



FI Ref. 14-16628

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## Regulations regarding mortgage amortisation requirement

### Summary

Finansinspektionen decides on regulations regarding amortisation requirements.

On 23 March 2016, the Riksdag decided to adopt a law proposal with the changes suggested by the Committee on Finance for the implementation of an amortisation requirement in the Banking and Financing Business Act (2004:297). The new statutory provision on amortisation requirements entered into force on 1 May 2016. On 31 March 2016, the Government decided to amend the Banking and Financing Business Ordinance (2004:329), which grants an authorisation to Finansinspektionen to issue regulations that regulate the amortisation requirement in detail. On 12 May 2016 the Government granted its approval for Finansinspektionen's proposal for the new regulations. The new regulations shall enter into force on 1 June 2016.

Mortgages serve an important function in the economy by enabling households to acquire a home and use their future income to pay off the loan. Hence, households do not have to save for the entire expense of a home before acquiring it. However, household indebtedness, which largely comprises mortgages, also creates risks for the Swedish economy. Experience from an international perspective suggests that households with a high loan-to-value ratio (LTV) are more inclined to significantly change their consumption behaviour in the event of economic shocks, which in turn can create and aggravate economic downturns. This is because such households may be sensitive to shocks, such as higher interest rates, a drop in house prices or loss of income. A rising share of new mortgage holders in Sweden take out mortgages that exceed 50 per cent of the value of the home (the ratio between the household's mortgage and the value of the home is called the 'loan-to-value ratio' (LTV) herein). At the same time, interest-only mortgages are common for households with LTVs of between 50 and 70 per cent. Finansinspektionen therefore assesses that the macroeconomic risks<sup>1</sup> associated with household indebtedness are currently escalating. Increased mortgage amortisation will

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<sup>1</sup> The concept of 'macroeconomic risks associated with household indebtedness' refers to the risk that downturns in the economy will be created or amplified by a decrease in consumption by highly indebted households.

ensure that these highly leveraged households will reduce their leverage over time, thereby reducing the risks.

It is therefore crucial to ensure that mortgages are amortised at an appropriate rate and to an appropriate extent. The adopted statutory provision prescribes that mortgage firms shall apply repayment terms which are consistent with a sound amortisation culture and which prevent excessively high household indebtedness. This is a matter of general principles which, when preparing regulations regarding the amortisation requirement, must be pinpointed.

Some changes were made to the proposal that Finansinspektionen submitted for consultation on 18 December 2015 as a result of the changes to the proposed law that were made after the Committee on Finance's report and due to the consultation responses that were submitted to Finansinspektionen. In this memorandum, Finansinspektionen discusses a large portion of the consultation responses that were submitted. Finansinspektionen has considered all of the responses that were submitted even if they are not discussed in this memorandum. Like the consultation proposal, the regulations cover mortgages granted by credit institutions, i.e. banks and credit market companies ('mortgage firms'). Mortgages granted by foreign firms operating in Sweden are also covered. Finansinspektionen considers that the greatest risks are posed by households with debts exceeding 50 per cent of the home's value. The starting point for the regulations is therefore that mortgages in excess of 50 per cent of the home's value must be amortised. However, this only applies to mortgages granted after 1 June 2016. The requirement does not affect credit agreements that have already been entered into.

Since the risks increase in line with the household's LTV, there is justification for structuring the amortisation requirement progressively to allow the amortisation rate to be reduced when the household reaches a slightly lower level of leverage. According to the regulations, new mortgages exceeding 70 per cent of the home's value are to be amortised by at least 2 per cent (of the total mortgage) annually, and by at least 1 per cent (of the total mortgage) annually when loans amount to between 50 and 70 per cent of the home's value. The valuation of the home shall be based on the market value. However, a continuous market valuation may run the risk of the regulation having procyclical effects, i.e. that the regulation could amplify cyclical and market fluctuations because amortisation decreases when house prices rise, and increases when house prices fall. To reduce this risk, a home may not be revalued more than once every five years. In addition, it shall be possible to perform a revaluation in the event of a considerable value change that is not attributable to the general price progression in the housing market, such as an increase in value owing to extensive renovation, conversion or extension of the home.

In order to protect individual borrowers and the economy, there must be exemptions from the amortisation requirement under certain circumstances. Mortgage firms are therefore allowed to grant mortgage holders a reprieve

from amortisation for a limited period if there are special grounds. This refers to occasions when the mortgage holder's financial circumstances have significantly deteriorated after the mortgage was granted. Typical situations in which exemptions might be granted include unemployment, sickness or a death in the family. However, other circumstances may also constitute special grounds. Mortgage firms may also allow an exemption for mortgages collateralised by newly built homes. However, this exemption is only applicable to the original purchaser for a maximum of five years from the date on which the home was occupied. Furthermore, mortgage firms may allow an exemption for credit collateralised by agriculture or forestry real estate (agricultural units in accordance with the Real Estate Tax Act).

In Finansinspektionen's assessment, the regulations ensure that mortgage firms, when granting loans, will apply terms which, as regards loan repayment, are consistent with a sound amortisation culture and which prevent excessively high household indebtedness. The advantages of the regulation are deemed to be significantly greater than the costs.

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## 1 Mortgage amortisation requirement

**Finansinspektionen's position:** Finansinspektionen has decided to issue regulations regarding an amortisation requirement for mortgages.

**Consultation memorandum:** Contained the same assessment.

**Consultation bodies:** Many of the consultation bodies share Finansinspektionen's concern for the risks associated with highly indebted households and are positive to bolstering the amortisation culture. *The Swedish Bankers' Association* states that it has promoted a healthier amortisation culture for several years and believes that the requirement overall is well worded and balanced. *Sveriges Riksbank* (the Riksbank) believes that the amortisation requirement is a step in the right direction, but that it is relatively mild from an international perspective. *Bluestep Finans AB* (Bluestep) is positive to an increased share of mortgages being amortised. *Riksförbundet Bostadsrätterna Sverige ekonomisk förening* (Bostadsrätterna) considers there to be many positive effects from increased amortisation and lower household indebtedness. *The Swedish Trade Union Confederation* (LO) welcomes a strong amortisation culture in Sweden since this is good for the stability of the Swedish economy. *The Swedish Consumers' Association* is positive to decreasing the indebtedness and financial risks of consumers and in the economy at large. *The Confederation of Swedish Enterprise* deems that establishing a permanent amortisation culture is sound from both a microeconomic and a macroeconomic perspective. *KTH Royal Institute of Technology* (KTH) finds Finansinspektionen's proposed amortisation requirement to be well balanced overall. *The Swedish Consumer Agency* deems that the proposal is sound, and that from a consumer perspective it is important for highly indebted households to reduce their loans over time. *The Swedish Association of Estate Agents* is in principle positive to measures that lead to an increase in households' amortisation of their mortgages. *The Swedish Confederation of Professional Associations* deems that a strong amortisation culture is positive and that an amortisation requirement can better contribute to this culture than the recommendation on individual amortisation schedules decided by the Swedish Bankers' Association. *The Swedish National Debt Office* agrees that it is appropriate to decrease the sensitivity of highly indebted households to disruptions in order to reduce the sensitivity of the economy. *The Swedish Savings Banks Association* supports in principle measures that can be assumed to promote a sound amortisation culture. *The School of Economics and Management at Lund University* deems that the debt level of Swedish households is high from an international and historical perspective, and that it constitutes a risk both for financial stability and the economy as a whole. The school therefore is positive to the need for rules to reduce the indebtedness of Swedish households being addressed. *Stockholm Chamber of Commerce* deems that measures to decrease the debt levels of households are justified with the aim of decreasing the long-term risks to the Swedish economy.

Finansinspektionen has consulted the *European Central Bank* (ECB) in accordance with Article 2.1 of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities. Given that house prices and the debt of households have increased sharply in Sweden since the mid-1990s, at the same time as the willingness to amortise mortgages has decreased, ECB welcomes the proposal for an amortisation requirement.

Even if many consultation bodies are basically positive to the increase in amortisation, some are opposed to the fact that it is being achieved through binding regulation. The opposition is primarily due to the negative economic effects that can arise as a result of binding regulation. Some consultation bodies take the position that these effects would decrease if the amortisation requirement could be applied with more flexibility based on the conditions of individual households. Some consultation bodies, including the Swedish Construction Federation, the Swedish Association of Estate Agents and Bostadsrätterna, take the position that a regulated amortisation requirement is not needed since amortisation in recent years has increased sharply on a voluntary basis.

Several consultation bodies, including the School of Economics and Management at Lund University, the *Swedish Property Federation*, the Swedish Construction Federation, the *Confederation of Swedish Enterprise*, the Swedish Confederation of Professional Associations, the Swedish National Debt Office, the Swedish Federation of Business Owners and Stockholm Chamber of Commerce, point out that the lack of housing is the primary reason for the rise in indebtedness and that the problem cannot be solved without taking measures to increase the construction of housing and to improve the function of the housing market. The Swedish Construction Federation states that the amortisation requirement can obstruct the construction of housing by impairing how the housing market functions and thus counteract the aim of housing policy.

Many consultation bodies point out that an amortisation requirement that targets new loans could impair the housing market's function through 'lock-in effects' that limit the desire of some households to move. The Swedish Trade Union Confederation, the Swedish Association of Estate Agents, Bluestep, *HSB*, Bostadsrätterna, the Swedish Savings Banks Association, Stockholm Chamber of Commerce, the *Association of Swedish Finance Houses*, the Swedish Construction Federation and *Sveriges Bostadsrättsbildare* take the position that the increased loan expenses resulting from an amortisation requirement weaken some households' position in the housing market. This typically applies to younger households and households with low income. The Swedish Consumers' Association does not agree with this assessment since these groups already have difficulty entering the housing market due to the high house prices. The Swedish Consumers' Association states that an amortisation requirement should lead to lower house price increases in the future.

Stockholm Chamber of Commerce and the Association of Swedish Finance Houses take the position that forced savings in the form of amortisation can push out other types of savings such as for education or other financial savings, which could have a higher return for households. The Swedish Federation of Business Owners points out that the amortisation requirement could make it difficult for small businesses to find funding since it will be more difficult for individuals to raise loans collateralised by their home in order to invest in a business. *The Swedish Competition Authority* and the Swedish Savings Banks Association state that an amortisation requirement will have a negative effect on the competition in the mortgage market since amortisation terms are an important means of competition.

Based on the viewpoints presented above, the Association of Swedish Finance Houses, the Swedish Federation of Business Owners, the Swedish Competition Authority, the Swedish Property Federation, Sveriges Bostadsrättsbildare and the Swedish Savings Banks Association reject the regulation in its entirety. Because there is uncertainty regarding how large the economic effects that are mentioned above will be and how different borrower groups may be affected, several consultation bodies emphasise the importance of carefully monitoring the effects of the amortisation requirement after its implementation. The Swedish Trade Union Confederation, among others, states that Finansinspektionen must follow in detail how the amortisation requirement affects the possibilities for low- and mid-income households to purchase their own home. The Swedish Trade Union Confederation deems that the need for a mortgage cap will decrease once rules for amortisation are implemented. The Swedish Trade Union Confederation therefore deems that Finansinspektionen should review and change the mortgage cap.

**FI's reasoning:** Finansinspektionen makes the assessment that the macroeconomic risks related to household indebtedness require measures to be taken and that an amortisation requirement is currently the most appropriate alternative. This is primarily because, over time, an amortisation requirement can have a substantial impact on household resilience to shocks without extensively restricting the possibility of households to borrow. Such a requirement is thus deemed to have substantial positive effects on macroeconomic stability while limiting the socioeconomic costs of the regulation compared to other regulation alternatives. Finansinspektionen, however, shares the opinion of the consultation bodies that an amortisation requirement, much like most other regulations, is associated with certain negative socioeconomic consequences. However, Finansinspektionen makes the assessment that the benefit of the regulation is greater than the cost of its consequences. Finansinspektionen goes into more detail about its reasoning for why an amortisation requirement is a reasonable way to manage the risks associated with household indebtedness in sections 1.1–1.3. The authority also gives its view on the socioeconomic effects in the consequence analysis in section 3 below. Section 3.1 discusses how the amortisation requirement will affect mortgage firms and competition in the housing market. Lock-in effects are discussed in section 3.2.3, higher entry thresholds and restricted

opportunities to borrow in section 3.2.4, restrictions in the freedom of households to choose preferred types of savings in section 3.2.5 and an increased risk that the first-hand buyer will make a loss on a sale of a newly built home in section 2.3.7.

## **1.1 Risks associated with household indebtedness**

### *1.1.1 Risks in general*

An international and historical comparison shows that the indebtedness of Swedish households – calculated as loans in relation to disposable income – is high. Highly indebted households may pose a risk, both to financial stability and the Swedish economy as a whole. If households cannot repay their debts, the firms granting loans to households, primarily banks and credit market companies ('mortgages firms'), incur losses which may jeopardise financial stability. However, Finansinspektionen considers that the vast majority of households with loans collateralised by homes ('mortgages') have sound resilience to economic shocks. Furthermore, Swedish borrowers compared with, for example, those in the United States have a far-reaching payment liability for their mortgages. On the whole, the risk of households not managing to pay their mortgages, and loan-granting firms suffering substantial credit losses, is thereby currently limited.

However, the mandate of Finansinspektionen also includes counteracting financial imbalances in order to stabilise the credit market.<sup>2</sup> Imbalances in the credit market can cause major fluctuations in the economy, which in turn may result in significant socioeconomic costs. Such imbalances may not only increase the risk of significant adjustments in asset prices (for example a drop in house prices), but also the risk of households drastically cutting down on their consumption of goods and services.

In the latest financial crisis, increasing indebtedness and surging house prices aggravated the economic downturn in countries such as Spain, Ireland, the United States, Denmark, the UK and the Netherlands. Experience from an international perspective indicates that it is mainly highly leveraged households that are sensitive, and that such households can reduce their consumption drastically in the event of shocks.<sup>3</sup> For example, Andersen et al. (2014) show that, in the last economic downturn, Danish households with LTVs (in this context the ratio between the household's mortgage and the home's value) of more than 40 per cent reduced their consumption significantly more than lower-leveraged households.

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<sup>2</sup> See section 1, point 3 of Finansinspektionen's Instructions Ordinance (2009:93). See also Finansinspektionen's Memorandum 'Finansinspektionen and Financial Stability', Ref. 14-16747.

<sup>3</sup> See e.g. Dynan (2012) 'Is a Household Debt Overhang Holding Back Consumption?', Brookings Papers on Economic Activity, Andersen et al. (2014) 'Household debt and consumption during the financial crises', WP 89, Danmarks Nationalbank, and Bunn and Rostom (2014), 'Household Debt and Spending', Bank of England Quarterly Bulletin 2014:3.

There are several potential reasons for why highly leveraged households have proven to be more sensitive and reacted more strongly than lower-leveraged households. Firstly, some of the highly leveraged households may have had unduly optimistic expectations of house price trends and therefore, based on their future income, saved too little and consumed too much before house prices fell. When their house price expectations did not transpire, such households instead decided to allocate more of their income to savings, for example by amortising their debts. Secondly, there may also have been highly leveraged households that had saved a great deal, but that had chosen to put their savings into financial assets instead such as shares and investment funds rather than amortising, and thereby increased their total assets instead of reducing their debts. As the value of financial assets tends to fall in the event of significant economic downturns, the wealth of households with extensive financial assets is affected more than households that chose to save by amortising their debts. Thirdly, it is common for unemployment to rise during major economic downturns, which means lower income for those affected. Unlike lower-leveraged households, highly leveraged households can be more sensitive to a loss of income and therefore be forced to make major adjustments in such situations.

When a large number of households simultaneously cut down on their consumption, this has a major impact on the general economic trend. Consequently there is a risk that the behaviour of individual households will together contribute to creating or aggravating an economic downturn. This means that there is a risk of socioeconomic costs that are often greater than the risk perceived by individual households. As individual households do not consider socioeconomic risks when they take on debt, an 'externality' arises in the form of a risk to the national economy.

House prices and household indebtedness have soared in Sweden since the mid-1990s, while a historical comparison shows that the mortgage interest paid by households has been, and is, low. There is consequently a risk that certain households have unduly optimistic expectations about future house prices and interest-rate levels. Finansinspektionen sees a risk of vulnerabilities building up despite there largely being structural explanations for the higher aggregated level of indebtedness, primarily the fact that more households own their own home instead of renting one. If house prices and indebtedness continue to rise, risks might escalate further.

Based on experience from an international perspective, Finansinspektionen deems that the risks are primarily associated with highly leveraged households. It is difficult to pinpoint the limit between a highly leveraged household and a lower-leveraged one. In Denmark, households were more sensitive if they had an LTV of more than 40 per cent. At the same time, households saved more in Sweden than they did in Denmark before the crisis. This suggests that the limit between a highly leveraged household and a lower-leveraged one is probably slightly higher in Sweden. Finansinspektionen deems the macroeconomic risks to be higher for households with mortgages that exceed 50 per cent of the

home's value. This group of households is currently increasing, while less than half of households with LTVs of between 50 per cent and 70 per cent amortise (see section 1.3.2).

### *1.1.2 Previous measures to manage the risks of household indebtedness were insufficient*

Finansinspektionen has previously taken several measures to manage the risks associated with household indebtedness. Since 2010, for example, Finansinspektionen has introduced a 'mortgage cap', increased capital requirements for mortgages and produced, as commissioned by the Government, a proposal for individually tailored amortisation plans. These measures have not sufficiently dampened the macroeconomic risks associated with household indebtedness.

#### *The mortgage cap*

Finansinspektionen decided to introduce a 'mortgage cap' in 2010.<sup>4</sup> The mortgage cap means that a firm that grants loans collateralised by a home should limit this credit so that the LTV for the home does not exceed 85 per cent of its market value. The objective of the mortgage cap when it was introduced was, and still is today, to counteract unsound lending practices in the mortgage market and thereby reduce risks for individual borrowers. The aim of the regulation is also to reduce the proportion of highly leveraged households. A development in which mortgage firms use high LTVs as a competitive tool may create unacceptable risks for consumers and erode confidence in the credit market. Such a development is not considered to be consistent with the sound business practice requirement according to the 'sound business practice rule' contained in Chapter 6, section 4 of the Banking and Financing Business Act (2004:297 – the BFA).

Finansinspektionen has regularly investigated the degree to which mortgage firms comply with the mortgage cap, and can conclude that compliance is satisfactory. Finansinspektionen's latest annual mortgage survey (published in April 2016) confirmed that the mortgage cap continues to function. Few households take out loans above this cap (i.e. more than 85 per cent of the market value), while households that take out high mortgages amortise more. The survey also showed that virtually all households leveraged above the mortgage cap are amortising.<sup>5</sup> Therefore, Finansinspektionen deems that the mortgage cap has had a dampening effect on the previous trend of rising LTVs, while at the same time the proportion of new borrowers with very high LTVs

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<sup>4</sup> Finansinspektionen's general guidelines (FFFS 2010:2) regarding limitations to the size of loans collateralised by homes.

<sup>5</sup> Unsecured loans are included in the LTV calculations for the mortgage survey. Consequently, the fact that certain households have an LTV exceeding 85 per cent does not mean that lenders are not complying with the general guidelines for the mortgage cap.

has decreased.<sup>6</sup> International evaluations also show that measures like the mortgage cap generally appear to have a dampening effect on indebtedness.<sup>7</sup>

The mortgage cap focuses on the economic risks for individual households. Although the mortgage cap generally means that households have a certain buffer against falling house prices, it does not mean that households reduce their leverage over time. The mortgage cap therefore only provides limited protection against households significantly changing their consumption behaviour in the event of economic shocks. Therefore the measure has not sufficiently curbed the risks that highly leveraged households pose to macroeconomic stability.

#### *Individually tailored amortisation plans*

Finansinspektionen published a report entitled ‘Individually tailored amortisation plans’ on 14 October 2013.<sup>8</sup> The report was published in light of Finansinspektionen having been commissioned by the Government to strengthen the foundation of a sound amortisation culture and to investigate the conditions for appropriate regulation that would require mortgage firms to provide proposals for individually tailored amortisation plans to new mortgage customers or existing customers wishing to increase their loans.

Finansinspektionen proposed that mortgage firms should provide, and justify to consumers, an individually tailored amortisation plan in light of the high indebtedness of households and the mandate from the Government. The purpose was to increase consumer awareness of and knowledge about the importance of amortisation, and hence promote sound, stable financial markets.

Finansinspektionen’s proposal means that mortgage firms should discuss alternative amortisation plans with customers. A firm should use simple calculations to demonstrate how amortisation affects household finances. The firm should finally propose an amortisation plan and justify why following the plan is in the best long-term interests of the customer. According to the proposal, the consumer should actively decide whether to accept or reject the plan. However, the proposal did not include a mandatory requirement for customers to amortise their mortgages.

