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Consultation response to the memorandum proposing an amortisation requirement

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The Riksbank welcomes the Ministry of Finance's proposal for the introduction of a new legal provision introducing an amortisation requirement. On previous occasions, including in its Financial Stability Report 2015:1, the Riksbank has underlined the importance of introducing an amortisation requirement in order to reduce the risks associated with high household indebtedness.

The Riksbank sees significant risks posed by the increased debt of households. The rapid implementation of much-needed measures is therefore of the utmost importance. An amortisation requirement is a step along the way, but far from sufficient to reduce these risks to acceptable levels. One reason is that the amortisation requirement only affects new mortgages. In accordance with what is stated in Financial Stability Report 2015:1, the Riksbank recommends that the Government and responsible authorities take additional measures as soon as possible in order to reduce the risks in the household sector.

The proposals in the memorandum also relate to the important overarching issue of the wording of Finansinspektionen's macroprudential policy mandate. This area was also discussed by the Riksbank in the abovementioned financial stability report. In the report, the Riksbank recommended that the Riksdag and the Swedish Government clarify as soon as possible Finansinspektionen's mandate and tools for macroprudential policy.

In short, Sweden is in major need of an efficient macroprudential policy framework. Even if the Riksbank largely welcomes the legislative proposal, it expects further initiatives to be taken as soon as possible.

Regarding the memorandum's proposal for the wording and prerequisites for the amortisation requirement, the Riksbank has the following comments.

The Riksbank opposes the proposal that Finansinspektionen must obtain prior approval from the Government before the amortisation requirement provisions are adopted. It is important that Finansinspektionen pursues a macroprudential policy that is operationally independent. The Riksbank is of the opinion that such an unclear delegation of the amortisation requirement risks hindering the implementation of the requirement and reducing the scope for accountability. This in turn impairs the prerequisites for an efficient, long-term macroprudential policy in Sweden. It is therefore important that the Riksdag and the Government clarify Finansinspektionen's mandate and tools for macroprudential policy as soon as possible.

■ According to the Riksbank, the legislative text should make it clear that the aim of the amortisation requirement is to counteract financial and macroeconomic stability risks.

The Riksbank shares the view expressed in the memorandum that there may be special grounds for granting exemptions to the amortisation requirement. It is the opinion of the Riksbank, however, that the scope for the banks to grant exemptions should be limited to certain conditions and that exemptions should be temporary. Wider scope for granting exemptions risks undermining the efficacy of the measures. It is also important that the amortisation requirement is worded as a minimum amortisation level, giving credit institutions the freedom to require a more rapid rate of amortisation. The exemption provision should also be worded as an option for credit institutions to grant exemptions rather than a right for certain groups to demand them.

The Riksbank opposes the proposal in the memorandum to exempt newly built homes from the amortisation requirement.

Amortisation requirement – a step in the right direction

On several occasions, the Riksbank has underlined the importance of introducing an amortisation requirement as soon as possible, including in its Financial Stability Report 2015:1. The reason for this is the high and growing level of Swedish household debt and the risks associated with this trend. A legal amendment introducing an amortisation requirement is therefore necessary as a step towards managing the risks associated with high household indebtedness. The Riksbank therefore welcomes the Ministry of Finance's proposal to introduce new legislation on an amortisation requirement for new mortgages. It is important for financial and macroeconomic stability that the amortisation requirement is put in place as soon as possible.

Other tools over and above the amortisation requirement are also needed to reduce the risks associated with household indebtedness

The amortisation habits of Swedish households stand out in an international comparison. It is more common in other countries to amortise, and to do so at a faster rate than in Sweden, often without the authorities having to impose requirements or recommendations on borrowers. In most countries, the loan has a clear maturity date, which specifies when the debt is to be repaid, often between 20 and 40 years, and the proportion of interest-only loans is often low. The proposal for an amortisation requirement, presented but then withdrawn by Finansinspektionen in the spring, stated that it was only required to amortise down to 50 per cent of the debt and over a significantly longer period than is applied internationally.¹

