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Consultation response regarding the proposal to introduce a stricter amortisation requirement for new mortgage holders with high loan-to-income ratios

2017-09-08

The Riksbank welcomes Finansinspektionen's proposal for stricter amortisation requirements for highly indebted households. Swedish households' high and rising indebtedness forms a serious threat to financial and macroeconomic stability. It is therefore necessary to introduce as quickly as possible measures to increase households' resilience.

The proposal for stricter amortisation requirements now being put forward is aimed at households with high indebtedness in relation to household income, and it thus complements the current amortisation requirement. The Riksbank therefore welcomes this proposal, but wishes to emphasise how important it is that households' resilience increases and the risks inherent in household indebtedness are reduced, and to point out that further macroprudential measures may be needed if this does not happen. The Riksbank therefore considers it important that the amortisation requirement and household resilience are evaluated regularly to assess whether the desired effects have been achieved.

Although welcoming the proposal for stricter amortisation requirements, the Riksbank considers there is a need to clarify some parts of the proposed regulations.

The importance of household debt declining in relation to income

The Riksbank has previously pointed out that the current amortisation requirement is relatively mild in an international perspective and should be supplemented with income-based debt limitations so that it affects household debt, not only in relation to the value of the home but also in relation to the household income (see the Riksbank's consultation response on *Proposal on new regulations on amortisation requirements for new mortgages, DNR 2015-00875*).

The stricter amortisation requirements now proposed are aimed at households with high debts in relation to household income, that is, households that are vulnerable to shocks in the economy. The Riksbank therefore welcomes the stricter amortisation requirements and considers it important that they are introduced quickly.

The Riksbank considers it of the utmost importance that the growth in debt is slowed down and wishes to point out that it is essential to continue to implement measures to increase the resilience of the household sector and to reduce the risks. It is necessary to introduce measures that create a better balance between supply and demand on the housing market and also to introduce tax reforms. Further macroprudential measures may also need to be taken.

Incomes in calculation of borrowers' debt-to-income ratios

Finansinspektionen proposes that the calculation of borrowers' debt-to-income ratios shall be based on their total income before tax, using the most recently established earned income. The Riksbank sees the practical advantages of proposing that borrowers' income before tax, rather than disposable income, is used as a basis for calculating the debt-to-income ratio. At the same time, it is disposable income and not income before tax that best reflects households' debt-servicing ability. The Riksbank thinks that it would have been better conceptually if the calculations had been based on disposable income, but considers that Finansinspektionen's definition of income is acceptable.

Finansinspektionen proposes that other income that the most recently verified earned income could be included in income before tax, on condition that this income is verified and lasting. As the basic principle is that the mortgage company will determine if the income is verified and lasting, the Riksbank considers that further clarification is needed as to what constitutes verified and lasting income. This would make it easier to apply the regulations uniformly.

Further, the Riksbank considers that it is unclear which regulations apply with regard to a change in income after a mortgage has been granted and how this will affect the debt-to-income ratio and amortisation requirement. To avoid misunderstanding when applying the regulations, the Riksbank considers that Finansinspektionen should clarify in the regulations what discretion the mortgage company has with regard to the right to recalculate the debt-to-income ratio after a change in income.

The definition of debt

When choosing which debt amount shall be included in the debt-to-income ratio, Finansinspektionen has weighed two main alternatives against one another. The first alternative is that the debt amount shall be calculated on the basis of all of the borrowers' mortgages. The second alternative is that the debt amount shall be calculated on the basis of all of the borrowers' loans. Finansinspektionen thinks, and the Riksbank shares this view, that the second alternative provides a more correct picture of the borrowers' total debts.

However, Finansinspektionen thinks that there are a number of practical arguments against using borrowers' total debt as a basis, for instance, that it can be difficult to capture the loan takers' total debts including consumption loans. The Riksbank thinks that such arguments can also apply if only mortgages are included in the definition of debt. As Finansinspektionen still does not have the authority to announce regulations regarding amortisation requirements for some companies that supply mortgages, this means that some mortgages will not be visible in credit reports (for instance, from UC) and will thus not be covered by the amortisation requirement.

The Riksbank also sees a number of practical difficulties with a broad definition of debt, as in Sweden there is unfortunately no national credit register. As it is important that the stricter amortisation requirements are introduced quickly, the Riksbank considers that Finansinspektionen's definition of debt is acceptable given the circumstances.

At the same time, this is an even stronger indication of the need for authorities to have access to anonymous data at individual level to be able to analyse risks in the financial system. At European level, and even in Sweden, there is a large project underway on collecting data on credit at corporate level.¹ The Riksbank considers a corresponding project for credit at individual level would be desirable. To attain more transparent credit-granting in Sweden, the

¹ The ECB's AnaCredit reporting and the Riksbank's credit database (KRITA).

Riksbank considers it necessary to establish a nationwide and complete credit information register. Information from such a register could be used by both those granting credit and the authorities.

One of Finansinspektionen's arguments against introducing a debt-to-income limit based solely on mortgages is that there is a risk that the issuing of unsecured loans will increase. At the same time, it is proposed that only mortgages should be included in the definition of debt in the stricter amortisation requirements. Given this, the Riksbank considers that it is particularly important that Finansinspektionen, like the banks, continues to oversee that unsecured loans do not increase in the wake of the amortisation proposal.

Exemption for newly built homes

Finansinspektionen also proposes that the exemptions that apply to newly build homes according to the amortisation regulations (FFFS 2016:16 10 §) and agricultural buildings (11 §) shall also apply with regard to the stricter amortisation requirements. The Riksbank considers that Finansinspektionen should clarify what loan-to-value ratio and debt-to-income ratio are used as a basis for the amortisation amount once the first five years have passed. The Riksbank considers that it is not clear whether the amortisation amount is based on the loan-to-value ratio and the debt-to-income ratio when the home was acquired or those applying after the five years.

Evaluation

The Riksbank considers that it is still important to regularly evaluate to what extent the amortisation requirement is observed and how, for instance, the exemptions from the amortisation requirements will be applied. This is important, partly to obtain an overall picture of the amortisation requirement's efficacy, and partly to find out whether the scope for exemption might be used as a means of competition.

A more thorough evaluation of the regulation should also be performed at regular intervals after it comes into force. Such an evaluation should include the question of whether households' resilience has increased and whether the amortisation requirement has slowed down the growth in debt. If the desired effect has not been achieved, the Riksbank considers that Finansinspektionen should consider adjusting the amortisation requirements. As there are different ways of defining debts and incomes, for instance, these definitions can be reviewed. Moreover, one could consider adjusting the percentage that households are expected to amortise. As it is uncertain what effects the amortisation requirements will have on households' resilience and the risks linked to household debt, other macroprudential policy measures may also need to be introduced.

On behalf of the Executive Board

Stefan Ingves

Emelie Nilsson

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 report was presented by Peter van Santen and Dilan Ölcer.