Finansinspektionen made the assessment in the report that the Consumer Credit Act (2010:1846) needed to be amended before the proposal could be implemented in Finansinspektionen’s regulations. Such an amendment is proposed in the report ‘Strengthened consumer protection on the mortgage market’ (SOU 2015:40). In the report, it is also proposed that lenders be subject to a new regulatory requirement to issue a proposal for an individually tailored amortisation plan. The amortisation plan is to be in the long-term

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<sup>6</sup> See Finansinspektionen’s report ‘The Swedish Mortgage Market 2015’, 14 April 2016.

<sup>7</sup> See Kuttner and Shim (2013) ‘Can non-interest rate policies stabilise housing markets? Evidence from a panel of 57 economies’, BIS Working Papers No. 433.

<sup>8</sup> See Finansinspektionen’s report ‘Individually tailored amortisation plans’, Ref. 13-8919.

interest of the consumer. Preparatory work for the report is in progress, and it remains to be seen when the proposals can enter into force.

Individually tailored amortisation plans are already in use, because the Swedish Bankers' Association has, since 1 July 2014, recommended that its members provide all new mortgage customers with one. Although the Swedish Bankers' Association's recommendation to its members concerning individually tailored amortisation plans remains in place, the association has withdrawn its general recommendation for mortgage firms to ensure that mortgages are amortised down to a certain LTV (read more about this in section 1.4). In light of this, Finansinspektionen finds that neither the Swedish Bankers' Association's recommendation concerning individually tailored amortisation plans nor the proposed regulatory requirement for such plans suffices to ensure a reduction in the macroeconomic risks associated with household indebtedness. However, individually tailored amortisation plans can function well by giving borrowers better fundamentals for deciding whether, and by how much, they want to amortise their mortgage.

#### *Increased capital requirements for mortgages*

Finansinspektionen introduced a 15 per cent risk weight floor for mortgages in 2013 to ensure that the mortgage firms' internal models for calculating capital requirements do not underestimate the credit risk in the mortgage portfolios. This risk weight floor was increased from 15 per cent to 25 per cent in 2014 to also take the systemic risks posed by mortgages into account. In addition Finansinspektionen introduced higher overall capital and buffer requirements. The latest measure is that Finansinspektionen, on 15 March 2016, decided to increase the countercyclical capital buffer and the set buffer rate at 2 per cent. This buffer rate shall be applied as of 19 March 2017.

The purpose of the capital requirements that Finansinspektionen imposes on the mortgage firms is to ensure that the firms have sufficient capital to cope with shocks. However, the effects of the requirement on the progression of household indebtedness are limited and thus do not sufficiently curb the macroeconomic risks posed by highly leveraged households.

#### *1.1.3 Conclusion*

Imbalances in the credit market may cause major fluctuations in the economy which are associated with significant socioeconomic costs. When a large number of households simultaneously cut down on their consumption, this has a major impact on general economic growth. Consequently there is a risk that the behaviour of individual households will, combined, contribute to creating and aggravating an economic downturn. Finansinspektionen's assessment is that households with a loan-to-value ratio in excess of 50 per cent constitute the greatest macroeconomic risks. This group of households is currently growing, while fewer than half of households with LTVs of between 50 per cent and 70 per cent amortise. A continued rise in house prices and indebtedness would mean a further increase in the risks.

Finansinspektionen has already been commissioned to work to promote a stable financial system featuring a high level of confidence. The authority has also been given an extended mandate to take measures to counteract financial imbalances in order to stabilise the credit market. Finansinspektionen's analysis of the effects of previous measures shows that amortisation has increased in recent years. Finansinspektionen is therefore of the opinion that the measures have helped to curb the progression of debt in the household sector. The growth in lending to Swedish households has been lower in recent years than at the start of the 2000s, but it has increased sharply since mid-2012. In the space of a few years, rising house prices and low interest rates may further push up credit growth and the proportion of highly leveraged households. This may lead to a build-up of vulnerabilities. The combination of increasing credit growth, a rising proportion of new mortgage holders with an LTV exceeding 50 per cent and the Swedish Bankers' Association's decision in November 2014 to withdraw its amortisation recommendation mean that further measures are required to curb the macroeconomic risks associated with indebtedness.

## **1.2 An amortisation requirement is an appropriate measure to curb the risks associated with household indebtedness**

The new provision regarding the amortisation requirement set out in Chapter 6, section 3b of the Banking and Financing Business Act entails that mortgage firms shall apply repayment terms which are consistent with a sound amortisation culture and which prevent excessively high household indebtedness.<sup>9</sup> According to the Bill, the purpose of the amortisation requirement is to counteract macroeconomic and financial stability risks associated with household indebtedness. The amortisation requirement may also, according to the Bill, be viewed as a means to protect consumers.

Finansinspektionen essentially shares the view of household indebtedness expressed in the Bill as well as why it is appropriate to introduce a mortgage amortisation requirement. There are in fact several measures, both within and outside of Finansinspektionen's area of responsibility, which might conceivably help to curb the various risks associated with high household indebtedness. The various risks comprise consumer risks, the risk of credit losses for lenders and macroeconomic risks. The choice of measure should be adapted to the risk mainly being addressed. Finansinspektionen finds that a mortgage amortisation requirement is currently the most appropriate alternative within its area of responsibility for managing the macroeconomic risks associated with household indebtedness. This is primarily because, over time, an amortisation requirement can have a substantial impact on household resilience to shocks without extensively restricting the initial possibility of households to take out large loans in relation to the value of the home. Such a requirement is thus considered to have substantial positive effects on macroeconomic stability while limiting the socioeconomic costs of the

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<sup>9</sup> See Bill 2015/16:89 p. 4.

regulation. Finansinspektionen goes into detail on the negative effects in the consequence analysis in section 3 of this memorandum.

### **1.3 Further information about the objective and effects of the amortisation requirement**

#### *1.3.1 Objective of the amortisation requirement*

The purpose of the amortisation requirement, according to the Bill, is to counteract macroeconomic and financial stability risks associated with household indebtedness. According to the new statutory provision, mortgage firms shall apply repayment terms which are consistent with a sound amortisation culture and which prevent excessively high household indebtedness. However, more detailed regulation of the amortisation requirement shall be issued via regulations. Finansinspektionen's intention with the new regulations is therefore to better define and describe the amortisation requirement.

As previously mentioned, a rising proportion of new mortgage holders in Sweden are taking out mortgages exceeding 50 per cent of the home's value. At the same time, interest-only alternatives are common for those with LTVs amounting to between 50 per cent and 70 per cent. Since highly leveraged households can be sensitive to shocks and may pose a macroeconomic risk, Finansinspektionen deems that measures should be directed at such households with a view to bolstering their resilience and hence reducing the risks in their indebtedness. An amortisation requirement is currently the most appropriate measure for achieving this purpose. The objective of the proposed regulations is therefore for households with loan-to-value ratios in excess of 50 per cent to reduce their loans over time.

Today, approximately 86 per cent of households with new mortgages and loan-to-value ratios in excess of 70 per cent amortise their loans. On the other hand, amortisation is less common for households with loan-to-value ratios amounting to between 50 and 70 per cent. Only 51 per cent of these households amortise. Households with a loan-to-value ratio in excess of 70 per cent amortise on average 1.4 per cent of their loans per year. The corresponding percentage for households with a loan-to-value ratio between 50 and 70 per cent is approximately 0.9 per cent. The amortisation requirement ought to be directed at households that have loan amounts within both of these intervals, i.e. both at leverage exceeding 70 per cent of the home's value and at leverage amounting to between 50 and 70 per cent of the value of the home's value. Through this, Finansinspektionen would like to ensure that the highest leveraged households continue to amortise and increase their resilience to shocks. Without the amortisation recommendation from the Swedish Bankers' Association (see above in section 1.1.2 and also in section 1.4), there is otherwise a risk that interest-only mortgages would once again become an important competitive tool for mortgage firms and that fewer mortgage holders with loan-to-value ratios of more than 70 per cent would amortise. Borrowers with loan-to-value ratios amounting to between 50 and 70 per cent will also

amortise more than they do currently, which means that their loans will decrease more rapidly.

However, it is important for the regulation to include the possibility of exemptions so that mortgage firms can grant households affected by economic shocks a reprieve from amortisation for a limited period. Otherwise, there is a risk that increased debt service payments due to higher amortisation will lead to a reduction in household resilience to shocks. Furthermore, the preparatory work for the new provision in the Banking and Financing Business Act states that an exemption from the amortisation requirement should be available for mortgages for newly built homes. According to the report from the Committee on Finance, this possibility should be limited to at the most five years.

Another overall objective is to avoid a deterioration of the competition in the banking market as a consequence of the amortisation requirement. For this reason the requirement should be devised as far as possible to ensure that the conditions for a borrower to switch lenders are not deteriorated.

### *1.3.2 Previous and current amortisation behaviour*

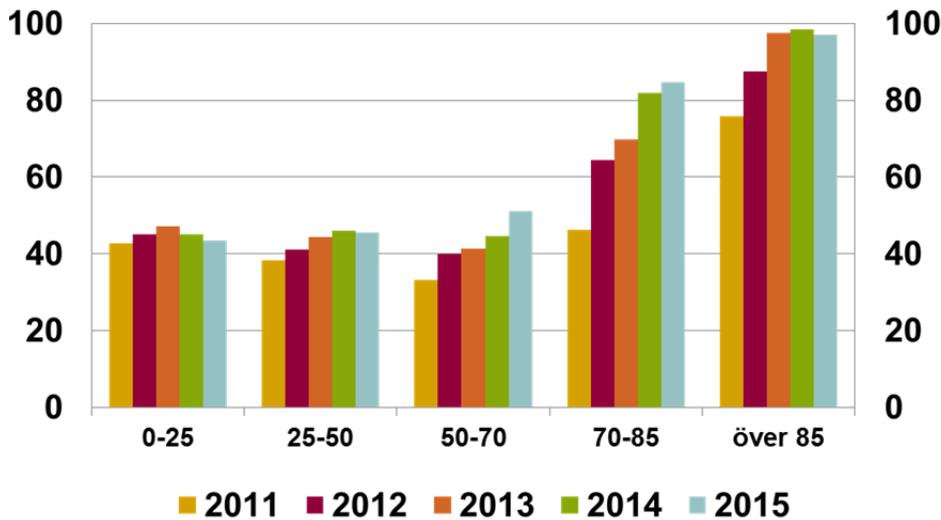
Amortisation culture differs significantly from country to country. In many European countries, a typical mortgage is amortised over a period of approximately 30–40 years. These countries infrequently use interest-only loans. This culture often exists despite a lack of regulation. At the same time, it is also common in many of these countries for households to take out new loans collateralised by their homes when they need to borrow. In the past it has been common for households to amortise in Sweden too, but it became more routine at the beginning of the 2000s for borrowers to be granted interest-only mortgages. A similar development also occurred in some other countries, such as Denmark and the Netherlands. Since the introduction of the mortgage cap in 2010, Finansinspektionen has been working to increase the proportion of households in Sweden that amortise, which has contributed to a growing number of new borrowers choosing to amortise.

Through its annual mortgage survey, Finansinspektionen gathers information about new borrowers and their amortisation behaviour. The most recent year for which data from the mortgage survey is available is 2015, and in that year, 67 per cent of all households with new loans amortised their loans.<sup>10</sup> Approximately 65 per cent of the entire mortgage stock (i.e. all households with mortgages) also amortised.

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<sup>10</sup> In the survey, 'new mortgages' refers to loans collateralised by homes, which are taken out by borrowers who have acquired a new home or by existing borrowers who have taken out a new loan for an existing home during the sample period. New loans that arise when customers change banks are also included.

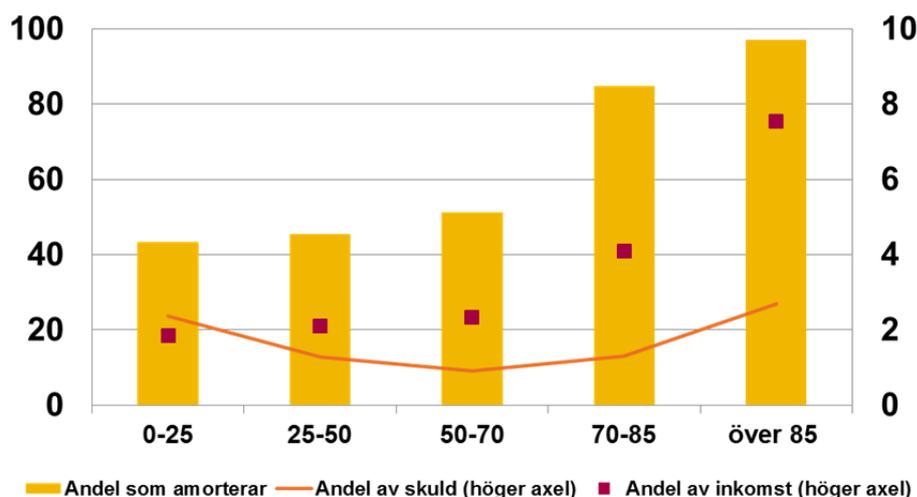
**Diagram 1. Proportion of borrowers with new mortgages that amortise at various LTVs (%)**



Source: Finansinspektionen’s mortgage surveys.

Amortisation is more common among borrowers with high LTVs (Diagram 1). Almost nine out of ten new borrowers with loan-to-value ratios exceeding 70 per cent amortise, which is almost double the number of new borrowers with lower loan-to-value ratios. There are also certain differences in the amount of average amortisation in relation to the borrower’s income or in relation to the size of the loan (Diagram 2). On average new borrowers spend 2.2 per cent of their income after tax on amortisation, corresponding on average to around 1.2 per cent of the total loan amount per year. As borrowers with lower LTVs generally have lower loans than borrowers with high LTVs, they amortise slightly more in relation to their total loan size. Borrowers with LTVs of more than 85 per cent (i.e. borrowers with ‘unsecured loans’) amortise significantly more in relation to their income than borrowers with lower LTVs.

Diagram 2. Amortisation at various LTVs in 2015 (new loans)<sup>11</sup>



Source: Finansinspektionen's mortgage survey.

To sum up, most new borrowers with LTVs of more than 70 per cent amortise. However, households with LTVs below 70 per cent amortise less. Higher amortisation among households with LTVs amounting to between 50 per cent and 70 per cent can thus help to reduce the sensitivity of such households to shocks and thereby the macroeconomic risks associated with household indebtedness.

### 1.3.3 Effects of an amortisation requirement

As previously mentioned, experience from an international perspective implies that in the event of economic shocks, highly leveraged households reduce their consumption more than lower-leveraged households. An amortisation requirement may reduce the macroeconomic risks associated with these households in several ways.

The most direct effect of an amortisation requirement is that household debts decrease more rapidly than they would otherwise have done. Lower debts mean that household interest payments will be lower than they would otherwise have been. Consequently, this mitigates the risk of certain households underestimating the effects on their finances in the event of future interest rate increases or lower income as a consequence of, for example, retirement and therefore not having sufficient margins in their finances. Furthermore, higher margins also increase households' ability to deal with unexpected shocks such as unemployment or major expenses.

At the same time, an amortisation requirement leads to higher debt service, i.e. total interest and amortisation. An inflexible amortisation requirement could

<sup>11</sup> The figures for amortisation as a proportion of income and the amortisation rate respectively refer to the average for all new borrowers and therefore also reflect households that do not amortise. The amortisation rate is measured as annual amortisation in relation to total loan volume, i.e. annual amortisation/total mortgages.

thus contribute to reducing household resilience. It is therefore important that the regulations are formulated so that mortgage firms can grant mortgage holders affected by economic shocks a reprieve from amortisation for a limited period. There is otherwise a risk that household resilience to shocks will decrease.

Increased amortisation may also help to mitigate the risks associated with households with unduly optimistic expectations in relation to house prices and interest rates. Households that consume a great deal in the belief that house prices will rise or that low interest rates in the future mean there is no need to save can be expected to react more drastically if their expectations do not transpire. An amortisation requirement may reduce these reactions by ensuring that highly leveraged households reduce their debts over time. Thus, any adjustments owing to reduced consumption may also be less dramatic. An amortisation requirement thus limits the risk of a period of excessive indebtedness and consumption creating and aggravating sharp economic downturns.

It is reasonable to assume that an amortisation requirement will increase the savings of some of the households affected. However, there may be households that had planned to save substantially in other ways than through amortisation. Saving through amortisation may replace other savings for these households. Consequently this does not necessarily increase their aggregate savings or their resilience. However, when balancing other savings against amortisation, it is important also to consider how the various types of savings affect the relationship between total household assets and debts (both residential assets and financial assets). A household that chooses to put its savings into financial assets instead of amortising has more total assets, but also higher debts than a household that amortises. As the value of homes and financial assets may be expected to move in the same direction, a drop in prices will have a greater impact on the net wealth (i.e. the difference between assets and liabilities) of highly leveraged households than lower-leveraged households. At the same time, the opposite applies for a price rise, i.e. the net wealth of highly leveraged households increases more. By increasing amortisation, an amortisation requirement helps to limit total household assets and debts and thus fluctuations in the net wealth of households. This increases resilience to a negative price trend, which reduces the risks to macroeconomic stability. However, this comes at the expense of households not benefiting as much from a rise in the price of financial assets (read more in section 3).

An amortisation requirement may also have indirect effects on the risks associated with household indebtedness and the housing market by changing the behaviour of households and mortgage firms.<sup>12</sup> The higher housing expenses generated by an amortisation requirement make it less attractive for households to take on high debt, as doing so would reduce the scope of

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<sup>12</sup> This is discussed in more detail in Finansinspektionen's memorandum 'Measures to handle household indebtedness – amortisation requirement', Finansinspektionen Ref. 14-15503.

consumption or other savings. This can decrease demand for residential properties and mortgages, which in turn slows the growth in house prices. This also decreases the need to borrow to buy a specific home. Curbed house prices may also reduce the risk of a major drop in house prices. In order to counteract curbed demand for newly built homes, the preparatory work for the new provision of the Banking and Financing Business Act proposed that an exemption be made from the amortisation requirement for the acquisition of such properties.<sup>13</sup> The rationale is that the amortisation requirement shall not have a negative impact on housing construction. The supply of credit may also be curbed by an amortisation requirement as increased housing expenses affect how much mortgage firms are permitted to lend to a borrower at a certain income. An amortisation requirement may thus also have a certain contractionary impact on credit supply.

The anticipated effects of the proposed amortisation requirement will need to be evaluated when the regulations have been in force for some time. In connection with such an evaluation, a review can be performed of whether amendments to the regulations are required.

#### **1.4 Current and future rules**

There is currently no requirement for mortgage amortisation under business law. Nor is there any such requirement in the legislation that preceded BFA. Chapter 2, section 13 of the Banking Business Act (1987:617) included a provision setting out that loans could only be granted provided there was due cause to believe that the borrower would honour the loan obligation ('the assurance rule') and that satisfactory collateral was provided for the loan ('the collateral rule'). When the Banking Business Act was repealed and replaced by BFA, it was stated that the formulation of the provisions relating to credit assessment should be more flexible on matters relating to factors that may be taken into consideration during the assessment. In light thereof, it is now stated in BFA (Chapter 8, section 1) that a loan should only be granted if there are good grounds for assuming that commitments will be honoured. For example, it is set out in Finansinspektionen's general guidelines (FFFS 2014:11) regarding consumer credit that a lender should perform a housing cost calculation as part of its assessment of a consumer's repayment ability.

As mentioned in section 1.1.2, the Swedish Bankers' Association had previously recommended to its members that mortgages should be amortised. This recommendation entailed that from the spring of 2014, mortgages should be amortised down to 70 per cent of the home's market value within a period of 10 to 15 years. At the same time the association recommended that its members produce individually tailored amortisation plans for new mortgage customers. On 7 October 2014 the Swedish Bankers' Association announced that its Board had decided to make the amortisation recommendation more stringent. The Bankers' Association intended to recommend that all new loans

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<sup>13</sup> Bill 2015/16:89, p. 18.

with an LTV of more than 50 per cent of the home's market value should be amortised. However, the Board of the Association had not, at that time, decided on the final formulation of the new recommendation.

The Swedish Competition Authority called attention to the information issued by the Swedish Bankers' Association on 7 October 2014 and noted that the recommendation involved a stricter approach compared to what had previously applied, and that it affected a greater share of the loan stock than had previously been the case. The Swedish Competition Authority decided to investigate whether the Swedish Bankers' Association's issuance of amortisation recommendations to its members was contrary to the rules relating to anti-competitive cooperation.

In light of the substantial interest in the matter, the Swedish Competition Authority decided on 7 November 2014 to publish a report on its assessment and the preliminary analysis that it had issued to the Swedish Bankers' Association. The Swedish Competition Authority concluded that the Swedish Bankers' Association's amortisation recommendation meant that member firms ought to act in a certain way in the market, which entailed a risk of materially restricting competition. According to the preliminary analysis of the Swedish Competition Authority, the Swedish Bankers' Association's recommendation could thus constitute a decision by a union of firms that could contravene the competition rules.<sup>14</sup>

The Swedish Competition Authority also expressed that competition functions best if each individual firm determines its own strategies and customer offerings. Furthermore, the Swedish Competition Authority expressed that if there is justification for limiting the freedom of a firm to devise its customer offering, such limitation should occur through the regulation of a public authority. This opinion is based on the fact that regulations issued by a public authority can and should be structured with the aim of retaining, as far as possible, the scope and impetus of firms to compete with each other. When trade associations produce their own rules, there is a greater risk of them being structured in a way that benefits the firms involved and which harms competition.