The Riksbank has expressed the view that the Government and responsible authorities should take other measures as soon as possible to reduce the risks associated with household loans. The amortisation requirement is one measure but is not enough to manage the risks associated with high household indebtedness. One reason is that the requirement only affects new mortgages. High and increasing indebtedness poses risks to both individual households and the national economy. Other countries with the same trend have taken a range of measures to manage the risks associated with rising housing prices and debts in the household sector. Common measures include abolishing or reducing tax relief on interest payments, introducing loan-to-value and debt-to-income limits, and raising risk weights for mortgages. In Sweden, Finansinspektionen has taken certain measures. But additional measures are needed in several different policy areas that tackle the underlying causes of increased

¹ If the home is not revalued, the proposal for an amortisation requirement presented by Finansinspektionen in the spring meant that households with a loan-to-value ratio of 85 per cent would need to amortise down to a loan-to-value ratio of 50 per cent in 32 years.

■ indebtedness. This refers primarily to measures to combat the structural problems on the housing market, i.e. measures to increase housing supply and to reduce incentives to build up debt.

Important to give Finansinspektionen an unequivocal mandate and clear tools

It is the assessment of the Riksbank that the Swedish Government and the Riksdag should clarify Finansinspektionen's mandate and tools for macroprudential policy over and above the amortisation requirement.

The Government has issued an ordinance giving Finansinspektionen the main responsibility for macroprudential policy. It has become evident, however, that the regulatory framework does not give Finansinspektionen a sufficiently clear mandate to take measures to counteract financial imbalances. This lack of clarity risks delaying and hampering the introduction of necessary measures to reduce the risks associated with household indebtedness and to counteract other financial imbalances going forward. It is therefore of the utmost importance that Finansinspektionen's mandate and tools for macroprudential policy are clarified and set out in law. The mandate should also make it clear that Finansinspektionen can take measures to counteract financial imbalances even when there are no immediate risks to financial stability, but rather risks to macroeconomic stability.

Although the Riksbank takes a mostly positive view of the new legislative proposal, it wishes to make a number of comments on the proposed wording of and prerequisites for the amortisation requirement. The main gist of the comments concerns the efficacy of the amortisation requirement. The amortisation requirement will be limited to new mortgages only. This is why it is very important that Finansinspektionen has the scope and freedom to implement the amortisation requirement based on a sufficiently broad and clear mandate, that exemptions are kept to a minimum and that as many mortgage-lenders as possible are covered, including foreign institutions that provide mortgages to private individuals in Sweden.

The comments are discussed below.

The proposal for prior approval from the Government is not compatible with Finansinspektionen's operational independence

The memorandum proposes that Finansinspektionen must obtain prior approval from the Government before the amortisation requirement provisions are adopted. This is justified by the fact that it is important for the measures to be well-balanced, both when it comes to wording and timing, as the macroeconomic effects of an amortisation requirement are potentially substantial. The memorandum also states that obtaining prior approval from the Government is appropriate as amortisation provisions can be seen to represent an intervention in a private individual's finances.

The Riksbank does not think that obtaining prior approval from the Government is compatible with the ESRB's² recommendation of operational independence.³

Macroprudential policy is a relatively new policy area within which many countries have fairly recently introduced organisational and operational frameworks. The background to this is the inadequate oversight which was exposed by the financial crisis. Traditional financial oversight - with a focus on individual institutions - proved to be insufficient in terms of safeguarding stability in the financial system. The supervision needed to be supplemented by an analysis of the links between different institutes and markets, as

² European Systemic Risk Board.

³ Recommendation of the European Systemic Risk Board (ESRB) of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3), (2012/C 41/01).

well as the contagion risks such links could give rise to. This kind of oversight of the system as a whole – i.e. macroprudential policy – requires another kind of analysis and places different demands on the institutional structure when compared to traditional oversight. Within the EU, the work the ESRB - the EU's macroprudential body - has undertaken to define these requirements more clearly has come to have a significant impact on many EU countries' frameworks. The ESRB's recommendation regarding national mandates for macroprudential policy has been particularly influential.

