considers that Section 4 of the proposed regulations should be clarified to enable a harmonised application of the regulations.*

*The Riksbank considers that there may be special grounds to grant exemptions to the amortisation requirements and thus shares Finansinspektionen's view on this issue.*

*The Riksbank considers it important that Finansinspektionen continually evaluates the application of the amortisation requirements and their consequences. If the desired effect is not achieved, Finansinspektionen should review the regulations.*

The Riksbank has long been concerned about the high and growing level of Swedish household debt and the risks associated with this trend.<sup>1</sup> The Riksbank therefore welcomes Finansinspektionen's proposal for new regulations requiring the amortisation of new mortgages and believes that this is a step in the right direction. As Finansinspektionen mentions in its consultative memo, international studies show that households with high loan-to-value ratios, that is high debts in relation to the value of their housing, tend to reduce their consumption more in the event of a macroeconomic shock than households with low loan-to-value ratios.<sup>2</sup> Households with high loan-to-value ratios thus constitute a risk to the macroeconomy. In order to

<sup>1</sup> See, for example, Financial Stability Report 2014:2, Sveriges Riksbank, and Monetary Policy Report July 2013, Sveriges Riksbank.

<sup>2</sup> See, for example, Andersen et al. (2014) "Household debt and consumption during the financial crises", WP 89, Danmarks Nationalbank.

■ reduce this risk, it is therefore important that the households increase the amortisation of their mortgages.

Although the Riksbank takes a positive view of the new regulations, it does wish to make a number of comments on the proposals. These are presented below.

### **Reassessment of housing every fifth year**

Finansinspektionen proposes that the households should be allowed to reassess the value of their housing every fifth year and that the loan-to-value ratio and the size of the amortisation payments should be determined on the basis of the new market value.

Here the Riksbank would like to point out that the research Finansinspektionen refers to in its consultative memo also shows that households with high debt ratios, that is high debts in relation to their disposable incomes, reduce their incomes more than households with low debt ratios in the event of a macroeconomic shock. If Finansinspektionen adopts regulations that make it possible for households to reassess the value of their housing every fifth year at the same time as housing prices increase more than incomes, this means that many households will be able to continue to have large debts or even to increase their debts in relation to their incomes despite the fact that their loan-to-value ratios have fallen.<sup>3</sup> The economic risks associated with household indebtedness will then remain or increase. The Riksbank therefore believes that it is important that the households reduce their debts not only in relation to the value of their housing but also in relation to their incomes.

The proposed amortisation requirements only apply to new mortgages with a loan-to-value ratio above 50 per cent. Without the possibility to reassess the value of the housing after purchase, it would – all else being equal – take approximately 9 years to amortise a mortgage from a loan-to-value ratio of 85 per cent to 70 per cent. The Swedish Bankers' Association's earlier recommendation to the banks was that a mortgage should be amortised down to a loan-to-value ratio of 70 per cent over a period of 10 to 15 years. In other words, Finansinspektionen's amortisation requirements, without the possibility to reassess the value of housing, are not significantly different from the previous recommendation of the Swedish Bankers' Association. If reassessment is not permitted, the proposals also mean that households would need to amortise a mortgage from a loan-to-value ratio of 85 to 50 per cent over a period of 32 years. In an international comparison this would seem to be a moderate rate. In many other countries, mortgage holders are expected to amortise their entire mortgages within 30 to 40 years.

Against this background, the Riksbank's assessment is that the impact of the amortisation requirements with regard to slowing down the development of the debt ratio may be far too weak if the opportunity to reassess housing values every fifth year is provided. There are measures that could effectively limit the risk of debts continuing to grow more rapidly than incomes. The Riksbank believes that such measures should be considered, and this becomes even more urgent if the regulations make it possible to reassess values every fifth year.

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<sup>3</sup> The Riksbank's credit data from the eight largest banks shows that approximately 23 per cent of the households with mortgages increased their net debts between July 2013 and July 2014. See Winstrand, Jakob and Dilan Ölcer, "How indebted are the Swedish households?" Economic Commentary, Sveriges Riksbank, no.1, 2014, and Alfelt, Gustav and Jakob Winstrand (2015) "Household indebtedness in Sweden – update for 2014" Economic Commentary, Sveriges Riksbank, no. 1, 2015.

■ With regard to the reassessment of housing values it is also worth noting that the regulations permit an asymmetry in how an increase in housing prices is dealt with compared to a fall in housing prices.

### **The reassessment of housing in connection with a significant change in value**

Section 4 of the proposed regulations stipulate that if the market value of a house or a flat changes substantially for a reason other than the general development of housing prices, then a reassessment may be made sooner than every fifth year. Although the enclosed consultative memo provides examples of situations that may justify a substantial change in the value of the housing, it is not clear how large a change should be to be considered substantial. It may also be difficult in practice to differentiate between increases in value that arise from changes specific to a particular property and those that relate to changes in the general price level for housing.

The Riksbank therefore considers that the regulations in Section 4 should be clarified, for example so that it is made apparent what determines whether a change in value is substantial or not. An alternative is also to combine the regulations with general guidelines in order to enable a harmonised application of the regulations on what can be considered to constitute a substantial change in the value of the housing.

As the regulations permit reassessment in the event of substantial changes in value, the Riksbank's assessment is that it is important to also clarify how a value assessment may be conducted and who should be allowed to conduct it.

### **Exemptions from amortisation requirements**

The Riksbank supports Finansinspektionen's proposal that, where there are special grounds, mortgage companies should be permitted to make a mortgage holder exempt from making amortisation payments during a limited period.

### **Continual follow-up and evaluation of the amortisation regulations**

As mentioned above, the Riksbank considers that it is important that the households reduce their debts both in relation to the value of their housing and in relation to their incomes. It also is important that Finansinspektionen continually follows up how the amortisation requirements are applied and what effects they have. It is important that the credit institutions apply the regulations in a uniform way and do not use them as a means of competition. It is important that practices do not develop that lead to circumvention of the regulations, for example by households borrowing to amortise or by abuse of the regulations governing exemptions. It would also be desirable for Finansinspektionen to gain access to valuation data if valuation is carried out by an organisation that is not subject to supervision by Finansinspektionen.

If it proves to be the case that the amortisation regulations are not complied with as intended, the Riksbank considers that Finansinspektionen should be prepared to act by adjusting the regulations.

The Riksbank has only adopted a stance on the proposed amortisation requirements. However, these are expected to have only a limited effect on aggregate indebtedness in Sweden. Moreover, it will take a long time before the effects have an impact. Although the proposed amortisation requirements are a step in the right direction, the Riksbank's assessment is that they are insufficient to fully deal with the problems associated with household indebtedness. There is still a great need to introduce

- further measures. It will be necessary to introduce such measures gradually and over a long period of time.

On behalf of the Executive Board:

Stefan Ingves

Hanna Köhler

Taking part in the decision: Stefan Ingves (Chairman), Kerstin af Jochnick, Martin Flodén, Per Jansson, Henry Ohlsson and Cecilia Skingsley.

The reporting officer was Dilan Ölcer.