The Swedish Bankers' Association decided to withdraw its recommendation in light of the Swedish Competition Authority's preliminary analysis. As the Association had revoked its amortisation recommendation, the related investigation of the Swedish Competition Authority was also concluded. However, the recommendation of the Swedish Bankers' Association – that its members should produce individually tailored amortisation plans – still remains.

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<sup>14</sup> See Swedish Competition Authority, Fakta: Konkurrensverkets utredning av Svenska Bankföreningens amorteringsrekommendation [Facts: The Swedish Competition Authority's investigation of the Swedish Bankers' Association's amortisation recommendation], Ref. 674/2014.

A decision on the ‘Mortgage Credit Directive’ has been made at EU level.<sup>15</sup> Although the Directive does not include a mortgage amortisation requirement, it does not prevent national regulation in areas that its scope does not cover. In the report ‘Strengthened consumer protection on the mortgage market’<sup>16</sup>, there is a proposal for how the Directive shall be implemented in Swedish law and a request that individually tailored amortisation plans be set up. Finansinspektionen finds that the amortisation regulations are consistent with Sweden’s obligations pursuant to EU law.

There are civil laws regulating the financial conditions between people who live together or co-own a home. This may involve people who are married or cohabiting, or relatives that, for example, have acquired a holiday home together. Although the proposed amortisation requirement affects the amortisation of the loans that may be taken out to acquire a home, this does not change or affect the civil law rules applicable to people who jointly own or live in a home together.

### **1.5 Legal conditions for issuing regulations regarding amortisation requirements**

**Finansinspektionen’s position:** The new statutory provision in Chapter 6, section 3b of the Banking and Financing Business Act together with the authorisation set out in Chapter 16, section 1, point 4 of the Banking and Financing Business Act and Chapter 5, section 2, point 5 of the Banking and Financing Business Ordinance (2004:329) grants Finansinspektionen the right to issue regulations to regulate the amortisation requirement in detail.

**Consultation memorandum:** Contained the same assessment.

**Consultation bodies:** *The Confederation of Swedish Enterprise* deems that the constitutional framework in Sweden must be seen as implying that an amortisation requirement, which according to the confederation regulates the relationship between individuals, shall be issued in the form of a law. The Confederation of Swedish Enterprise deems therefore that it is unfortunate on constitutional grounds that the regulations are not issued in the form of law. *The Board of Swedish Industry and Commerce for Better Regulation* takes the position that Finansinspektionen’s regulations regarding amortisation directly affect the financial internal relationship between individuals and thus shall be issued as a law. *The Association of Swedish Finance Houses, the Administrative Court of Appeal of Jönköping, the Swedish Savings Banks Association* and the *Swedish Investment Fund Association* take the position that it is inappropriate for an authority to regulate something that has such far-

<sup>15</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

<sup>16</sup> SOU 2015:40.

reaching consequences for individuals, even if the Council on Legislation has determined that Finansinspektionen's authorisation is not in conflict with the provisions of the Instrument of Government.

**FI's reasoning:**

*1.5.1 How does an amortisation requirement stand in relation to the Instrument of Government?*

The Government writes in the Bill for the new provision set out in Chapter 6, section 3b of the Banking and Financing Business Act that amortisation regulations which target mortgage firms under the supervision of Finansinspektionen and that do not entail that a mortgage contract between a mortgage firm and an individual can become invalid, or that either party has the right to lodge claims for damages against the other, come under public law.<sup>17</sup> Hence, regulations regarding an amortisation requirement do not belong in the compulsory section of the law according to Chapter 8, section 2, paragraph 1, point 1 of the Instrument of Government. This means that, according to the Bill, delegation of the right to adopt regulations is possible pursuant to the Instrument of Government. The Council on Legislation expressed its opinion on 17 December 2015 and found that the proposed authorisation is not in conflict with the provisions of the Instrument of Government.

*1.5.2 Authorisation to issue regulations regarding amortisation requirements*

The new provision regarding the amortisation requirement set out in Chapter 6, section 3b of the Banking and Financing Business Act, together with the authorisation granted in Chapter 16, section 1, point 4 of the same act, gives the Government or the authority decided by the Government the right to issue regulations regarding the measures that a credit institution shall take to fulfil the new provision. In turn, the Government has decided to give Finansinspektionen the right to issue such regulations.<sup>18</sup>

According to the Bill, the more detailed regulation of the amortisation requirement should occur at a lower level than by law. The purpose of the amortisation requirement, according to the Bill, is to counteract macroeconomic and financial stability risks associated with household indebtedness. This may be considered to be the purpose over time. However, according to the Bill, it will eventually be necessary to review and adapt the requirement. The need to adapt the regulation may emerge quickly if conditions in the economy or housing market change. Adapting the amortisation requirement through the customary legislative process appears, according to the Bill, to be somewhat inflexible, which could result in a failure to counteract risks in time. Expectations about an amortisation requirement and

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<sup>17</sup> Bill 2015/16:89, p. 16.

<sup>18</sup> See Chapter 5, section 2, point 5 of the Banking and Financing Business Ordinance (2004:329).

similar measures that can have a direct impact on the finances of individual households can also lead to a change in household behaviour. If, over a protracted period of time, there is uncertainty about future measures, there is a risk that households will be faced with difficult decision-making situations. In this case, there is a risk of the imbalances that the measures are intended to counteract instead being amplified.

Furthermore, according to the Bill, it is relatively time-consuming and complex to analyse credit market trends on an ongoing basis and to assess whether imbalances are emerging, and to take a stance on when and which measures need to be taken. The same applies to the conditions for taking a position on whether implemented measures need adjusting. The Bill also states that Finansinspektionen already has a specific responsibility for analysing risks as part of its macroprudential supervision and for taking measures to counteract financial imbalances with a view to stabilising the credit market. Furthermore, Finansinspektionen has already taken a number of measures to manage risks associated with household indebtedness. According to the Bill, the more detailed formulation of the amortisation requirement must be seen in the context of these measures and the amortisation requirement may need adjusting in light of further measures taken by Finansinspektionen, within the framework of the current authorisations or based on future authorisations in legislation, and in light of future market conditions.

According to the Bill, such a regime, in which more detailed regulation occurs at a lower level than by law, follows the systematic approach in other laws in the financial markets field, in which the right to adopt regulations is largely delegated to the Government or the authority designated by the Government.

Finansinspektionen agrees with the considerations expressed in the Bill as to why it is appropriate for the more detailed regulation of the amortisation requirement to occur at a lower level than by law.

Finansinspektionen shall obtain the Government's consent before deciding on the regulations. This consent was granted by the Government on 12 May 2016.

## **1.6 Preparation**

### *1.6.1 General*

On 11 November 2014 Finansinspektionen presented its intention to prepare a proposal regarding a mortgage amortisation requirement.<sup>19</sup> The focus of the proposal was stated to be that households should annually amortise an amount corresponding to 2 per cent of the initial loan every year until the loan-to-value ratio is 70 per cent, and subsequently 1 per cent until the loan-to-value ratio is 50 per cent. The basis was that the requirement would apply to new mortgages.

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<sup>19</sup> The press release from 11 November 2014 can be found on Finansinspektionen's website, [www.fi.se](http://www.fi.se).

On 11 March 2015 Finansinspektionen submitted for consultation a proposal for new regulations regarding mortgage amortisation requirements. During its work to prepare new regulations, Finansinspektionen consulted an external reference group comprising representatives of the Swedish Consumer Agency, the Swedish Competition Authority and the Swedish Bankers' Association. It was proposed that the regulations should enter into force on 1 August 2015. However, certain consulted bodies found that the legal basis for Finansinspektionen to decide on such regulations was deficient. In light of the feedback from the consulted bodies, Finansinspektionen ascertained that the legal status was uncertain and that the authorisation required clarification. Therefore, Finansinspektionen decided to put further regulatory work on hold.

On 4 September 2015, the Ministry of Finance submitted for consultation a memorandum proposing a new legal provision regarding amortisation requirements in the Banking and Financing Business Act. The memorandum set out that the more detailed regulation of the amortisation requirement should occur at a lower level than by law. Therefore, an authorisation was also proposed for the Government or the authority designated by the Government to issue regulations with the more detailed regulation of the amortisation requirement. On 2 November 2015, Finansinspektionen issued its opinion of the proposal in the memorandum.<sup>20</sup>

On 10 December 2015, the Government decided to obtain an opinion from the Council on Legislation regarding a proposed law on the amortisation requirement. Therein, a new provision regarding an amortisation requirement in the Banking and Financing Business Act was proposed. Furthermore, it was proposed that the Government or the authority designated by the Government, shall be able to issue regulations regarding which measures a credit institution shall take to fulfil the new provision. The Council on Legislation expressed its opinion on 17 December 2015 and found that the proposed authorisation is not in conflict with the provisions of the Instrument of Government.

Finansinspektionen submitted a new proposal for regulations regarding the more detailed regulation of the amortisation requirement on 18 December 2015. The proposal was based on the proposal issued for consultation by Finansinspektionen on 11 March 2015. Some amendments had been made to the proposal, mainly due to the comments from the draft bill but also due to responses from consultation bodies received by Finansinspektionen in the spring of 2015.

On 4 February 2016, the Government submitted to the Riksdag Bill 2015/16:89 proposing an amortisation requirement. The Committee on Finance supported the proposal in part. The Committee on Finance was of the opinion that the exemption proposed in the Bill for the acquisition of newly built homes should be limited to at the most five years. The Committee on Finance also emphasised the importance of exempting agricultural and forestry real estate

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<sup>20</sup> The consultation response is available on Finansinspektionen's website, [www.fi.se](http://www.fi.se).

from the amortisation requirement. On 23 March 2016, the Riksdag passed a decision on the amortisation requirement and the right for the Government, or the authority designated by the Government, to issue regulations containing the more detailed regulation. The Riksdag decided that the new statutory requirement would enter into force on 1 May 2016. On 31 March 2016, the Government decided to delegate the right to issue regulations to Finansinspektionen.

On 18 April 2016, Finansinspektionen's Board of Directors decided to send to the Government a proposal for regulations that contain the more detailed regulation of the amortisation requirement. When preparing the regulations, Finansinspektionen has taken into consideration the feedback received during the consultation period. At the Cabinet meeting on 12 May 2016 the Government granted its approval for the regulations.

#### *1.6.2 Date when the regulations shall start to apply*

**Finansinspektionen's position:** The new regulations shall enter into force on 1 June 2016.

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** Several consultation bodies, including the *Swedish Bankers' Association, Bluestep, the Swedish Savings Banks Association, Stockholm Chamber of Commerce, the Swedish Federation of Business Owners, the Association of Swedish Finance Houses and the Board of Swedish Industry and Commerce for Better Regulation*, state that the time between the decision and its entry into force is too short for the affected firms to be able to adapt their systems, secure the necessary documentation and educate their staff. They instead propose that entry into force be postponed until 1 November 2016.

**FI's reasoning:** Finansinspektionen deems it important that the regulation be in place as soon as possible. In order to be able to fulfil the requirements in the regulations, the mortgage firms will need to train their staff and adapt their systems. The regulation entering into force relatively quickly following a decision by Finansinspektionen's Board of Directors may result in practical difficulties for the firms. Only small changes are being made to the regulation in relation to the proposal that was previously presented. Mortgage firms and households have been aware of significant parts of the regulations for a relatively long time. It can also be assumed that both mortgage firms and households adapted their decisions some time ago under the assumption that the amortisation regulations would enter into force on 1 June 2016. Given this, Finansinspektionen believes that entry into force on 1 June 2016 is reasonable.

## **2 Motivation for the formulation of the amortisation requirement**

## 2.1 Main features of the regulation

An amortisation requirement is being implemented in the Banking and Financing Business Act through the new provision set out in Chapter 6, section 3b in the Act. The requirement is directed to finance institutions, that is banks and credit market companies (mortgage firms), and it comprises mortgages for individuals. This pertains to credit associated with liens on real property, leasehold rights, tenant-owner property, or similar rights, or that which is associated with corresponding rights in a building that does not belong to the property. Thus the requirement does not comprise, for example, credit that is granted to real estate firms that acquire commercial property. Furthermore, the requirement entails that mortgage firms, when granting mortgages, shall apply repayment terms that are consistent with a sound amortisation culture and that prevent excessively high household indebtedness. The requirement shall comprise new mortgages and thus does not impact credit agreements that have already been entered into.

The Riksdag has decided that detailed regulation of the amortisation requirement shall be implemented through regulations issued by the Government or the authority designated by the Government. As previously mentioned, the Government has decided to delegate the right to issue regulations to Finansinspektionen. Presented below are the main features in the regulations that shall ensure that mortgage firms apply repayment terms which are consistent with a sound amortisation culture and which prevent excessively high household indebtedness.

The regulations apply to mortgage firms (i.e. banks and credit market companies). The regulations will also be applied to foreign lenders that operate in Sweden. This is developed in section 2.2.

Finansinspektionen's assessment is that the amortisation requirement is to comprise mortgages that exceed 50 per cent of the home's value. The borrower's total mortgage, including existing loans, shall form the basis for calculating the LTV. In light of Finansinspektionen's assessment that risks increase as LTV increases, the rate of amortisation is to be higher for highly leveraged households. Annual amortisation is to be determined as a percentage (1% or 2%) of total leverage. In the event a borrower, who has existing leverage that is not comprised by the regulations, is granted a mortgage after the regulations enter into force, the mortgage firm may permit amortisation of the supplementary loan either in accordance with that described above or in accordance with an alternative that entails the supplementary loan is amortised by at least ten per cent a year. The mortgage firm shall inform the borrower in writing of the information that formed the basis for calculating the amortisation requirement. This position is developed in section 2.3.

The new statutory provision only comprises new mortgages, and thus does not impact credit agreements that have already been entered into.<sup>21</sup> New mortgages refers to mortgages that are granted through loan agreements that were entered into after the regulations started to apply. See further information about this position in section 2.4.

In order to calculate the LTV, total leverage must be placed in relation to the value of the home. The home's market value forms the basis for the amortisation requirement. An important question is therefore the extent to which it should be possible to calculate the LTV based on a revaluation of the market value of the home. Revaluation of the home is to be allowed, but not more frequently than every fifth year. In addition, revaluation is to be allowed if the value of the home substantially increases for reasons not attributable to the general price progression in the housing market. This may primarily involve an increase in value following extensive renovation, conversion or extension of the home. This means that future revaluations of the home may impact the amortisation obligation as such, as well as the amount of amortisation. The requirement shall only comprise homes in Sweden. Property for seasonal and secondary use and holiday homes are also to be comprised by routines that apply to the mortgage cap limit. In light of that which has been expressed in the preparatory work in relation to agricultural and forestry real estate, loans collateralised by this type of property shall not to be comprised. Finansinspektionen develops its position in section 2.5.

According to the preparatory work for the new provision, it should be possible for mortgage firms to grant exemptions from the amortisation requirement where special grounds exist, e.g. in the event of the death of a close relative, unemployment, illness or divorce. Finansinspektionen agrees with this assessment. An amortisation requirement means that total household debt service, i.e. total interest and amortisation, may increase. An amortisation requirement without the possibility to grant exemptions could thus reduce household resilience to shocks and consequently increase the risks faced by both individual households and the macroeconomic situation. According to the regulations, mortgage firms are to be able to grant households that are hit by financial problems a reprieve from amortisation for a specific amount of time. The point of departure, however, is always that the circumstances that constitute the temporary exemption from the amortisation requirement occur after a mortgage has been granted and thus do not exist when the loan is granted. Furthermore, the exemption must be within the framework of generally accepted standards for granting loans.<sup>22</sup> This position is developed in section 2.6.

According to the preparatory work for the new provision in the Banking and Financing Business Act, it should be possible to exempt credit that is granted

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<sup>21</sup> Bill 2015/16:89, p. 14.

<sup>22</sup> Bill 2015/16:89, p. 18.

for the acquisition of newly built homes from the amortisation requirement.<sup>23</sup> As opposed to the proposal in the Bill, the Committee on Finance was of the opinion that the exemption should be limited to at the most five years. The Riksdag decided in favour of the Committee on Finance's proposal. This possibility exists for the first buyer of the home. Read more in section 2.7 where Finansinspektionen describes how the exemption will be implemented in the regulations.

## 2.2 Which firms are comprised by the regulation?

**Finansinspektionen's position:** The new regulations shall comprise credit institutions, i.e. banks and credit market companies (mortgage firms). The new regulations shall also comprise foreign firms that grant mortgages in Sweden through branches or in some other manner.

**Consultation memorandum:** Contained the same proposals.

**FI's reasoning:** The new statutory provision on the amortisation requirement is being implemented in the Banking and Financing Business Act, which comprises credit institutions (mortgage firms). According to the preparatory work for the new provision, there is currently no reason for the amortisation requirement to comprise credit granted by firms outside of the Banking and Financing Business Act's area of application since these firms represent a negligible portion of the mortgage market.<sup>24</sup> Mortgage firms grant almost all mortgages in Sweden. This is primarily due to these firms having access, at a relatively low price, to the large volume of capital required to operate in the mortgage market. The loans taken out to pay for a home are usually large, in any event in relation to loans granted for borrowers to purchase goods and services. Mortgage firms have access to a high volume of capital at a fairly limited cost since only these firms are entitled, to a substantial degree, to receive deposits from the general public. Another important funding source for some of the large mortgage firms is their issuance of covered bonds.

The new regulations also comprise foreign firms that grant mortgages in Sweden through branches or in some other manner. The starting point is that the regulations issued in Sweden to protect consumers, for example, are to apply to all players active in the country. This follows from the preparatory work to Chapter 1, section 2 of the BFA.<sup>25</sup> The preparatory work for the new provision in the Banking and Financing Business Act states that the amortisation requirement also aims to protect consumers.<sup>26</sup> Finansinspektionen agrees with this assessment.

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<sup>23</sup> Bill 2015/16:89, p. 18.

<sup>24</sup> Bill 2015/16:89, p. 14.

<sup>25</sup> Bill 2002/03:139 p. 510.

<sup>26</sup> Bill 2015/16:89, p. 15.

As mentioned above, there has been an inquiry into how the Mortgage Credit Directive shall be implemented in Swedish law. The inquiry completed its assignment in March 2015 and subsequently submitted the report ‘Strengthened consumer protection on the mortgage market’ (SOU 2015:40). In the report, a new law regarding creditors and credit intermediaries is proposed. The firms covered by the proposed law, but which are not banks or credit market companies, will according to the report not generally be subject to the rules in the BFA. Since they are not comprised by the Banking and Financing Business Act, neither will they be comprised by Finansinspektionen’s regulations. The issue of whether these firms will be comprised by the amortisation requirement in the future is primarily a subject for legislative review.

### **2.3 The amortisation requirement shall be based on the size of the mortgage in relation to the home’s value**

#### *2.3.1 General*

**Finansinspektionen’s position:** The new regulations shall comprise new mortgages if the total mortgage (both new and existing amounts) results in an LTV of over 50 per cent. The total mortgage shall thus form the basis for calculating the LTV. If the amount of the loans in total that has been collateralised by the same home exceeds 70 per cent of the home’s value, annual amortisation shall correspond to 2 per cent of the total original loan amount. As of when leverage is 70 per cent until it reaches 50 per cent of the value of the home, annual amortisation shall be 1 per cent of the total original loan amount. The regulations comprise mortgages, i.e. loans that are collateralised by a home or the equivalent in Sweden.

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** *The Swedish National Debt Office and the School of Economics and Management at Lund University*

question whether unsecured loans and loans to tenant-ownership associations should not also be comprised by the amortisation requirement. If this were the case, the purpose of reducing household sensitivity to shocks would be better served. The consultation bodies thus propose that the amortisation requirement not be limited to mortgages.

In its response, *Bluestep* states that it is inappropriate to require amortisation and thus make it more difficult to convert expensive unsecured credit to mortgages for borrowers experiencing problems with debt. An important aspect of *Bluestep*’s business concept involves helping customers implement changes of this kind, but flexibility in the rate of amortisation is required. The consultation body also states that exemptions for first-time buyers are also justified since these buyers might require a more flexible application. *Bluestep* proposes that mortgage firms should to a certain extent, for example 10 per cent of the firm’s mortgage stock, be able to waive the amortisation requirement altogether.

In a situation whereby several mortgage firms have granted credit to the same borrower and with the same collateral, Bluestep states that clarification is required regarding how mortgage firms are to ensure sufficient amortisation. Bluestep is of the opinion that this type of situation requires continuous information sharing between the mortgage firms regarding the borrower's amortisation and how it changes during the term of the loan.

*The Swedish Bankers' Association* would like to have clarification regarding whether the total amount (the debt) can be recalculated in the event of revaluation, in other words whether previous amortisation is to be included.