This recommended that Member States nominate a macroprudential body which should be given clear targets and control over appropriate instruments. There should also be clear and fast procedures for allocating the macroprudential body new instruments when necessary. Another important cornerstone is that the macroprudential body is to be operationally independent – especially from political bodies and the finance sector – and ultimately accountable to the national parliament.

The background to the ESRB's emphasis on clear targets, control over tools, operational independence and being accountable to parliament is what is known as "inaction bias", i.e. the tendency towards inactivity, which is considered to exist in the macroprudential policy area.⁴ This is due to the fact that the costs of macroprudential policy measures – lower short-term growth – are noticed directly in the economy, while the benefits – reduced risk of financial crises and better conditions for long-term growth – take much longer to manifest themselves and are more difficult to measure. A certain degree of political independence in this area has therefore been deemed to benefit the long-term economic development of countries.

Governance of the authorities is necessary for the Riksdag and the Government to be able to fulfil the political mandate given to them by the electorate. The Riksbank sees problems, however, with a process that requires prior approval from the Government as proposed in the memorandum. The amortisation requirement is a tool that is to be allocated to Finansinspektionen according to the proposal. The proposed legislative amendment constitutes the mandate and hence sets the limits for how the tool is to be used. The prior approval requirement opens the door to speculation over whether the Government is able to influence operational implementation of the tool and hence backpedal over its delegation of it. Such an unclear delegation of the amortisation requirement risks having a negative effect on public confidence in macroprudential policy. It would also hamper implementation of measures and restrict the scope for accountability in the macroprudential policy area.

Furthermore, it would set an unfortunate precedent regarding independence in other macroprudential measures and impair the conditions for good, long-term macroprudential policy in Sweden. In summary, there are good reasons for ensuring that macroprudential instruments aimed at contributing to long-term financial and macroeconomic stability are not influenced by more short-term considerations. This does not however prevent the Government from tasking Finansinspektionen to retroactively evaluate the implementation of macroprudential policy instruments and report back to the Government.

The aim of the amortisation requirement should be made clear by the wording of the legislation

According to the proposed wording, credit institutions are to apply terms and conditions that, when it comes to repayment, are compatible with a sound amortisation

⁴ For more information on "inaction bias", see Goodhart, Charles A.E. (2011), *The Macro-Prudential Authority: Powers, Scope and Accountability*, *OECD Journal: Financial Market Trends*, Volume 2011/2, Paris and Borio, Claudio (2014), *Macroprudential frameworks: (too) great expectations?*, in D. Schoenmarker (Ed.), *Macroprudentialism*, pp. 29-46, London: CEPR Press.

■ culture and do not contribute to excessively high indebtedness. The aim of counteracting financial and macroeconomic stability risks can only be found in the memorandum's description of the grounds that will constitute the legislative history of the new provision. Since the provision is worded as a policy rule for credit institutions, and furthermore is to constitute the basis for Finansinspektionen's mandate for introducing an amortisation requirement, it is desirable that the aim of counteracting financial and macroeconomic stability risks is made clear in the legislative text itself.

There should be scope for exemptions on special grounds but it is important not to undermine the amortisation requirement

According to a proposal in the memorandum, it should be possible to exempt some households from the amortisation requirement under certain circumstances. The proposal states that such exemptions shall be given on special grounds, for example the death of a family member, unemployment, illness or divorce occurring after the mortgage has been taken out.

The Riksbank shares the view expressed in the memorandum that there may be special grounds for granting exemptions to the amortisation requirement.

It is very important that the future provision is worded as a minimum amortisation level, giving credit institutions the freedom to require a more rapid rate of amortisation. The exemption provision should also be worded as an option for credit institutions to grant exemptions rather than a right for certain groups to demand them. This would allow credit institutions to weigh an exemption against other considerations, such as their own credit exposure, instead of being forced to accept risks that may result in increased vulnerability.

Although it is important that there is scope for relief when special grounds exist for the household, it is also important that the effect of the amortisation requirement is not undermined by widespread exemptions. It is the Riksbank's opinion therefore that the scope for exemptions should be limited to special grounds, that the exemption should be temporary and that the underlying reasons should be regularly reviewed. So as not to negate the aim of the exemption, the Riksbank also recommends that Finansinspektionen keep track of the extent to which the banks make use of the scope for granting exemptions, what grounds are given for granting them and how long they are granted for.

Exemptions for newly built homes should not be given

The memorandum also proposes that purchases of newly built homes should be another basis for exemption. No reasons or analysis of the consequences of the proposal are offered in the memorandum.

The Riksbank considers it inappropriate to exempt newly built homes from the amortisation requirement.

According to the Riksbank's assessment, there is a major need for new homes to be built in Sweden. One reason is to increase geographical mobility so that it is easy for people to move to where there are jobs or higher education opportunities. Another reason is to stem an unhealthy price trend on the housing market and thereby reduce the risks associated with high household indebtedness. However, there are currently several underlying structural problems on the Swedish housing market which are hampering housing construction. These include, for example, demanding land and planning processes, the municipalities' planning monopoly, limited access to land ready for development, a lack of competition in the civil engineering and construction sectors,

■ regulations on the rental market and current legislation which facilitates appeals and places considerable demands on the quality of the housing being built.⁵

If the underlying problems on the supply side are not dealt with, there is a risk that the exemption from the amortisation requirement for newly built homes will lead to demand increasing without a notable increase in supply. Such a situation could lead to the risks associated with household indebtedness increasing further, which is the opposite effect the amortisation requirement is expected to have.

If the purpose of the proposal to exempt newly built homes from the amortisation requirement is to stimulate housing construction, then the Riksbank is of the opinion that it is better to introduce other clearly targeted measures, such as changes to the tax system or structural measures which improve the conditions for construction, rather than using macroprudential instruments. Even if newly built homes only represent a small part of the total housing stock, the use of the amortisation requirement for other purposes than those intended risks reducing its effectiveness.

The implementation of this kind of exemption also entails setting a number of difficult boundaries, such as how long a home should be considered newly built and therefore applicable for an exemption from the amortisation requirement, whether only the first buyer should be permitted to take advantage of the exemption or whether all potential buyers over a specific time period should be able to take advantage of it, and whether an exemption would reduce the incentive to build rental properties.

Another question which should be examined is whether the risks the amortisation requirement is designed to deal with are in reality greater for households that buy newly built homes. As newly built homes are often more expensive than other homes, it is reasonable to assume that a household which buys a newly built home has a larger debt than other households, both in relation to the value of the home and the household's income. Households with large debts are deemed to be more exposed to risks and to react more strongly to changes in economic conditions. Furthermore, when purchasing a newly built tenant-owned home, the tenant-owner automatically becomes a member of the housing cooperative, which has also taken on large debts. This exposes the tenant-owner to even greater risks. In conclusion, exempting highly indebted households could undermine the purpose of the amortisation requirement.

On behalf of the Executive Board

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⁵ See Bergendahl, Per-Anders, Monika Hjeds Löfmark and Hans Lind (2015), "Bostadsmarknaden och den ekonomiska utvecklingen" (The housing market and economic development), Appendix 3 to Långtidsutredningen (Long-Term Survey of the Swedish Economy) 2015, SOU 2015:48, Emanuelsson, Robert (2015), "Utbudet av bostäder i Sverige" (The supply of housing in Sweden), *Sveriges Riksbank Economic Review* 2: 47-73, and Bokriskskommittén (Housing Crisis Committee) (2014), "*En fungerande bostadsmarknad – en reformagenda*" (*An efficient housing market - an agenda for reform*), and Nybyggarkommissionen (The New Construction Commission) (2014), "*En bostadspolitisk agenda för Sverige – 63 förslag för ökat byggande*" (*A housing policy agenda for Sweden – 63 proposals for increased construction*).

■ The following took part in the Executive Board's decision: Stefan Ingves (Chairman), Kerstin af Jochnick, Martin Flodén, Per Jansson, Henry Ohlsson and Cecilia Skingsley.

The rapporteur was Magnus Georgsson.