**FI's reasoning:** The new statutory provision on the amortisation requirement in Chapter 6 of the Banking and Financing Business Act comprises credit associated with liens on real property, tenant-owner property or similar rights. That the requirement only comprises mortgages is clearly stated in the preparatory work for the provision. The regulations shall not comprise unsecured loans or loans to tenant-ownership associations. Issuing regulations regarding amortisation requirements for e.g. unsecured loans is not included in the authorisation in Chapter 16, section 1, point 4 in the Banking and Financing Business Act or Chapter 5, section 2 point 5 in the Banking and Financing Business Ordinance (2004:329).

Experiences from several countries suggest that households with a high LTV tend to react more to a drop in house prices than do lower-leveraged households (see section 1.1.1). It is difficult to pinpoint the limit between a highly leveraged household and a low-leveraged one. In conjunction with the latest financial crisis, approximately half of the households in Denmark reduced their consumption by more than the drop in each household's income. This suggests that the relevant LTV from a social perspective coincides approximately with the average LTV for the entire mortgage stock. The amortisation requirement shall therefore comprise a significant share of the new mortgages.

Finansinspektionen deems that the most appropriate way of determining which households are to be subject to the requirement is by looking at the size of the household's mortgage in relation to the home's value. This is in line both with practices in other countries that have implemented an amortisation requirement<sup>27</sup> and how the Swedish Bankers' Association's previous amortisation recommendation was formulated. When formulating the regulations, Finansinspektionen has taken the previous recommendation into consideration. The previous recommendation stipulated that mortgages should be amortised down to an LTV of 70 per cent after 10 to 15 years. Finansinspektionen is of the opinion, however, that slightly more far-reaching requirements are needed

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<sup>27</sup> For example, there are guidelines in Denmark that no more than 55 per cent of all mortgages with an LTV of more than 75 per cent should be interest-only by 2020. See 'More robust property financing', Danish FSA, September 2014.

and that the amortisation requirement shall comprise loans whose leverage exceeds 50 per cent of the home's value. This corresponds to the position in the Swedish Bankers' Association's proposed tightening of the amortisation recommendation (see section 1.4).

Since households with LTV between 50 and 70 per cent amortise to a significantly lower extent than households with higher leverage, the amortisation requirement will primarily increase the share that amortises in the former group (see Diagram 3 in Appendix 1). Finansinspektionen reverts in section 2.5 to the value of the home that should be used as the basis for calculating the amortisation requirement and when valuations should be carried out.

Compared to a requirement stipulating that the entire mortgage must be amortised, the regulations allow households whose leverage is lower than 50 per cent of the value of the home not to amortise, thus giving them greater freedom to consume or save in another way. A household can also choose to continue amortising its mortgage, and a mortgage firm can always require amortisation in accordance with the conditions stipulated in the mortgage contract. The regulations allow some exemptions for highly leveraged households, which results in additional flexibility. The conditions for exemptions are presented in section 2.6 (Exemptions on special grounds) and 2.7 (Newly built homes). In addition, loans that are collateralised by agriculture or forestry real estate are exempted (see section 2.5.2). An alternative amortisation rate is also possible for new mortgages if the borrower also has existing mortgages that were granted before the regulations entered into force (section 2.3.2). Finansinspektionen is not of the opinion that additional exemptions or special rules need to be introduced. There is thus no reason to exempt a specific share of a mortgage firm's lending from the amortisation requirement. Neither is there reason to exempt mortgages to borrowers who have a weak financial situation because, among other things, the aim of the requirement is to manage the risks associated with high household indebtedness. Exempting mortgages granted to households that are first-time home buyers, senior loans or what is known as equity release from the amortisation requirement is not justified either (see more about this in section 2.4.12).

Even an amortisation requirement that only comprises mortgages that are larger than 50 per cent of the home's value can have a significant effect on the housing market and the economy. This impact largely depends on the selected amortisation rate. This points towards not imposing overly strict requirements but rather, if necessary, adjusting the amortisation requirement at a later stage. Finansinspektionen is of the opinion that the risks associated with mortgages that exceed 70 per cent of the home's value are aggravated, which is why it is reasonable for the amortisation rate for these to be higher. On the other hand, the amortisation rate may be slightly lower if leverage falls below 70 per cent of the home's value. The amortisation requirement is thus structured

progressively to allow the amortisation rate to be reduced when the household reaches a slightly lower level of leverage.

If leverage is extended at any time after the original loan was granted, thus making the total loan amount higher than the original loan amount, the amount of amortisation shall be calculated based on the new total loan amount. The amortisation amount may, however, not be recalculated in cases where new loans are granted but the total loan amount, due to previous amortisation, does not increase beyond the original loan amount. This is because it would be unreasonable if the amortisation amount could be reduced by taking on further leverage.

When revaluation is allowed, both the total debt (including previous amortisation) and the amortisation amount are recalculated. A home revaluation may be carried out in accordance with the provisions of section 2.5. If total leverage is equal to or below 50 per cent of the home's value in the latest valuation, no amortisation is required.

The basis for the calculation of the amortisation requirement is the home. Who the borrowers are and the number of borrowers are irrelevant. The amortisation rate is calculated without consideration of these aspects. The amortisation rate shall, for example, not be affected by whether there are several borrowers that are mutually responsible for a mortgage. The borrowers and mortgage firms for such loans are free to allocate the amortisation between the borrowers in the manner agreed. If several borrowers have individual loans collateralised by the same home, the amortisation amount of the total leverage is, as a starting point, allocated proportionally according to each borrower's share of total leverage. However, the borrowers are free to choose to break down the amortisation in a different way. The total amount of amortisation for the loans collateralised by the same home must, however, always equal at least the amount that the amortisation requirement entails. Amortisation for new or increased leverage shall be calculated on the basis of the total leverage for the same home compared with the home's value.

If a mortgage firm has already granted loans collateralised by a specific home, and another mortgage firm is considering granting a loan collateralised by the same home, the second firm must calculate the total LTV based on the existing valuation (unless five years have passed since the previous valuation) and ensure that the loan is amortised thereafter. This entails that the second mortgage firm must obtain assurance of the extent to which amortisation is being made to the first mortgage firm. If the borrower cannot show that amortisation is being made to a certain extent to the first mortgage firm, the second mortgage firm must act as if no amortisation were made to the first mortgage firm. The same applies to any further mortgage firms that grant mortgages collateralised by the same home. If the borrower asks to lower amortisation at one of the mortgage firms, that firm must ensure that amortisation, if lowered, is in line with the regulations. The borrower can show to what extent he or she is amortising to the other firm. Thus the regulations do

not require a direct exchange of information between the mortgage firms. Neither is it necessary to obtain information on a continuous basis. However, a mortgage firm that is considering lowering the amortisation amount must obtain relevant information at that specific time, either from the other lenders with a power of attorney, with consent from the borrower or directly from the borrower, so that the firm can ensure adherence to the regulations.

The regulations do not prevent the borrower from amortising additionally or more quickly than the rate stipulated by the amortisation requirement. However, such amortisation should not lead to a subsequent interest-only period. Rather, amortisation is to remain in place at a minimum of the annual amount as long as the LTV exceeds 50 per cent. It would otherwise be possible, within the framework of the limitations imposed by the mortgage cap, to create an interest-only period by initially taking a larger loan than required in order to pay back part of the loan shortly thereafter. However, the annual amortisation amount may be adjusted in accordance with the requirement in the event that amortisation in excess of the requirement results in the LTV falling below either the 70 per cent or 50 per cent thresholds. The borrowers and mortgage firm are also allowed to divide the annual payment into, for example, monthly instalments or some other time intervals of less than one year. The regulations do not entail a limitation of the mortgage firm's right to require amortisation in addition to that specified in the regulations.

### *2.3.2 Amortisation rate when the borrower has existing leverage*

**Finansinspektionen's position:** It shall be possible for the mortgage firm to grant an alternative amortisation rate for supplementary loans granted to a borrower who has existing mortgages that were granted before the regulations entered into force (existing mortgages).

The regulations do not require amortisation of existing mortgages (that the amortisation requirement only comprises new mortgages will be addressed in section 2.4). If a mortgage firm grants a mortgage to a borrower who has existing mortgages, the new leverage must be amortised, however. In accordance with the primary rule specified in section 2.3.1, if total leverage entails an LTV over 70 per cent, the new mortgage is to be amortised annually by at least 2 per cent of the total leverage. If total leverage entails an LTV over 50 per cent, the new mortgage is to be amortised annually by at least 1 per cent of the total leverage. When the new mortgage has been paid off or the LTV reaches 50 per cent (whichever occurs first), the amortisation requirement will cease.

If the borrower has mortgages that were granted before the regulations entered into force, the mortgage firm may, as an alternative to amortisation according to the primary rule, allow new mortgages (supplementary loans) to be amortised by at least ten per cent a year. If existing supplementary loans are being amortised by 10 per cent a year, these loans shall *not* be included when calculating the total loan amount, and thus neither shall they be included in LTV when calculating the amortisation requirement for other loans. As long

as a supplementary loan is being amortised by 10 per cent a year, this shall not affect the amortisation obligation or amortisation rate for other loans.

It is not a requirement that a supplementary loan be amortised by 10 per cent a year until the loan is fully repaid. Amortisation according to the alternative rule may be terminated at any time, at which point the supplementary loan shall be added to the loans that are not being amortised in accordance with the alternative rule. The amortisation obligation and the rate of amortisation shall then be calculated using the total leverage as specified in the primary rule. If the total leverage according to the primary rule were to fall below an LTV of 50 per cent, for example, there is no requirement on amortisation. If the LTV were to rise above 50 per cent, however, amortisation shall apply in accordance with the primary rule.

If a supplementary loan has been included in the loans amortised in accordance with the primary rule, it is not possible to go back to amortisation in accordance with the alternative rule since this possibility applies only to new loans.

**Consultation memorandum:** Contained the proposal that any new mortgages are to be amortised and that the LTV is to be calculated based on total leverage. The consultation memorandum, however, did not contain a proposal for an alternative amortisation rate for supplementary loans.

**Consultation bodies:** Several consultation bodies, such as *the Swedish Bankers' Association, the Swedish Confederation of Professional Associations, the Swedish National Debt Office, the Swedish Savings Banks Association, the Board of Swedish Industry and Commerce for Better Regulation and Bluestep*, have stated that the proposal could entail very quick amortisation for small supplementary loans since the amortisation amount would be calculated based on the total amount of loans. The consultation bodies have noted that there is a risk that the effect of that described above would lead to more households deciding to apply for unsecured loans. These loans are outside the scope of the regulations and would therefore not need to be amortised at the same rate. The interest on unsecured loans is generally significantly higher than the interest on mortgages. However, since the amortisation rate on supplementary credit in the form of a mortgage would be very quick, the borrower might still feel motivated to choose an unsecured loan in order to obtain a lower monthly expense.

Consequently, some of the consultation bodies propose that a mortgage firm, when increasing a borrower's mortgage, should have the possibility to require amortisation either in accordance with the alternative proposed by Finansinspektionen or to allow the customer to amortise the supplementary loan by at least ten per cent a year, which would mean an amortisation period of ten years for the supplementary loan.

**FI's reasoning:** If the supplementary loan is small in comparison to the existing mortgages, the amortisation amount, which is determined by the combined amount of the mortgages, could be very high in relation to the size of the supplementary loan. There would be a significant increase in expenditure, which means there is a substantial risk that the borrower would instead choose to apply for an unsecured loan. Finansinspektionen is of the opinion that such a development would be unfortunate.

In light of this, it will be possible for mortgage firms to allow a supplementary loan in a situation of this kind to be amortised by at least ten per cent of the supplementary loan's original amount every year.

However, Finansinspektionen is not of the opinion that alternative amortisation rates are justified for supplementary loans if no portion of the mortgage was granted before the regulations entered into force. If no part of the mortgage was granted before the regulations entered into force, the effect described above will not arise to the same extent since amortisation will already be in place for the existing loans. The alternative amortisation amount is thus only to be allowed if part of the borrower's mortgage was granted before the regulations entered into force.

### *2.3.3 Mortgage firms shall provide information regarding the basis for calculating the amortisation requirement*

**Finansinspektionen's position:** A mortgage firm shall inform each borrower in writing of the information that forms the basis for calculating the amortisation requirement. A provision with this requirement is being implemented in the regulations.

**Consultation memorandum:** Did not include an express proposal for this.

**FI's reasoning:** The mortgage firm must inform the mortgage holder of the information that forms the basis for calculating the amortisation requirement so the borrower can gain insight into how the amortisation requirement is applied. This includes information on the value of the home used to calculate the amortisation amount, the size of the loan that forms the basis for calculation and the LTV.

The consultation proposal specified that a firm must ensure that all of the necessary information on the valuation that is used can be submitted to the borrower and to a mortgage firm specified by the borrower. This obligation remains unchanged. For the sake of clarity, however, the regulations should specify that the firm is also obligated to provide the information to the borrower.

## **2.4 The amortisation requirement shall apply to new mortgages**

### *2.4.1 General*

**Finansinspektionen's position:** The amortisation requirement shall only apply to new mortgages. The main rule is that a mortgage is to be regarded as 'new' if it was granted through a loan agreement entered into after the regulations started to apply.

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** In its response, *the Swedish Bankers' Association* described a situation in which a customer, prior to the regulations entering into force, is granted an increase to his or her mortgage, but chooses to return the debt instrument to the bank when he or she would like for the funds to be paid. It may take several months before the customer wants to receive the funds due to the time it takes, for example, to engage craftsmen. According to the Swedish Bankers' Association, the loan decision generally applies for six months. The bank may have promised amortisation in accordance with the bank's rules at that time. The Swedish Bankers' Association is of the opinion that the amortisation terms in the issued debt instrument apply, even if the customer returns it after the regulations have entered into force.

*The Administrative Court of Appeal in Stockholm* has submitted a number of proposals for clarifying the regulations. The proposals primarily concern what is to be considered a new mortgage.

**FI's reasoning:** The new provision set out in Chapter 6, section 3b of the Banking and Financing Business Act enters into force on 1 May 2016 and will be applied to credit that is granted after that time. The provision shall not impact credit agreements that have already been entered into.

The regulations will, just like the new provisions in the Banking and Financing Business Act, be applied to credit that is granted after the regulations enter into force. However, loan agreements that are entered into after this time and with the aim of paying for the acquisition of a home are exempted if the home is acquired, i.e. a binding agreement has been entered into, before the regulations enter into force. As regards the specific situation described by the Swedish Bankers' Association, i.e. that a mortgage is granted before the regulations enter into force but that the customer returns the debt instrument after the regulations enter into force and the funds are paid at that time, Finansinspektionen does not see a reason to change the basic approach that a mortgage is to be considered new if it is granted through a loan agreement that is entered into after the regulations enter into force. The decisive aspect in this situation shall be the point of time that a binding loan agreement is entered into by the two parties.

To prevent competition in the banking market from deteriorating as a result of the amortisation requirement, borrowers who have mortgages that were granted before the regulations entered into force but who still have their home and do not want to increase their mortgage will not be comprised by an amortisation requirement if they switch lenders. If an existing mortgage is replaced by a new

mortgage with a different lender, this is not to be considered new lending. In order to clarify what is regarded as new lending, Finansinspektionen provides an explanation below of how certain situations are to be assessed and when new lending is to be deemed as arising.

In light of the feedback provided primarily by the Administrative Court of Appeal in Stockholm, the regulations have been clarified in some respects. Clarification mostly pertains to what is considered to be new lending.

#### *2.4.2 The borrower has the same home, but would like to switch lenders*

**Finansinspektionen's position:** The point of departure is to be that a borrower with a mortgage granted before the regulations entered into force and who wants to keep his or her home shall be able to switch lenders without this being deemed as taking out a new loan. This assumes there is no overall increase to the mortgage. If the mortgage is increased only to pay interest differential compensation in conjunction with switching banks, neither is this loan to be considered a new loan.

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** No consultation bodies had any objections to the proposal.

**FI's reasoning:** Finansinspektionen welcomes households to examine the various terms offered by different mortgage firms and does not want to undermine the conditions for households to switch from one bank to another. It would therefore be negative if switching lenders were to entail an amortisation obligation for a mortgage holder who would not otherwise be affected by the amortisation requirement. This could possibly undermine the conditions necessary for competition between different lenders. In light of this, switching lenders shall not be considered to constitute new lending.

#### *2.4.3 The borrower has the same home but would like to replace old mortgages with new mortgages with the existing lender*

**Finansinspektionen's position:** If a mortgage that is not comprised by the amortisation requirement is replaced by a new mortgage (same borrower and same lender) collateralised by the same home, the new mortgage shall not be comprised by the amortisation requirement as long as the size of the loan stays the same. If the mortgage is increased only to pay interest differential compensation in conjunction with rescheduling the mortgage, neither is this increase to be considered a new loan.

**Consultation memorandum:** Did not contain a clear position on this issue.

**Consultation bodies:** *Bluestep's* interpretation is that an exemption from the concept of new lending should apply when a borrower replaces existing credit with new credit with the same lender and in the event the amount of credit increases in order to pay interest differential compensation. *Bluestep* also

interprets Finansinspektionen's position in section 2.4.2 to entail that loans that are increased to pay accrued and unpaid interest and fees, regardless of whether they are with a new or existing lender, shall not be considered as a new loan and thus not be comprised by the amortisation requirement.

**FI's reasoning:** The amortisation requirement shall not prevent mortgage holders from rescheduling their mortgages with their existing mortgage firm for an existing home when their existing mortgages are not comprised by the regulations. One reason for rescheduling, for example, might be to lower overall interest expense. If an existing mortgage, which is not comprised by the amortisation requirement, is replaced by a new mortgage with the same lender, the new loan, therefore, does not need to be amortised in accordance with the regulations. This applies to the extent that the new mortgage is the same size as or smaller than the existing loan. If the mortgage is increased only to pay interest differential compensation in conjunction with rescheduling the mortgage, neither is this increase to be considered a new loan.

#### *2.4.4 Borrowers move house and want to retain existing credit*

**Finansinspektionen's position:** Mortgage holders who move may sometimes have the option of retaining their existing mortgage, and to collateralise their loan by the new home instead of the old home. If the household moves to a new home and the mortgage's collateral is replaced by new collateral, the loan is to be treated as new lending. This also applies if the size of the loan decreases or remains unchanged.

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** *The Swedish National Debt Office* is of the opinion that the proposal is problematic because it can create an undesirable lock-in effect in that some households will choose not to move house since doing so would result in an amortisation requirement – even though the size of the loan is the same or smaller. The Swedish National Debt Office is of the opinion that such a lock-in effect would impair mobility in the housing market, which would reinforce the already existing problems in the market.

**FI's reasoning:** Finansinspektionen is not of the opinion that it would be reasonable to exempt highly leveraged households that move to a new home. Exemptions of this kind would to a significant extent risk counteracting the aim of curbing the risks associated with household indebtedness. If such an exemption were allowed, changing collateral within an existing loan agreement could become a typical way to behave when moving house for households that do not need to increase their loans. A potentially very large share of the households that would otherwise be comprised by the requirement would thus be exempted. Not applying the provisions of the regulations when changing collateral could also create unreasonable situations, in which some prospective home buyers would be expected to amortise to some extent, while others could avoid being subject to the amortisation requirement despite their respective LTVs being the same. This would especially disfavour first-time home buyers.

*2.4.5 The person acquiring a home takes over existing mortgages on the home*

**Finansinspektionen's position:** This may arise when the person acquiring a home is given the option of taking over the mortgages held by the former owner of the property. In this case the loans taken over are regarded as new loans and are subject to the amortisation requirement.

**Consultation memorandum:** Contained the same proposals.

**FI's reasoning:** Similar reasons as in section 2.4.4 apply. Households that move house and take over existing mortgages shall be comprised by the amortisation requirement.

*2.4.6 An amortisation firm acquires a credit portfolio from another amortisation firm*

**Finansinspektionen's position:** There will be no change to the amortisation requirement in the event a mortgage firm acquires a credit portfolio from another mortgage firm.

**Consultation memorandum:** Contained the same proposals.

**FI's reasoning:** When a mortgage firm acquires a credit portfolio from another mortgage firm, the mortgage holders whose mortgages were transferred should not be regarded as having taken on new loans. The amortisation requirement is therefore not impacted as a result of the credit portfolio being transferred. The same applies if a mortgage firm acquires another mortgage firm or if a mortgage firm acquires a lender that is not a credit institution.

*2.4.7 Changes to terms and conditions (for example, in relation to interest rates or voluntary amortisation) for a mortgage not subject to the amortisation requirement*

**Finansinspektionen's position:** A change to the terms in a mortgage contract that is not comprised by the amortisation requirement shall not entail that the loan is considered a new loan.

**Consultation memorandum:** Contained the same proposals.

**FI's reasoning:** Some mortgage terms are changed relatively frequently. This applies, for example, to interest rates. The starting point in such situations shall be that no 'new loans' arise.

*2.4.8 The home is acquired before the amortisation requirement enters into force but the mortgage is granted after that time*

**Finansinspektionen's position:** In cases whereby a binding agreement to purchase a home is entered into before the amortisation requirement enters into force, the amortisation requirement shall not comprise the mortgages that are subsequently granted to the person acquiring the home for the home's acquisition.

As specified in section 2.7, the possibility to be granted an interest-only period when acquiring a newly built home is limited to a maximum of five years. Therefore, if a newly built home is acquired after the regulations enter into force, an interest-only period of a maximum of five years is possible. If a newly built home is acquired through a binding agreement that is entered into before the amortisation requirement enters into force, the amortisation requirement shall not comprise the mortgages that are subsequently granted for the home's acquisition.

**Consultation memorandum:** According to the proposal, mortgage firms that grant credit to households that acquire a newly built home may allow the borrower not to amortise (for an unlimited amount of time). According to the proposal, it would not matter whether a newly built home was acquired before or after the regulations entered into force.

**Consultation bodies:** *The Swedish Association of Estate Agents* is of the opinion that the concept of 'binding agreement' needs to be clarified since agreements to transfer property are not always the same. There can be different types of terms that make an agreement binding but where one of the parties, generally the buyer, is entitled to request an annulment of the purchase after the agreement has entered into force. This might pertain, for example, to transfer agreements when acquiring a tenant-owner apartment. Even if such an agreement satisfies the formal requirement in the act on tenant ownership, to be valid it is dependent on the buyer being accepted as a member of the tenant-owners' association.

**FI's reasoning:** It should generally not be difficult to assess whether an agreement is binding or not. As the point of departure, an agreement is binding if having entered into it entails a significant financial risk for the parties. If one of the parties due to circumstances outside its control is entitled to withdraw from the agreement, this generally does not mean that the agreement is not binding. An agreement to transfer a tenant-owner apartment, which to be valid is dependent on the buyer being accepted as a member of the tenant-owners' association, is generally to be regarded as binding

#### *2.4.9 Loan commitment obtained before the amortisation requirement started to apply*

**Finansinspektionen's position:** If a loan commitment is granted before the amortisation requirement begins to apply, but the loan agreement is entered into after the amortisation requirement begins to apply, the mortgage is to be regarded as new and is thus comprised by the amortisation requirement.

**Consultation memorandum:** Contained the same proposals.

**FI's reasoning:** Situations may arise in which a loan commitment is made before the regulations enter into force, but in which the home is acquired and the loan agreement is entered into after entry into force. The loan commitment

does not have independent value in this respect; rather, these loans are comprised by the amortisation requirement.

#### *2.4.10 Construction loan*

**Finansinspektionen's position:** For construction loans, other types of credit used during the construction phase of a single-family home and mortgages to which the credit is subsequently converted, it is significant whether the date that the agreement for construction on the home that is to serve as collateral for the mortgage is entered into before or after the regulations enter into force. If the agreement is entered into before the regulations enter into force, the credit and the mortgages which later replace the credit used to pay for the construction shall be exempted from the amortisation requirement.

If the agreement for construction is entered into after the regulations enter into force, the credit and the mortgages which later replace the credit used for the construction shall be comprised by the time-limited exemption option for newly built homes. An interest-only period of a maximum of five years can thus be granted for these mortgages.

These terms apply provided it is the borrower who is having the single-family home built, either by having purchased a comprehensive solution through a building company or by using various contractual parties to construct the house. For single-family homes that are built by a construction company or similar, see section 2.4.8.

**Consultation memorandum:** Given that the proposal allowed the possibility for an unlimited interest-only period when acquiring newly built homes, it entailed that mortgage firms did not need to require amortisation.

**FI's reasoning:** A household that intends to have a single-family home built can be granted a type of credit known as a construction loan. The credit is used to pay for the construction of the house. This credit is not normally collateralised by any property as there is still no housing on the site. Construction loans that comply with this principle will therefore not be subject to the amortisation requirement. Completion of the building means that there is a home that may serve as collateral for a mortgage. A construction loan is normally converted into or replaced by a mortgage for which the home serves as collateral.

It can take a considerable amount of time to construct a single-family home. Finansinspektionen is of the opinion that a household that has entered into an agreement for the construction of a single-family home before the regulations entered into force shall not subsequently be comprised by an amortisation requirement of which the household was potentially not aware.

The consultation proposal contained the possibility for an unlimited interest-only period when acquiring newly built homes. Given that the possibility for an interest-only period for mortgages collateralised by newly built homes is

limited to a specified period, single-family homes whose construction commences after the regulations enter into force shall be allowed an interest-only period that is limited to a maximum of five years.

#### *2.4.11 Increasing a mortgage*

**Finansinspektionen's position:** All increases to a mortgage after the regulations have entered into force shall be comprised by the amortisation requirement, but with some exceptions as described in this memorandum. This applies even if the increase (supplementary loan) arises as a result of a unsecured loan being converted. As described in section 2.4.3, an increase to a loan is exempted if it is used to pay interest differential compensation in cases whereby a borrower during a condition period wishes to change the fixed interest period for his or her loans. This applies provided that the loans for which the fixed interest period is being changed are exempted from the amortisation requirement.

The conditions that apply to the amortisation rate for a 'supplementary loan' if some portion of the mortgage is not comprised by the amortisation requirement are described in section 2.3.2.

That which applies to senior loans and equity release, which can at times be granted as increases to mortgages, is described in section 2.4.12.

**Consultation memorandum:** As regards amortisation rate, the proposal has been changed as described in section 2.3.2.

**Consultation bodies:** The opinions of the consultation bodies regarding amortisation rate for supplementary loans are described in section 2.3.2. Section 2.4.3 presents feedback on the consequences for mortgages, which were granted before the regulations entered into force, being rescheduled with the existing mortgage firm.

**FI's reasoning:** Mortgages that are granted after the regulations entered into force shall be comprised by the amortisation requirement. Finansinspektionen is of the opinion that the same conditions shall apply to increases to mortgages that are granted after the regulations enter into force. The reasons underlying the changes to the proposal are described in sections 2.3.2 and 2.4.3.

#### *2.4.12 Senior loans and equity release*

**Finansinspektionen's position:** Senior loans and equity release are collateralised by the home and shall not be treated differently than other mortgages.

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** Primarily *Svensk Hypotekspension AB* (Svensk Hypotekspension), *the Swedish Federation of Business Owners* and *Bluestep* have stated the following in summary. All types of senior loans should be

exempted from the amortisation requirement since requiring amortisation counteracts the aim of the loans. The aim is to give households more liquidity, but an amortisation requirement increases the household's monthly expenses.

As regards equity release, Svensk Hypotekspension in particular has stated the following. Equity release should be exempted from the amortisation requirement since this type of loan does not contain any of the risks that the regulations aim to reduce. According to the firm, the credit becomes due for payment at the borrower's death, if the borrower during his or her lifetime sells the home or if the borrower due to age or illness permanently leaves the home to live in a nursing home or similar. Svensk Hypotekspension is of the opinion that equity release should not be confused with senior loans since senior loans do not satisfy the criteria in relation to duration, grounds for cancellation and debt-free guarantee. Since equity release lasts a lifetime, the borrower does not risk having to pay back or renegotiate the credit during the remainder of his or her lifetime. According to Svensk Hypotekspension, its borrowers are not sensitive to shocks since it is the object, rather than the subject, which enables payment of the credit amount and interest. The firm is of the opinion that the reasons given for implementing the statutory provision on amortisation and the consultation regulations on the amortisation requirement do not apply to equity release.

Svensk Hypotekspension states that it will not be comprised by the regulations since it is not currently a credit institution. However, if the firm's product is not exempted, it will not be possible for it to obtain authorisation as a credit institution or for it to be acquired by a credit institution in the future. If the amortisation requirement is extended to include firms that fall under the proposed law on mortgage institutions,<sup>28</sup> Svensk Hypotekspension's operations would probably be comprised.

Svensk Hypotekspension further states that the regulations seriously restrict the firm's business opportunities. A restriction of this kind in relation to an individual business may only be implemented as a means to protect important public interests and in observance of the principle of proportionality, in accordance with Chapter 2, section 17 in the Instrument of Government and Articles 16 and 52 in the EU Charter of Fundamental Rights. Equity release is not comprised by the Mortgage Credit Directive. According to Svensk Hypotekspension, approximately 10,000 borrowers have thus far utilised this type of credit, and an additional 1,000 new borrowers, with a credit volume of approximately SEK 500 million annually, will be added every year.

**FI's reasoning:** Senior loans and equity release generally pertain to loans collateralised by a home and for which the borrower does not pay interest or amortise. The terms for the various types of credit vary. Equity release generally refers to loans that become due for payment at the borrower's death and which include a debt-free guarantee; that is, the repayable amount can

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<sup>28</sup> See SOU 2015:40.

never exceed the market value the borrower or the borrower's estate would be able sell the home for.

Finansinspektionen is not of the opinion that there is cause to treat these types of loans differently than other mortgages as regards application of the amortisation requirement. These loans shall be amortised to the extent that total leverage exceeds 50 per cent of the value of the home. In many cases, however, individuals who have been granted senior loans and equity release probably have a lower LTV than 50 per cent and are thus not impacted by the amortisation requirement. Senior loans and equity release that were granted by an agreement entered into before the regulations begin to apply but which are utilised after this time are not to be regarded as a new mortgage and shall thus not be comprised by the amortisation requirement.

Finansinspektionen does not share Svensk Hypotekspension's assessment that the terms that normally apply to equity release entail that these types of loans should be exempted from the amortisation requirement. Despite the terms that apply when this type of credit is granted, there is still a risk that shocks can impact the household's consumption behaviour. Even with the debt-free guarantee, a drop in house prices would result in a reduction to these households' capital and ability to consume. Furthermore, there is also a risk of household over-indebtedness with this type of credit. Even if the credit will not result in the borrower having residual debt when the home is sold, the credit will lessen the borrower's buffer, i.e. the surplus value in the home, in relation to the amount of credit. It is far from certain that the borrower will not want to sell the home and move to another one for a reason other than a move to a nursing home, for example. In this situation it would be very relevant for the borrower to have a significant surplus value in the home to enable such a move. Furthermore both senior loans and equity release are generally associated with considerably higher interest expenses than regular mortgages. Since the interest payments are accumulated and added to the existing debt, total leverage increases more quickly over time. Consequently, there is good reason to keep the LTV down for these loans. The reasons underlying implementation of the amortisation requirement, therefore, are also relevant for senior loans and equity release. In conclusion, there is not sufficient cause to exempt senior loans or equity release from the amortisation requirement.

Amortisation firms, that is banks and credit market companies, hold a special position in society in relation to other types of firms due to the importance of their operations in various respects. The firms have a central assignment in the financial system and, from the perspective of society, conduct important activities. From this perspective, it is very important that the businesses are run appropriately. Similar reasoning also applies to other firms that are active in the financial sector. The special position of financial firms is expressed in legislation in that these firms are subject to special business regulations and are under the supervision of Finansinspektionen.

A central aspect of the operations at a mortgage firm involves granting mortgages. In section 1, Finansinspektionen explained which macroeconomic risks household indebtedness constitutes. In light of the reasons specified in the preparatory work for the new provision of the Banking and Financing Business Act and in this memorandum, implementation of the amortisation requirement is meant to protect important public interests. The Instrument of Government, thus, does not constitute an obstacle to implementing such a requirement. Given that set out above, neither is an amortisation requirement in conflict with Articles 16 and 52 in the EU Charter of Fundamental Rights.

#### *2.4.13 Separation, etc.*

**Finansinspektionen's position:** In the event the person who remains in the home after a separation or similar only takes over the other party's portion of the existing mortgage, this does not constitute new lending. Provided the mortgage in question was taken out before the regulations entered into force, the amortisation requirement does not apply. However, this assumes there is no overall increase to the mortgage.

In cases where the person who remains in the home takes over the other party's portion, but also increases the total mortgage (for example, to compensate the person moving out for the surplus value generated in the home), the increase is to be regarded as new lending subject to the amortisation requirement. The increase can be amortised by at least ten per cent per year under certain circumstances (see section 2.3.2), but otherwise it is to be amortised in the same way as other new mortgages.

**Consultation memorandum:** Contained the same proposals. The consultation memorandum, however, did not contain a proposal for an alternative amortisation rate for supplementary loans (section 2.3.2).

**FI's reasoning:** A separation or similar circumstances may result in someone who formed part of a household and who contributed to and paid for the home leaving that home. One of the individuals who shared the home may keep it on his or her own. Such situations may – following a division of marital property for example – result in the need to increase the mortgage and thereby an amortisation requirement.

#### *2.4.14 Additional mortgage holders*

**Finansinspektionen's position:** Situations may arise whereby a person initially acquires a home and then a second person subsequently acquires a portion of the home with the intention of co-owning the home with the first person for a long-period of time

No new lending shall be deemed to arise if the additional person acquires a portion of the home by taking over a portion of the first person's loan, and neither of them take out any loans that increase the total mortgage. The same applies if the additional person takes out his or her own mortgage and this loan

replaces a portion of the first person's loan (the total leverage remains the same). An amortisation requirement does not arise in that situation either.

New lending subject to the amortisation requirement arises if the acquisition is financed by the second person taking out a loan collateralised by the home which increases the total mortgage. As in the second case, only the new portion of the total leverage is subject to the amortisation requirement.

**Consultation memorandum:** Contained the same proposals.

**FI's reasoning:** The amortisation requirement shall not make it difficult for more than one person to co-own a home and share an existing mortgage if the mortgage was granted before the regulations entered into force. However, an increase to the existing mortgage shall be comprised.

## 2.5 Home valuation

### 2.5.1 Valuation

**Finansinspektionen's position:** Application of the amortisation requirement shall be based on the home's changing market value. The starting point is the market value of the home when it was acquired. Revaluation of the home may be implemented no earlier than five years after acquisition or after a revaluation that resulted in the amortisation amount being changed. A revaluation that does not lead to a changed amortisation amount shall not prevent a new revaluation from being performed earlier.

Revaluation is also to be allowed in the event of a considerable value change to the home that is not attributable to the general price progression in the housing market in the country or local area.

A new valuation shall also apply when a new owner acquires a home. A home is to be appraised in conjunction with new leverage being granted for mortgage holders who already own a home and take on further leverage collateralised by the home after the regulations enter into force.

**Consultation memorandum:** Contained more or less the same proposals.

**Consultation bodies:** *The Riksbank* is of the opinion that the possibility for revaluation entails lower amortisation, even though amortisation without revaluation would be low compared to other countries. It is also important to consider debt as a percentage of income. Through revaluation, this relationship can even increase if house prices increase faster than income. In its current form, the amortisation requirement is expected only to have a small impact on indebtedness.

*The Association of Swedish Finance Houses, Bluestep, Swedish Bankers' Association, Stockholm Chamber of Commerce and Bostadsrätterna* are of the opinion that market valuation should be allowed when switching lenders. They

deem the restricted valuation principle to entail several complications, especially when switching lenders. The restriction places great demands on information sharing when switching lenders, and it has a limited impact on the amortisation amount. Property valuations might be internal documents that cannot be handed over due to an agreement with the assessment institution. The benefit of the restricted valuation principle is marginal.

The restricted valuation principle will cause difficulties in relation to sharing information about a valuation when changing banks. A new lender will be at the mercy of the previous lender's willingness to share information, which could result in long processing times since the change will not be a priority for the existing lender. This could lead to a customer having to wait a long time for a response to a request for information about terms since the final credit assessment cannot be produced without information on the amortisation amount. *The Swedish Competition Authority* believes that these conditions might entail a risk of competition being restricted.

The Swedish Bankers' Association and Bluestep state that a bank, due to bank confidentiality, is not allowed to share information about a customer's valuation without the customer's consent. They want revaluation of a home to be allowed when switching lenders, or for clarification to be made that the new mortgage firm does not need to accept a previous valuation. Several consultation bodies are of the opinion that if the restricted valuation principle is to remain in place, the information exchange must be regulated.

The Swedish Bankers' Association deems that the definition of 'market value' needs to be reformulated. The association says that market value should be defined in exactly the same manner as assessment institutions and community builders define it, i.e. that market value is the price that the home could probably be sold for if it were offered on a free and open market with a sufficient amount of marketing time, without there being a relationship between the parties or coercion. The Swedish Bankers' Association's definition is similar but not exactly the same. Bluestep forwards similar viewpoints, namely that the concepts of 'market value' and 'market price' are used synonymously, but that market price can greatly deviate from market value in the case of transfers between relatives or conversion.

Furthermore, the Swedish Bankers' Association is of the opinion that exemptions for mortgages collateralised by newly built homes create difficulties in terms of valuations for these homes. The exemption for newly built homes is likely to result in first-time buyers having to pay a 'premium' for the home. This must likely be taken into account when the bank is to appraise the home, which may have consequences both when calculating the amortisation requirement and applying the mortgage cap.

The Swedish Bankers' Association, the Riksbank and the *Swedish Association of Estate Agents* are of the opinion that the concept of 'considerable value change' needs to be clarified. Demarcation may be difficult since

Finansinspektionen's memorandum provides few examples of what might constitute such a change in value. They would like for the regulations to be clarified, and the Swedish Bankers' Association proposes that revaluation is to be allowed if a specific proportional increase in value has taken place (20 per cent, for example). Furthermore, it should be clarified that a revaluation due to extensive renovation or conversion may only take place when such a project is complete. It should not be possible to give speculative valuations on future work.

**FI's reasoning:** In light of Finansinspektionen's assessment that it is primarily mortgages exceeding 50 per cent of a home's value that need to be amortised, an important starting point is which value of the home is to be used. The amortisation requirement shall be based on the home's changing market value. In order to achieve a certain restriction and thus prevent rising house prices from quickly leading to lower amortisation, revaluation of a home shall not be allowed more frequently than every fifth year (which can be called a 'restricted valuation principle'). If a revaluation does not lead to a change in the amortisation rate, it is not necessary to wait an additional five years for a new revaluation of the home. The aim of the restricted valuation principle is to prevent a sharp price increase from quickly reducing the amortisation rate.

This implies that no earlier than five years following the acquisition of a home is it permitted to revalue the home and, based on the new valuation, alter the amortisation rate of the loan. However, the mortgage firm shall neither be obliged to accept a certain house valuation nor bear the cost it. Households that acquired their home before the amortisation requirement entered into force can have their home revalued if and when the mortgage is increased, regardless of whether five years have elapsed since its acquisition. This applies the first time an increase to the loan occurs after the amortisation requirement has entered into force. After that the normal rules for when revaluations can be carried out will apply.

As the Riksbank points out, the possibility of revaluation might mean lower amortisation, especially if house prices increase substantially. Finansinspektionen, however, is of the opinion that not allowing revaluation at all would be unreasonable. Not allowing revaluation at all would result in amortisation continuing until the actual LTV was significantly lower than 50 per cent; it might reach 20 per cent, for example. This would be much more far-reaching than Finansinspektionen deems necessary to curb the risks associated with household indebtedness.

There is cause, however, to allow revaluation of the home earlier than five years after the latest revaluation if the value of the home has increased for reasons not attributable to the general price progression in the housing market. Conditions that can give rise to a considerable value change are, for example, extensive renovation, conversion or extension of the home. Thus this refers to extensive changes that appreciably alter the value of the home. Renovating individual rooms (including the bathroom and kitchen), adding a balcony or a

terrace, building a carport or installing broadband does not generally result in an increase in value. As regards work that raises the value of the home, it is not the cost of performing the work that is to be considered, but rather the impact the work has on the market value of the home that is relevant.

Finansinspektionen is not of the opinion that there is cause to clarify additionally what is considered to be a considerable value change.

If the mortgage is increased or a new loan is granted that is collateralised by the same home, the potential amortisation obligation for the new leverage shall be calculated on the basis of the last valuation performed (which may be at the time of acquisition). Thus revaluation of the home is not allowed for the purpose of further leverage unless five years have passed since a previous valuation was performed that resulted in the amortisation amount being changed. As previously mentioned, however, the LTV and amortisation amount are to be recalculated if the mortgage is increased. When five years have passed after the latest valuation which resulted in the amortisation amount being changed, or if work has been performed that raised the value of the home, a revaluation may be done that can impact amortisation for both the original and the new portions of the mortgage.

If there is a drop in house prices, a revaluation of the home may result in the amortisation requirement becoming more stringent, for example if the LTV were to rise above 70 per cent of the market value. As no home revaluation requirement has been proposed, these situations are likely to be rare and possible to avoid for borrowers who do not want to amortise more than they already do. However, the regulations do not restrict the lender's contractual right to require amortisation, which the lender may wish to do if the value of the home has declined, for example.

If unsecured loans are converted into mortgages, the result might be an LTV in excess of 85 per cent of the value of the home according to the latest valuation that was performed in accordance with the amortisation regulations. This is because conversion of unsecured loans into mortgages is allowed under the conditions of the mortgage cap, which include the possibility to perform a revaluation of the home at any time. If the conversion of an unsecured loan into a mortgage or another increase to a mortgage results in the LTV being higher than when the amortisation amount was calculated, the amortisation amount is to be recalculated based on the total leverage. Annual amortisation is to be 1 or 2 per cent of the total leverage when it was at its highest level. This also applies if the LTV were to exceed 85 per cent according to the amortisation regulations.

Several consultation bodies believe the restricted valuation principle leads to several complications, especially when switching lenders. In cases where the borrower intends to change mortgage firms, or the borrower applies for an additional mortgage from a different mortgage firm, the issue arises regarding how information on the relevant valuation is to be submitted to the new mortgage firm. According to Chapter 1, section 10 of the Banking and

Financing Business Act, an individual's relationship to a credit institution may not be unduly disclosed. If a mortgage firm is asked to send information to another mortgage firm, the firm must ensure that it is satisfying the legal requirements related, for example, to obtaining consent from the affected customers. When a change of banks takes place, it is because the customer wants the change. Thus it should be possible for Bank A to obtain consent from the customer to send information about the customer to Bank B. If either of the banks should feel the least bit uncertain regarding whether it is entitled to share information with another bank, it can always hand the information over to the customer and convey that the customer must personally hand over the information to the other bank. As described in section 2.3.3, the regulations also contain a provision that mortgage firms shall inform each borrower in writing of the information that forms the basis for calculating the amortisation requirement. If a borrower wants to obtain offers from several different prospective mortgage firms, the borrower will already have the information needed for prospective mortgage firms to submit an offer. Regulation of information sharing between mortgage firms is thus not necessary.

Since the aim is for the mortgage holder to be able to change mortgage firms, it is important that the information obtained for a valuation can be submitted to a new prospective mortgage firm. It is thus incumbent on the firm that obtains a valuation for a home to ensure that all of the necessary information in the valuation can be submitted without further ado to both the mortgage holder and to other mortgage firms if the mortgage holder so wishes.

Some consultation bodies have implied that a new mortgage firm would be 'bound' to a previous valuation, and that this would pose a problem for the new mortgage firm. It is true that the new mortgage firm, when the regulations on the amortisation requirement are applied, will be bound to the previous valuation. The new prospective mortgage firm must use the valuation that was performed by the existing mortgage firm to calculate the minimum required amortisation according to the regulations, unless at least five years have passed since the latest valuation was performed. The new prospective mortgage firm is, however, not prevented from performing or retrieving other valuations or imposing stricter requirements on amortisation than what is set out in these regulations. This means that the valuation from the existing mortgage firm will not force the prospective mortgage firm to act in a specific way, other than to set a certain minimum requirement as regards the amortisation amount in accordance with the valuation that performed as specified in section 4 of the regulations. Thus the new mortgage firm is allowed to obtain a new valuation of the home for its own credit assessment and risk management. A revaluation carried out to calculate the amortisation requirement may obviously also be used for other purposes, provided the valuation satisfies all of the requirements imposed for such purposes.

Finansinspektionen does not deem it necessary to change the definition of 'market value'. The definition is already being used when applying the

mortgage cap. In this memorandum, however, Finansinspektionen has reviewed usage of the concepts of ‘market value’ and ‘market price’.

The exemption for newly built homes does not mean that homes will be appraised differently than is the case today. In general when a home is valued, the valuation can deviate from the purchase price. If a buyer pays more for a home than it can be considered to be worth, this can impact how the amortisation requirement and mortgage cap are applied. In section 2.7, Finansinspektionen explains the reasons why credit that is granted for the acquisition of newly built homes may be exempted from the amortisation requirement

#### *2.5.2 Which homes are comprised?*

**Finansinspektionen’s position:** The requirement shall only comprise homes in Sweden. The amortisation requirement will therefore not comprise loans collateralised by a home in a foreign country. Property for seasonal and secondary use and holiday homes are also to be comprised by routines that apply to the mortgage cap limit. The requirement shall not comprise credit collateralised by agriculture or forestry real estate (agricultural units in accordance with the Real Estate Tax Act).

**Consultation memorandum:** Apart from that which applies to agriculture and forestry real estate, the consultation memorandum contained the same proposal. According to the consultation proposal, credit collateralised by agriculture or forestry real estate would be comprised by the amortisation requirement, but only for the portion of the credit that pertained to the residential section of the property. The proposal stipulated that the credit was to be distributed according to the tax-based division of agriculture and forestry real estate into a residential section and a business section.

**Consultation bodies:** *The Swedish Bankers’ Association, the Swedish Savings Banks Association and the Federation of Swedish Farmers (LRF)* are of the opinion that agriculture and forestry real estate should be exempted from the amortisation requirement since the requirement could comprise that which should be considered as business credit. According to the consultation bodies, this could be in conflict with the draft bill which states that the rules are only to comprise ‘mortgages’ to individuals. The affected volume is small. The LTV for agriculture and forestry real estate is generally limited to 70-75 per cent. Problems related to over-indebtedness and overpricing do not normally apply to agriculture real estate. The proposal also entails difficult questions regarding whether housing belongs to business operations or not. Some housing on this type of property is leased out as part of the business operations. The property can have several housing units. The loan products offered by banks are not suitable for amortisation. The regulations complicate investments in the business and entail a risk of distorted competition for Swedish forestry and agriculture.

Dividing up the loan based on the Swedish National Tax Board's division of the property into a business section and a residential section is complicated and difficult for banks and customers to manage and understand. It is a business loan. This fact does not change because some of the properties have housing. The amortisation requirement in this case is not appropriate because the credit comprises businesses and not private individuals. An artificial division would entail the farmer also having to amortise a portion of the loan that is for business operations. It is not possible only to amortise the portion of the loan that is for housing. The proposal would weaken competitiveness in relation to other countries. It goes against the intentions of the Government's efforts to produce a national food strategy. The proposal could also have a negative impact on the possibility to implement generational transitions.

**FI's reasoning:** That the requirement only comprises homes in Sweden corresponds to that which already applies in relation to the mortgage cap. The amortisation requirement will therefore not comprise loans collateralised by a home in a foreign country. This might potentially mean that a certain portion of household indebtedness attributable to homes is not affected by the amortisation requirement. However, Finansinspektionen considers that the scope of such loans, in relation to total mortgages, is limited and that the overall risks associated with such loans are therefore slight. There is therefore no call to extend the amortisation requirement to loans collateralised by homes in foreign countries.

'Home' and 'housing' refer to single-family or two-family homes and tenant-owner apartments that are used for residential purposes. Freehold apartments that are used for residential purposes are also comprised. As with the mortgage cap, the tax-based definition of a home or property shall not be given decisive importance.

The regulations comprise mortgages to individuals. 'Individuals' refers not only to physical persons or consumers, but also to firms or other types of businesses that acquire a home so that the firm's owner or proprietor can live there. It is thus irrelevant whether the home should thereby be classified as commercial premises or a commercial tenant-owner property because it was acquired by a legal person. The imposed amortisation requirements shall not be less stringent than for those acquiring homes privately. The financing of the acquisition of homes by legal persons should consequently be subject to the amortisation requirement.

Property for seasonal and secondary use and holiday homes are also to be comprised by routines that apply to the mortgage cap limit. Finansinspektionen sees no reason why holiday homes shall be exempt from the regulations as the mortgages related to holiday home can have a significant impact on total indebtedness.

A special issue pertains to what should apply to properties where agricultural or forestry operations can be conducted, but which also have one or more

homes. Several consultation bodies have stated that agriculture and forestry real estate should be exempted from the amortisation requirement. The Committee on Finance has expressed the importance of agriculture and forestry real estate being exempted from the amortisation requirement, and it has also referred to that which the Government wrote in the Bill. In light of this, the possibility has been introduced for mortgage firms to grant new lending collateralised by agriculture or forestry real estate (agricultural units in accordance with the Real Estate Tax Act) on an interest-only basis.

## 2.6 Exemptions on special grounds

**Finansinspektionen's position:** It is to be possible for a mortgage firm to grant a mortgage holder a reprieve from amortisation for a limited period if there are special grounds. The special grounds could pertain to situations in which the person's financial situation is greatly weakened after a mortgage has been granted. Furthermore, the interest-only period must be within the framework of generally accepted standards for granting loans.<sup>29</sup>

**Consultation memorandum:** Contained the same proposals.

**Consultation bodies:** Several consultation bodies, for example the *Riksbank*, the *Swedish National Debt Office*, the *Swedish Association of Estate Agents* and the *Swedish Confederation of Professional Employees* are positive to the possibility to grant exemptions from amortisation if there are special grounds. The Riksbank states that it is important that the possibility to grant an exemption on special grounds be limited in the manner proposed by Finansinspektionen, and that lenders do not exceed the framework that has been stipulated. The Riksbank and the Swedish National Debt Office support the proposal that it is to be at the discretion of the credit institution to grant exemptions.

Some consultation bodies, including the *Swedish Bankers' Association*, the *Swedish Trade Union Confederation* and the Swedish Confederation of Professional Employees are of the opinion that the meaning of 'special grounds' needs to be clarified. The Swedish Bankers' Association points out that Finansinspektionen does not regard a separation as constituting special grounds, while the association is of the opinion that it should. The Swedish Trade Union Confederation is of the opinion that firms *shall* grant exemptions when there are special grounds such as unemployment, illness and death in the family, and that it should be clear that a potential partner's situation is also to be taken into account. The Swedish Trade Union Confederation also deems that it should be made clear that an exemption is to be granted in the event of a partner's unemployment or illness.

The Swedish Bankers' Association and *Bluestep* raise the issue of how exemptions are to be documented since the banks have limited opportunities to

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<sup>29</sup> Bill 2015/16:89, p. 18.

process personal information. They state in conclusion that treating delicate personal information about health, for example, is prohibited without consent. Consent must be given voluntarily. The Swedish Bankers' Association believes there is a sense of urgency as regards Finansinspektionen's clarification of whether the grounds for exemptions are to be registered and, if so, which information is to be registered. A clarification must also be preceded by consultation with the Swedish Data Inspection Board.

The Riksbank believes there is a sense of urgency as regards the issue of following up to what extent lenders utilise the possibility to grant exemptions, which reasons are specified when exemptions are granted and what the duration is of the exemption periods granted by mortgage firms. This is important in relation to obtaining an aggregate picture of the effectiveness of the amortisation requirement and to obtain indications of the possibility to grant exemptions being used as for competitive purposes.

**FI's reasoning:** There is a risk of households becoming less resilient to negative shocks if there were no opportunities to permit an interest-only period. This can have major consequences for a household's finances and at an aggregate level lead to heightened macroeconomic risks. This would counteract the purpose of the regulations, i.e. to reduce the macroeconomic risks associated with highly leveraged households. On the basis of these reasons, mortgage firms can already allow a borrower to refrain from amortising for a limited period of time if there are special grounds. However, this requires that the circumstances that constitute special grounds occur after a mortgage has been granted and thus do not exist when the loan is granted.

It would be far too difficult to attempt to state in the regulations all of the specific reasons and circumstances that would give rise to an exemption. Every household has its specific situation, which mean that various perceivable negative scenarios have a different overall impact on each household's financial situation. Consequently, Finansinspektionen considers it shall be possible for mortgage firms to determine what constitutes special grounds from case to case. Mortgage firms have extensive experience of dealing with borrowers who are experiencing financial difficulty and are therefore well-prepared to decide whether the problem is of such a nature that a mortgage holder may be allowed to refrain from amortising for a limited period. Thus clarification of exactly which circumstances constitute special grounds is not necessary. The amortisation requirement and exemption possibilities should not significantly change how the mortgage firms deal with this kind of loan and borrowers with a weak cash flow compared with today.

There are many circumstances and situations that could constitute special grounds for allowing a borrower to refrain from amortising for a period. Typical situations are unemployment, long periods of sick leave and death in the immediate family. Although the changed circumstances that can affect a borrower may be of a permanent nature, an exemption from the amortisation requirement is to be temporary and regularly evaluated by the lender. The

purpose of the amortisation requirement is to reduce the macroeconomic risks associated with highly leveraged households. Allowing highly leveraged households to have a permanent exemption from the amortisation requirement would counteract this purpose. However, an exemption could be granted for several years if the grounds persist.

The starting point is that mortgage firms are to adhere to the existing procedures for administering credit. According to Chapter 8, section 2 of the Banking and Financing Business Act, a credit institution's credit assessment must be organised so that the person who makes decisions on a case has sufficient documentation with which to assess the risk of granting credit. According to Chapter 8, section 3 of the Banking and Financing Business Act, a credit institution's loan decision shall be documented in such a way as to show the basis for the decision and the processing of the loan application. Furthermore, according to Chapter 2, section 1, point 8 of Finansinspektionen's Regulations and General Guidelines regarding governance, risk management and control at credit institutions (FFFS 2014:1), a credit institution shall keep relevant information regarding operations and the internal organisation for five years. According to section 20 in Finansinspektionen's General Guidelines regarding credit risks in credit institutions and investment firms (FFFS 2004:6), institutions should have a sound credit culture, e.g. good knowledge about the customer. In order to satisfy these existing requirements, credit institutions already process a certain amount of personal information. The regulations related to the amortisation requirement should not entail an additional obligation for credit institutions to have good knowledge about the customer or to keep the information for future use.

In its supervision, Finansinspektionen will investigate compliance with the amortisation requirement in the same manner that it does for other applicable rules. Supervision may take place, for example, within the framework of the mortgage survey that Finansinspektionen conducts annually.

## **2.7 Time-limited possibility for exemptions for credit collateralised by newly built homes**

**Finansinspektionen's position:** Mortgage firms shall be permitted to allow mortgages collateralised by newly built homes to be exempted from the amortisation requirement. The interest-only period may be granted for five years at the most. The five-year period shall apply from the date of occupancy. In the regulations, 'occupancy' refers to the date that the home is completed and available for the first-hand buyer to move in. If a newly built home is completed but is not sold until, for example, one year later, the applicable occupancy date is the date of the buyer's occupancy. As regards single-family homes when the household planning to live there also has it built, the applicable date of occupancy is the date that the home is habitable and can serve as collateral for a mortgage.

The possibility for the exemption from the amortisation requirement shall comprise any supplementary loans that are granted within the five-year period. When the five-year period ends, all of the mortgages collateralised by the home shall be comprised by the amortisation requirement, regardless of whether they were granted in conjunction with the acquisition or on a subsequent date. The possibility for an interest-only period only applies to the first buyer of the home.

**Consultation memorandum:** Contained a proposal for an exemption from the amortisation requirement for loans collateralised by newly built homes. According to the proposal, however, the exemption was not limited in time.

**Consultation bodies:** Several consultation bodies, including *the Swedish Bankers' Association, the Riksbank, the Swedish Property Federation, the Swedish Consumer Agency, the Swedish Association of Estate Agents, the Swedish Confederation of Professional Associations, the Swedish National Debt Office, the Swedish Savings Banks Association, Stockholm Chamber of Commerce and Bostadsrätterna*, have forwarded their viewpoints on the proposal not to require amortisation for credit that is granted for the acquisition of newly built homes. The Riksbank, the Swedish Bankers' Association, the Swedish Confederation of Professional Associations and the Swedish Consumer Agency reject an exemption of this kind. Several bodies deem that the exemption should at least be for a limited period of time, for example five years. Some consultation bodies, such as the Swedish Bankers' Association, are of the opinion that the possibility for an interest-only period should be linked to the home and not to the first-time buyer. The Swedish Bankers' Association states that borrowers may be of the opinion that they are entitled to an interest-only period, thus resulting in pressure on banks to grant such an exemption. The exemption option may begin to be used as a competitive tool. *The Swedish Construction Federation* deems the exemption to be a measure that will somewhat alleviate the negative effects that the amortisation requirement will entail.

Several of the consultation bodies point out that a large number of homes need to be built in Sweden over the coming years, which means that a significant portion of households will be exempted from the amortisation requirement. This situation would result in an erosion of the regulations and a weakening of amortisation behaviour. The exemption also runs the risk of leading to lock-in effects. Furthermore, the exemption will lead to a price premium for newly built homes, which entails a higher risk for the households that buy such a home. The exemption will also make valuation of the home more difficult since a second-hand buyer will potentially not be prepared to pay as much for the home as the first-hand buyer. It is not possible to justify the exemption for newly built homes from the perspective of risk.

In its previous consultation statement, the Swedish Association of Estate Agents conveyed that loans for purchasing newly built homes should be exempted, but it has now refined its position. The Swedish Association of

Estate Agents deems that the aim of the exemption – to avoid negatively impacting new construction – is well-intentioned, but misgivings have been expressed within the association regarding how an exemption could impact the price progression for newly built homes in the long term. There is a risk of a significant drop in prices and thus a distortion in the housing market.

**FI's reasoning:** According to the preparatory work for the new provision regarding the amortisation requirement in Chapter 6, section 3b of the Banking and Financing Business Act, it should be possible to exempt credit from the amortisation requirement if it is granted for the acquisition of a newly built home. The reason for this is to minimise the risk that fewer newly built homes will be constructed.<sup>30</sup> The Bill stated that the exemption should apply without a time limit for the first-hand buyer of the home. However, the Committee on Finance deemed that the possibility for an interest-only option should be limited to five years.

In light of this, the regulations contain the possibility for mortgage firms, for at most five years, to grant borrowers who acquire a newly built home an exemption. Such a possibility entails no obligation for the mortgage firms to grant a borrower an interest-only period. It is important that mortgage firms can require amortisation if they wish to do so.

The exemption possibility shall apply to all mortgages collateralised by the newly built home during the five-year period. It does not matter whether the mortgage was granted in conjunction with acquisition or later on during the five-year period. Having different regulations for supplementary loans would complicate the regulations and their application, and would not entail any significant benefits in relation to managing the risks associated with household indebtedness. Five years after the home is acquired, however, all of the loans that were granted during the five-year period will be comprised by the amortisation requirement.

As pointed out by several of the consultation bodies, the exemption possibility for newly built homes may weaken the effect of the regulation to a certain extent. At the same time, the exemption will be limited in time, as opposed to that stipulated in the consultation proposal. Newly built homes will also subsequently be sold after the initial purchase, even if a certain lock-in effect can be expected. These factors will result in interest-only possibilities being subsequently diminished. It is also possible that application of the exemption will be limited since mortgage firms are not obligated to grant interest-only mortgages, and they may be reluctant to grant interest-only periods. In cases where the LTV is high, it is very likely that mortgage firms will require the borrower to amortise in accordance with the firm's own risk management or due to other reasons.

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<sup>30</sup> Bill 2015/16:89, p. 18.

Several consultation bodies are concerned that the exemption will impact the home's valuation and that the first-hand buyer may have to pay a premium for the home due to the possibility of an interest-only period. One misgiving is that the exemption will impact price progression of newly built homes in the long term and that there is a risk of a significant drop in price. Finansinspektionen shares the view that the second-hand value for newly built homes may be lower when the home is sold again since the possibility to be exempted from the amortisation requirement will no longer exist. In individual cases, the possibility to be exempted from the amortisation requirement may mean that the first-hand buyer is prepared to pay a premium for the home. If this is the case, the valuation of the home that the mortgage firm is to work on the basis of will be affected, both in terms of calculating the amortisation requirement and when applying the mortgage cap. Since the possibility for an interest-only period is limited in time, the price premium that the first-time buyer may be prepared to pay will probably be lower than otherwise would have been the case.

That which constitutes, or which will constitute, a newly built home is generally not difficult to assess. However, there may be situations in which making this determination is not so simple. As the main rule, a newly built home exists in cases whereby new living space has been built and new homes have been created in the new space. A newly built home does not require the construction of an entirely new building. The reconstruction of existing buildings can lead to the creation of newly built homes. For example, it can be a case of a property's functional area of use being changed such that a home is created. For example, it should be possible to grant exemptions from the amortisation requirement for loans taken out to acquire a home that has emerged following the conversion of an industrial building, a storage facility or an attic that did not used to be a housing unit. Also, it should be possible to exempt loans taken out to acquire homes that have emerged following the extension of an existing residential property which gives rise to further housing units. However, exemptions cannot be granted for loans taken out to finance the extension of an existing housing unit. This means that building measures that only extend existing living space are not to be considered to be a newly built home. For the concept of new home to apply, the home must be made up of new living area. This means that homes created by larger housing units being divided up into several smaller units cannot be deemed to constitute such newly built homes that could enable mortgage firms to grant a borrower an interest-only period. The same applies to conversions of rental apartments to tenant-owner apartments. This consists only of a change in the tenure structure and does not entail the creation of new homes. Loans granted to borrowers who, in a conversion process, acquire what was formally a rented apartment are thus not covered by the exemption.

It is not unusual that individuals borrow money to acquire property and to pay for the construction of a home on the property. Sometimes loans known as construction loans are used initially and are then converted into mortgages. When there is a usable home on the property, a newly built home exists and the

mortgage firm may allow the mortgages that were granted to pay for the acquisition of the property and the erection of the building not to be amortised. This applies for the borrower who originally ordered the construction of the home with the purpose of using it. If a business constructs a home with the aim of selling it, the individual that acquires the home is to be deemed as the original buyer and the person to whom a mortgage firm may grant an interest-only period in accordance with the regulations.

### **3 Consequences of the regulations**

Finansinspektionen presents below the consequences it assesses the regulations will have on mortgage firms, society, consumers and Finansinspektionen. In its review of the consequence analysis, the Swedish Better Regulation Council found that the analysis satisfied the requirements in sections 6 and 7 in the Regulatory Impact Assessment Ordinance (2007:1244).

#### **3.1 Consequences for mortgage firms**

The firms directly affected by the proposed amortisation requirement are credit institutions (i.e. banks and credit market companies) that grant mortgages. This currently concerns approximately 130 firms. A limited number of these grant mortgages to any great extent. Mortgages are mostly granted by joint stock banks with associated mortgage firms and savings banks. In total these amount to around 90 firms. The eight largest players, Danske Bank, Handelsbanken, Länsförsäkringar Bank, Nordea, SBAB, SEB, Skandiabanken and Swedbank, together represent approximately 95 per cent of the total current mortgage volume in Sweden, which is thus almost the entire market.<sup>31</sup>

Finansinspektionen assesses that the regulations will entail slightly higher costs for the mortgage firms. Mortgage firms already handle amortisations. Consequently, the amortisation requirement is not expected to entail extensive adjustments for the firms, even if some one-off costs will arise in conjunction with adapting procedures and internal systems and when training personnel. Following consultation with the Swedish Bankers' Association, Finansinspektionen estimates that the amortisation requirement will give rise to a one-off cost of around SEK 3 to 7 million for each of the eight largest mortgage firms. Some of the expenses, such as those for training, will depend on the size of the mortgage firm and the scope of mortgage operations, while other expenses should be relatively the same regardless of the size or activities of the mortgage firm. Overall, these one-off costs should therefore be less for the smaller mortgage firms, but may still involve a greater burden in relation to the lower turnover of such firms. Finansinspektionen estimates that the one-off costs for small mortgage firms will on average be a maximum of SEK 1 million. On the whole, Finansinspektionen considers that the total one-off cost

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<sup>31</sup> It is these eight banks that are included in Finansinspektionen's mortgage survey.

for the entire mortgage sector will amount to no more than SEK 122 million.<sup>32</sup> These estimates are, however, subject to a great deal of uncertainty, and the actual cost may deviate from this estimate.

Even though the one-off costs may constitute a large burden for small mortgage firms relative to their turnover, Finansinspektionen does not assess that the regulations will result in any major limitations to competition in the mortgage market. This is primarily because the one-off costs are small in relation to the income generated by mortgage firms. Furthermore, the amortisation requirement is not expected to create obstacles for new players to enter the mortgage market since the requirement should not entail any significant additional expenses as regards commencing mortgage operations.

In addition to the one-off costs, some running costs will also arise for mortgage firms as a result of the regulations. It is mainly a case of the requirements possibly entailing some customer meetings taking a longer amount of time, with the result that mortgage firms may require more staff. In conjunction with switching lenders, information about the borrower's existing mortgages and amortisation is also required, for example when the latest valuation of the home was performed. Ongoing costs depend on both the size of the mortgage firm and the business model, and may therefore vary significantly from firm to firm. Finansinspektionen estimates that the total cost will reach a maximum of approximately SEK 105 million a year for the entire mortgage sector. This estimate is based on data from the 2015 mortgage survey when the eight largest mortgage firms over the course of the year drew up mortgage contracts totalling approximately SEK 540 billion. The average loan size was approximately SEK 1.75 million, which entailed around 310,000 customer meetings. The figure for the entire mortgage market was approximately 325,000 customer meetings. Finansinspektionen presumed in its calculation that the amortisation requirement will involve an increase in resources corresponding to 15 minutes of staff time per meeting and that the cost of one staff hour is SEK 1,300.

The mortgage firm and borrower are likely to have had many discussions about the loan's amortisation when the mortgage was granted. Therefore the issue of mortgage amortisation is already being dealt with as part of the mortgage firms' operating activities. This should mean that the amortisation requirement will not entail significant changes to a firm's customer meetings, organisation or systems. Finansinspektionen's estimate of the costs for the firms should thus be regarded as an upper limit.

The amortisation requirement will also eventually result in the mortgage firms' current mortgage volume being lower than it would have been without the requirement. This will probably entail lower interest income for mortgage

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<sup>32</sup> Using an average assumption of no more than SEK 5 million for the eight largest firms, the total amount will be:  $8 \times 5 \text{ million} + 82 \times 1 \text{ million} = \text{SEK } 122 \text{ million}$ .

firms, but at the same time lower risk for individual mortgage holders and the economy since borrowers will be less sensitive to shocks.

The interest-rate level is the most important competitive tool in the mortgage market. In contrast to interest payments, amortisation is not a cost for the borrowers, but represents expenditure that some borrowers may wish to avoid. Amortisation terms can consequently be an important competitive tool for mortgage firms. A regulation limiting the opportunities for firms to decide on their own amortisation terms may therefore lead to some deterioration in competition in the mortgage market. However, based on the risks to which highly leveraged households can impose on the economy, Finansinspektionen does not deem it desirable for mortgage firms to compete by offering interest-only options to highly leveraged households.

The amortisation requirement is not expected to give rise to any significant costs in the form of additional reporting for mortgage firms. The largest firms that grant mortgages report data to Finansinspektionen annually within the framework of the mortgage survey. The results of the survey are used to ensure compliance with the mortgage cap and to analyse the risks associated with household indebtedness. In the future, Finansinspektionen also intends to extend the mortgage survey to comprise adherence to the amortisation requirement regulations.

## **3.2 Impact on society and consumers**

### *3.2.1 Increased amortisation*

Through the regulations, a minimum amortisation rate is being introduced for new mortgages that exceed 50 per cent of the home's value. Highly leveraged households are assessed to react more strongly to negative shocks in the economy, which can create or reinforce an economic downturn. By ensuring that these households reduce their leverage over time, an amortisation requirement can help curb the macroeconomic risks that these households impose (see more about this under section 1).

Finansinspektionen has made estimates based on the sample of new loans compiled annually in the mortgage survey to assess how the amortisation requirement will affect borrowers' amortisation. These estimates are based on data from 2015 and take no account of behavioural effects, i.e. that borrowers may choose to borrow less than previously following the introduction of the requirement. Neither do the calculations take into account that the amortisation requirement can have a dampening effect on the growth of house prices.

The regulations entail that the share of households with new mortgages that amortise would increase from 67 to 87 per cent. The amortisation amount in relation to household income would on average rise from 3.3 to 6.0 per cent. For borrowers with an LTV over 50 per cent, which corresponds to the households affected by the requirement, the amortisation requirement would result in amortisation on average increasing from approximately SEK 1,450 to

SEK 2,950 a month, which is approximately double. Since borrowers with an LTV of 50-70 per cent currently amortise to a lesser extent than borrowers with an LTV over 70 per cent, the relative change of the share of borrowers who amortise would be greatest in the first group of borrowers (see Diagrams 3-5 in Appendix 1).<sup>33</sup>

Borrowers with an LTV over 85 per cent, that is borrowers who have taken out unsecured loans in conjunction with financing the home, clearly amortise more than other borrowers. This is probably primarily due to mortgage firms imposing higher requirements for the amortisation of unsecured loans. When Finansinspektionen assessed the effects of the amortisation requirement on these borrowers, the amortisation set out in the amortisation requirement was added to the amortisation amount originally paid for the household's unsecured loans. This means that amortisation for these borrowers as a result of the amortisation requirement will increase from an already high level of just over 7.5 per cent of income to just over 10.5 per cent of income. The calculation is based on the assumption that unsecured loans will continue to be amortised at the same rate after the regulations enter into force.

Uncollateralised loans such as consumer credit or unsecured loans that are taken out in conjunction with financing a house generally have a higher rate of interest than mortgages. It is therefore better for households with such loans to amortise them instead of their mortgages. Since it is unusual that lenders grant unsecured loans without requiring amortisation, the amortisation requirement imposed on mortgages will in many cases apply at the same time as amortisation requirements for other loans, which can lead to a higher total required amortisation amount. Thus, it is reasonable to expect that amortisation for borrowers who have unsecured loans will increase as a result of the amortisation requirement. However, it is not possible to eliminate the prospect of certain borrowers reducing their amortisation on unsecured loans as a consequence of the amortisation requirement. For households with new mortgages, unsecured loans constitute just under 0.7 per cent of their total new loans. On the whole, Finansinspektionen therefore judges that any higher interest expenses as a consequence of households amortising their mortgages rather than their other loans would be minor and only cover a limited number of households.

The proposed amortisation requirement, however, contains conditions under which the borrower can, under the conditions of the loan agreement, amortise the portions of the mortgage that have relatively higher interest first.

As regards the share that amortises, an analysis of the effects of the amortisation requirement on various income groups shows that individuals with the highest incomes are slightly more affected than those in other income

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<sup>33</sup> See Finansinspektionen's memorandum 'Measures to handle household indebtedness – amortisation requirement', Finansinspektionen Ref. 14-15503, for a more detailed analysis of the effects of various amortisation requirements.

groups. This is also the case when looking at the size of amortisation in relation to borrowers' income (Diagrams 6–8 in Appendix 1). This is in part because many borrowers with lower income already set aside a larger portion of their income for amortisation than borrowers with higher income do.

The change in amortisation behaviour is most significant in large cities, while borrowers in the rest of Sweden are not affected to the same extent (Diagrams 9–11 in Appendix 1). This is due firstly to amortisation currently being more common in the rest of Sweden and secondly because borrowers in the rest of Sweden do not have debts that are as large in relation to their income as those living in large cities.

It is at present clearly more common for younger borrowers to amortise more than older borrowers, which is probably because they are more highly leveraged (over 70 per cent). The amortisation requirement will therefore involve quite a substantial change in how many people amortise in the higher age groups. The change in amortisation as a proportion of income will be most significant for borrowers in the age group 30 to 50 years old, while it is least significant for borrowers over the age of 65 (Diagrams 12-14 in Appendix 1). Finally, Finansinspektionen's analysis shows that the amortisation requirement has a relatively equal effect on different types of family. There are no major differences between households with one or two adults, regardless of whether the household has children or not. As regards how large a share of income is used for amortisation, households with one adult currently amortise slightly more than households with two adults, and this situation is expected to continue even after the amortisation requirement enters into force (Diagrams 15-17 in Appendix 1).

### *3.2.2 Macroeconomic effects*

It is difficult to assess exactly the macroeconomic effects of the amortisation requirement. Finansinspektionen has estimated which effects the amortisation requirement would have on the aggregate LTV (loan in relation to the value of collateral) and debt-to-income ratio (loan in relation to disposable income) given unchanged behaviour for new borrowers compared to behaviour that existed in 2014. These estimates suggest that the amortisation requirement will eventually mean that the total LTV for all mortgaged households will fall by approximately 3.5 percentage points compared with no amortisation requirement being introduced. This means that the share of borrowers with an LTV over 50 per cent will drop, but since Finansinspektionen's estimates are based on the total level for all households with mortgages, it is not possible to determine exactly to what extent. Finansinspektionen's estimate also shows that the amortisation requirement will result in a long-term reduction in the aggregate debt-to-income ratio by around 17 percentage points for mortgaged households compared with no amortisation requirement being introduced.

Finansinspektionen has also assessed how house prices and consumption might be affected by an amortisation requirement. These assessments are characterised by a great deal of uncertainty since the connections are complex

and the calculations require several assumptions to be made. Using various households' financial situations and willingness to pay for a home as the starting point, it is possible to estimate how the amortisation requirement will impact house prices. It is primarily households with limited financial margins and households with a short planning horizon that will demand homes to a lesser extent. All in all, it is deemed that the amortisation requirement will result in aggregate demand for homes decreasing by approximately 5 per cent. If the supply of owner-occupied homes remains the same, it is reasonable to expect this reduced demand for homes to have a full impact on prices, which may thereby keep a lid on the price progression for several years. The supply of owner-occupied homes can, however, decrease slightly as a result of lower demand. Consequently the price impact would probably be slightly lower in the longer term. If house prices are subdued, people who already own a home will have lower wealth progression, while people moving and first-time buyers will find it cheaper to buy a home. All in all, the lower wealth progression is expected to curb consumption slightly. The dampening of consumption is expected to peak within a couple of years when it will amount to no more than 0.5 to 1 per cent compared with no requirement being introduced.<sup>34</sup>

Finansinspektionen's amortisation requirement will increase housing expenses for highly leveraged borrowers, which should have a certain dampening effect on the demand for homes. Since buyers of newly built homes can be granted an exemption from the amortisation requirement for five years, the demand for new homes is not expected to be impacted to any great extent. Demand for construction services (for example, renovation and conversion work) may also be affected in cases where these are financed by means of new mortgages.

### *3.2.3 Lock-in effects*

An amortisation requirement that only covers new mortgages inevitably creates a certain lock-in effect in the housing market. This is because households with older mortgages, to the extent that their desired level of consumption over time would be impacted by the amortisation requirement, will choose not to move as much as previously. To some extent, these households may decide not to move to avoid being subject to the amortisation requirement. Such lock-in effects mean that mobility will be impaired in the housing market and involve a socioeconomic cost. Finansinspektionen deems, however, that this effect is likely to be limited and will decrease over time since more households will move and take out new mortgages comprised by the amortisation requirement. The lock-in effect could be avoided if the amortisation requirement also comprised loan agreements that have already been entered into. However, having the amortisation requirement comprise loan agreements that have already been entered into would not be consistent with the transition regulations stipulated in the Banking and Financing Business Act.

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<sup>34</sup> See Finansinspektionen's memorandum 'Measures to handle household indebtedness – amortisation requirement', Finansinspektionen Ref. 14-15503 for a more detailed description of Finansinspektionen's estimates. The estimates are based on mortgage data from 2014.

The lock-in effect is likely to be the strongest for households that are planning to move to a more expensive home since it is primarily these households that can be expected to need to take out high mortgages. Households planning to move to a cheaper home should be more able to finance the acquisition of a home using equity rather than borrowed capital, even if they still need to borrow.

Households that purchase a newly built home can be expected to have lower incentive to move. This is because these households can be granted an exemption from the amortisation requirement up to five years as long as they keep the newly built home. Thus moving to a home that is not newly built within a five year period means the household will be comprised by the amortisation requirement. This may diminish their willingness to move, which might result in a slight decrease in mobility in the housing market. Since the exemption is limited to the first five years, however, this effect should be limited.

Amortisation increases the household's housing expenses but is fundamentally a way of saving. This suggests that a lock-in effect as a consequence of the amortisation requirement would not be as strong as it would if amortisation were a cost. Indeed, lock-in effects often involve behaviour that aims to avoid costs, for example a household that decides to continue living in its home to avoid paying capital gains tax when selling it. As amortisation is a kind of savings, the desire among households to avoid amortising should be significantly lower than, for example, the desire to avoid paying tax. The lock-in effect that arises as a result of the amortisation requirement will probably be the strongest for households that save very little or no monthly income, and thus will have to refrain from consuming rather than switching the form of savings if they need to amortise to a greater extent.

#### *3.2.4 Restricted opportunities to borrow*

Finansinspektionen's amortisation requirement may restrict the opportunities for some borrowers to borrow. This is because increased amortisation means higher monthly housing expenses, which may affect a mortgage firm's discretionary income calculations. These calculations are used as part of a mortgage firm's credit assessment and impact how much a borrower may borrow. Higher housing expenses may mean that borrowers cannot borrow as much as they would have been able to if their housing expenses had been lower. This may affect in particular borrowers who need to borrow a lot of money and take out a mortgage that is large in relation to the borrowers' income. Restricted borrowing capacity may hence mean that some first-time buyers find it more difficult to enter the housing market. However, the Swedish Bankers' Association's previous amortisation recommendations have meant that highly leveraged borrowers currently already amortise more. The amortisation requirement stipulated by the regulations should therefore only entail a marginal difference in the possibility for these households to borrow. As already mentioned, the amortisation requirement can be expected to have a dampening effect on house prices, which benefits first-time buyers. The way in

which the amortisation requirement will affect the ability of first-time buyers to purchase a home is hence ambiguous.

Instead it is likely primarily to be younger households in large cities that have been established in the housing market for a few years and want to move to a more expensive home (for example due to starting a family) that may experience a limitation on their borrowing possibilities as a consequence of the amortisation requirement. Owing to rising house prices in recent years, such households often have no difficulty paying for the capital investment in their new home, and therefore rarely need to borrow up to the mortgage cap limit. For this reason, they were previously unlikely to have amortised as much as highly leveraged households. On the other hand, they may need to take out large loans in relation to their income to afford a larger home if they want to continue living in an attractive area of a large city. All else being equal, this means that the running loan expenses will be a greater burden. As this group of households may be expected to need to increase their amortisation as a consequence of the amortisation requirement, it is also likely that they will experience a certain limitation in their borrowing capacity. This may mean that they will be forced to continue living in their old home for a longer period, or they may decide on a new home that is less expensive than they would otherwise have chosen.

Another group of households that can be impacted by restricted opportunities to borrow are self-employed persons who are dependent on being able to finance the start-up or expansion of a company by borrowing on his or her home.

Since agriculture and forestry real estate (agricultural units) is completely exempted from the amortisation requirement, these types of businesses should not be affected. Generally this type of property primarily consists of land and buildings that are used in business operations, and often also includes a residential section for the proprietor. By also allowing exemptions for the residential section of these properties, the households that run agricultural or forestry businesses receive special treatment since they are granted an exemption from the amortisation requirement regardless of the LTV for the home. This could mean that these households remain as highly leveraged over time, thus potentially entailing personal financial risk and sensitivity to shocks. Since the issue only concerns a limited number of households, Finansinspektionen does not deem the impact on socioeconomic risks to be great. As a result of agricultural and forestry real estate being exempted, these types of properties will become more attractive, even for households that are not planning to run an agricultural or forestry business. Consequently, it is possible that a certain price premium will arise for these properties. This will likely primarily concern relatively small properties that are located close to cities.

### *3.2.5 Restrictions in the freedom of households to choose preferred types of savings*

An amortisation requirement entails a restriction of the freedom of households to choose their preferred types of savings. For some households, this will mean that they amortise more than they would otherwise have done. This may mean that they reduce their consumption or reduce their other savings. The aggregate future yield might be lower than it would have been without an amortisation requirement for households that replace other types of savings with amortisation as a result of the requirement. This is because mortgage rates, primarily after tax relief on mortgage interest, are generally lower than the expected yield of many other types of savings. At the same time, however, the risk associated with household savings declines since the value of other savings, such as shares and investment funds, may fluctuate significantly. Amortisation always entails secure savings in the form of lower mortgages and lower interest payments in the future, while other types of savings generally entail both the possibility of higher returns as well as of a risk of losses. Considering the risk associated with various types of savings, amortisation thus does not need to be an inferior form of savings compared to riskier forms of savings.

Other types of savings than amortisation, however, generally have the advantage that the money is available if needed, for example in the event of a loss of income. It may be difficult in such a situation for a borrower to obtain a new loan corresponding to previous amortisation in order to sufficiently cover expenses, while shares or funds may be sold and money in savings accounts can be withdrawn. For this reason, an amortisation requirement may increase household vulnerability. At the same time, many households that currently save very little will have increased resilience to shocks as a result of increased amortisation.

### *3.2.6 Higher loan expenses result in lower household margins*

The amortisation requirement means that some households that take out loans after the requirements enter into force will have higher monthly expenses as a result of higher amortisation. Even if the amount of the expenses is known when the new loans are taken out, unexpected difficulties in the household's financial situation can arise. The increased expenses that the amortisation requirement result in might entail a significant burden if the household's financial situation is considerably worsened as a consequence of the requirement. There is a risk of the monthly expenses for some borrowers becoming so high owing to the amortisation requirement that they are forced to leave their home if they are affected by a loss of income, for example. Being forced to move under these circumstances can be a drawn out process associated with expense and a great deal of personal uncertainty. To prevent households from becoming less resilient to shocks, mortgage firms, under the regulations, can therefore grant borrowers a reprieve from amortisation if there are special grounds. Such exemptions, however, shall only apply for a limited period of time. Afterwards, borrowers must resume their amortisation. Exemptions may however be granted for several years if the grounds persist (cf. section 2.6).

Mortgage firms are already accustomed to managing customers who are facing financial problems, and they can grant temporary payment reprieves from interest and amortisation. By allowing exemptions from the amortisation requirement in relevant situations, Finansinspektionen's aim is for the option of flexibility to stay in place after the amortisation requirement enters into force.

That the exemption option is limited in time means that borrowers who are impacted by permanent difficulties in their financial situation may need to adjust their living situation. It is doubtful in these cases whether the household would have been able to stay in the home even without the amortisation requirement. It is important for mortgage firms to have a dialogue with their borrowers about their long-term financial situation. In cases where the borrower is affected by shocks and is granted a reprieve from amortisation, it is particularly important to discuss the long-term financial situation. This will make it easier for borrowers to consider, during the period when they are not amortising, whether they want to, or will need to, adjust their living situation in the future.

### *3.2.7 Exemptions for newly built homes may increase the risk of a loss on the part of the original buyer*

The possibility for the first-hand buyer of a newly built home to be granted an exemption from the amortisation requirement for up to five years might make newly built homes more attractive than existing homes. The willingness to pay for newly built homes may thus increase after the requirement enters into force, which will lead to a price premium being created compared to existing homes. This will likely primarily apply to the households that need to take out high mortgages and would thus need to amortise if the exemption option did not exist. Since the exemption only applies to the first-hand buyer of a newly built home, the price premium is not expected to persist when the house is sold again. This means that buyers of newly built homes run a greater risk of making a loss when selling their home than buyers of an existing home do.

It is difficult to predict in advance how high the price premium will be and consequently how great the risk of making a loss is for the original buyer when selling the home. The risk should be lower, however, the longer the original buyer keeps the home, provided that house prices increase at the same rate as incomes. That the exemption is limited to five years should also entail a lower price premium than if there had been no limitation in time. The regulations merely specify a possibility, not an obligation, for banks to grant exemptions for households that purchase newly built homes. The price premium and thus the risk of borrowers making a loss depend on to what extent banks choose to grant interest-only periods for highly leveraged households that purchase newly built homes. Since these households constitute at least as great a risk as other households for banks, the banks are expected to be restrictive when granting exemptions. The effects of the exemptions should thus be limited.

## **3.3 Implications for FI**

Finansinspektionen conducts an annual survey on new mortgages in which compliance to the mortgage cap, among other things, is followed up and the risks associated with household indebtedness are analysed. As part of this survey, Finansinspektionen also receives data that can be used to monitor the extent of compliance with an amortisation requirement. Even if more resources will be required to follow up the amortisation requirement, the proposed requirement is not expected to lead to any major consequences for Finansinspektionen.

## Appendix 1 – Effects on different categories of borrower

Finansinspektionen has estimated how the proposed regulations might affect different categories of borrower based on mortgage data from 2015.<sup>35</sup> These estimates relate to borrowers with new mortgages. All of the figures refer to the average for each category of borrower.

### Effects on borrowers with different LTVs

Diagram 3 Share that amortises per LTV interval

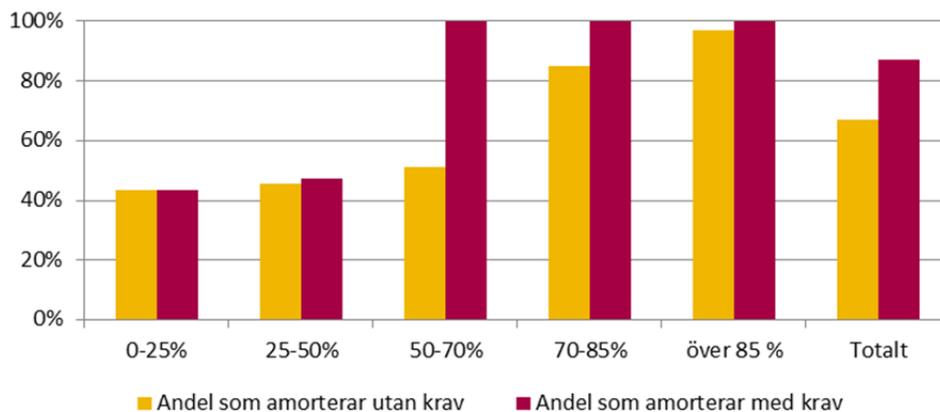
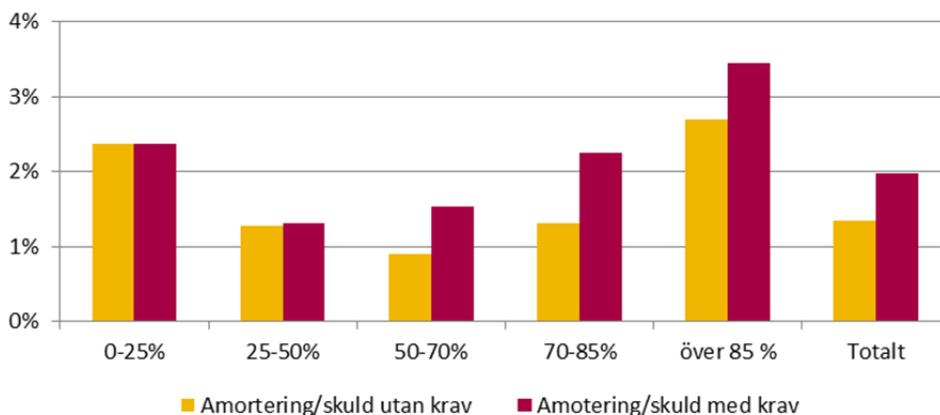
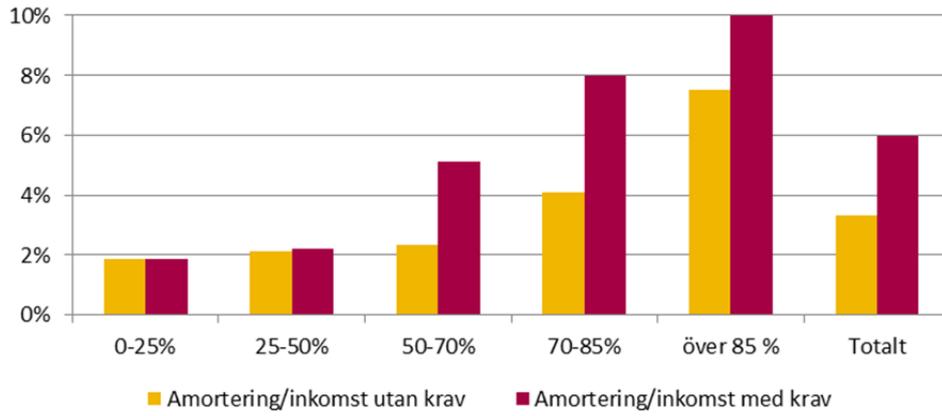


Diagram 4 Amortisation as a share of loans per LTV interval



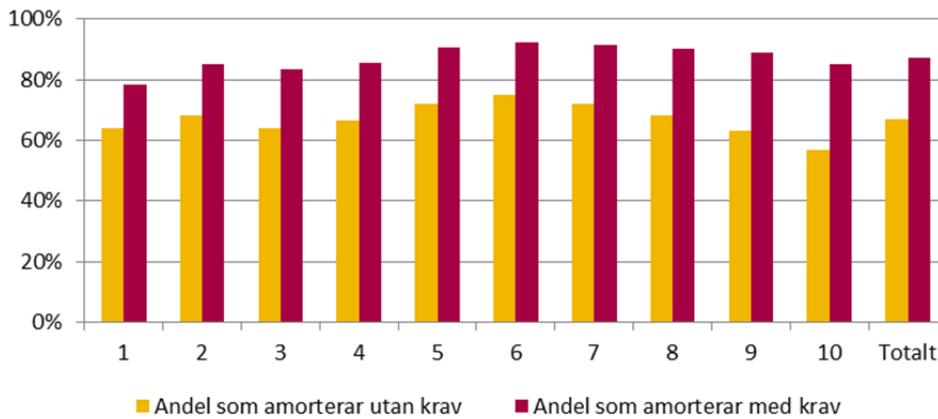
<sup>35</sup> See Finansinspektionen's report 'The Swedish Mortgage Market 2015', 14 April 2016 for a more detailed description of the data.

**Diagram 5 Amortisation as a share of income per LTV interval**

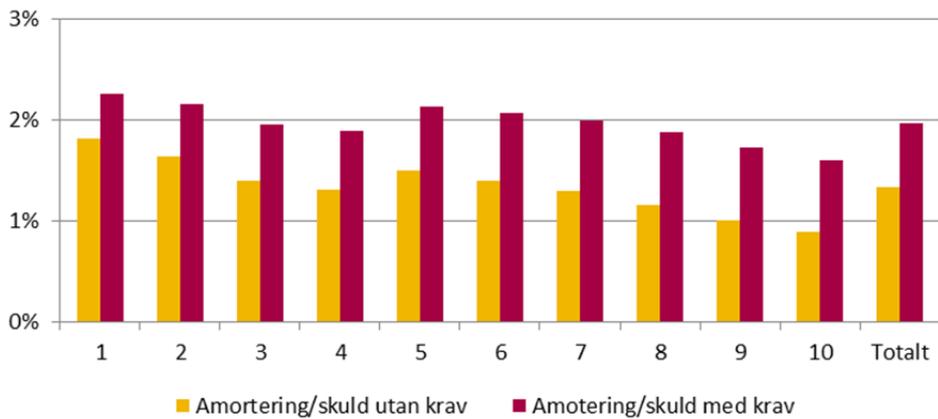


### Effects on different income groups<sup>36</sup>

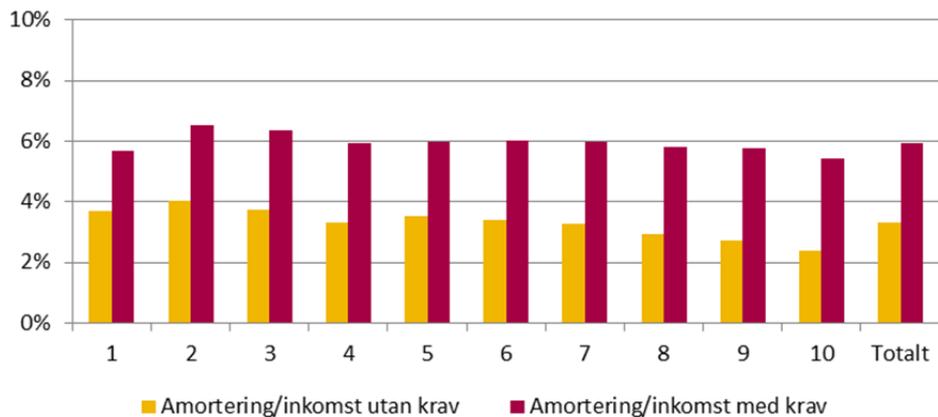
**Diagram 6 Share that amortises per income decile**



**Diagram 7 Amortisation as a share of loans per income decile**



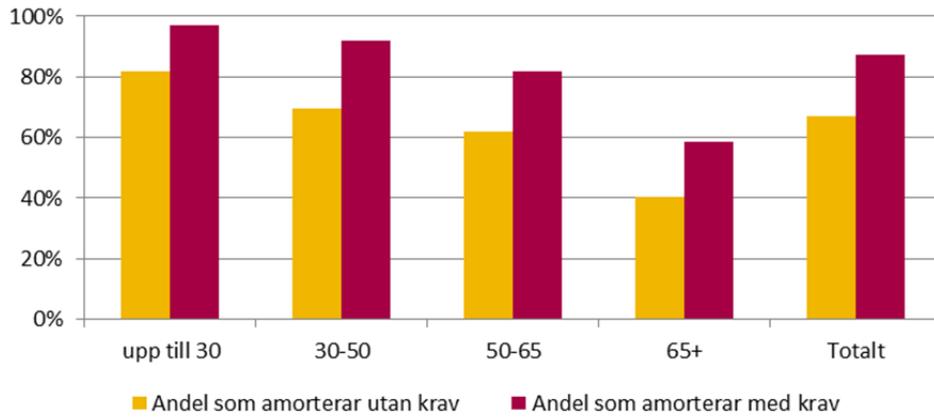
**Diagram 8 Amortisation as a share of income per income decile**



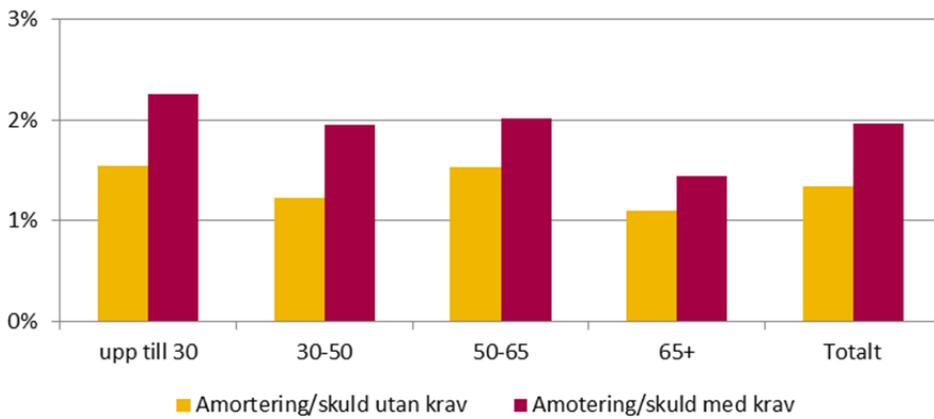
<sup>36</sup> The income groups are income deciles where Group 1 comprises households with monthly income after tax of SEK 0-20,747, Group 2 of SEK 20,747-24,891, Group 3 of SEK 24,891-29,850, Group 4 of SEK 29,850-35,383, Group 5 of SEK 35,383-40,070, Group 6 of SEK 40,070-44,360, Group 7 of SEK 44,360-48,750, Group 8 of SEK 48,750-55,047, Group 9 of SEK 55,047-63,614 and Group 10 of SEK 63,614-1,431,100.

## Effects on different age groups

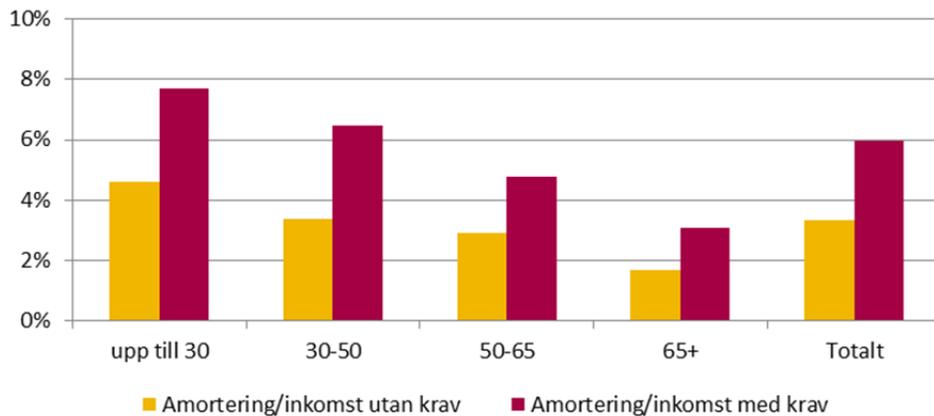
**Diagram 9 Share that amortises per age group**



**Diagram 10 Amortisation as a share of loans per age group**

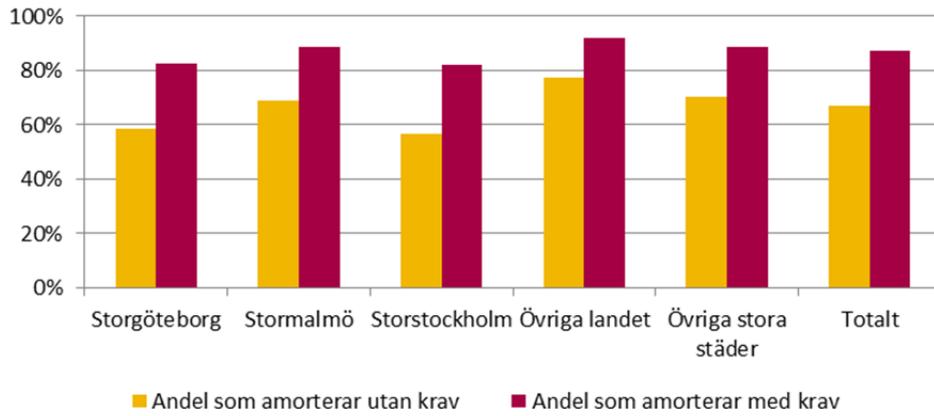


**Diagram 11 Amortisation as a share of income per age group**

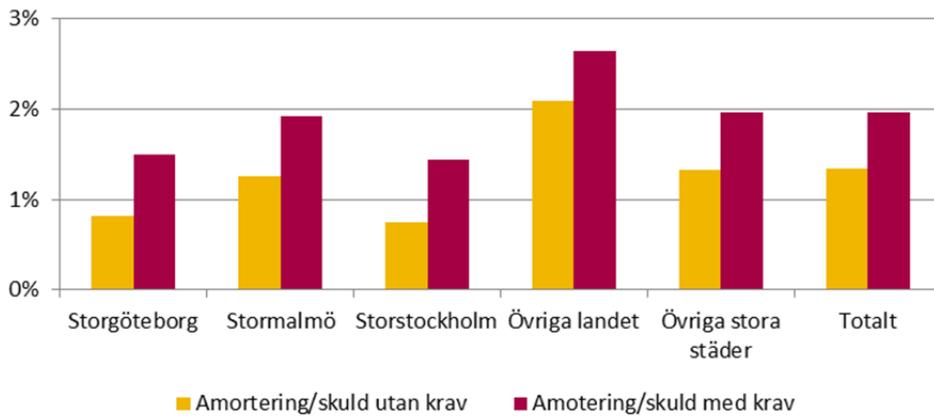


## Effects on different regions

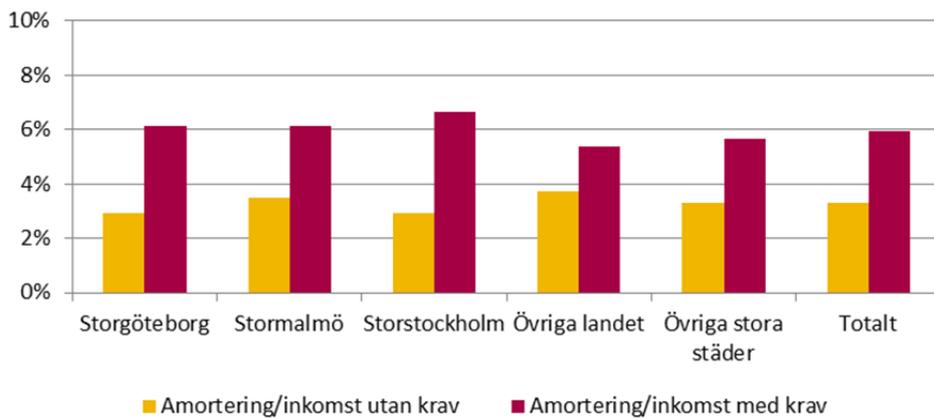
**Diagram 12 Share that amortises per region**



**Diagram 13 Amortisation as a share of loans per region**

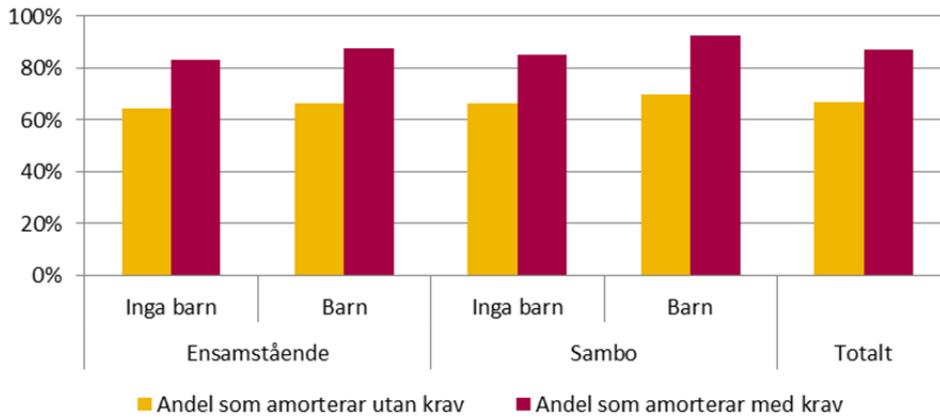


**Diagram 14 Amortisation as a share of income per region**

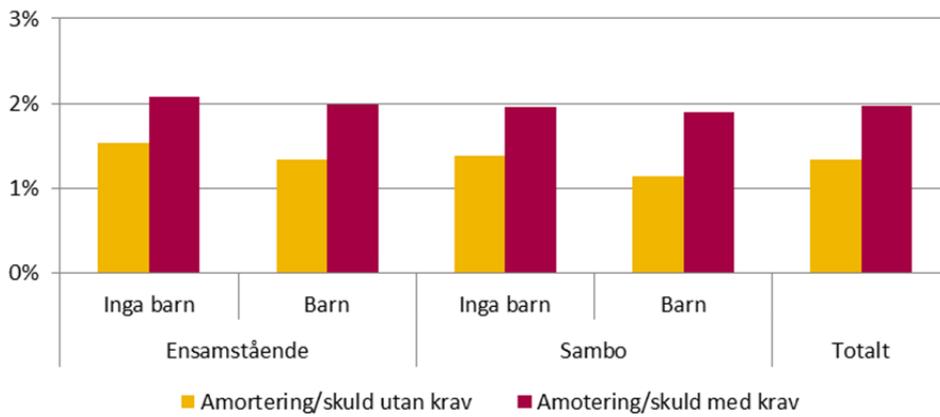


## Effects on different family types

**Diagram 15 Share that amortises for different family types**



**Diagram 16 Amortisation as a share of loans for different family types**



**Diagram 17 Amortisation as a share of income for different family types**

