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CONSULTATION RESPONSE REGARDING THE DRAFT AMENDMENT TO THE EXECUTIVE ORDER ON GOOD BUSINESS PRACTICE FOR MORTGAGE LENDING

The Danish Financial Supervisory Authority has issued a consultation regarding an amendment to the Executive Order on Good Business Practice for Mortgage Lending. The amendment should be viewed in light of the recommendation from the Systemic Risk Council made to the government on 30 March 2017. In this consultation response Danmarks Nationalbank expresses its views on the proposed amendment. It is not an evaluation of whether the government has complied with the recommendation from the Systemic Risk Council.

The aim of the recommendation from the Systemic Risk Council was to create a more robust housing market and to counteract a repeat of the development ahead of the financial crisis, where the widespread increase in adjustable-rate and deferred-amortization mortgages – in combination with expectations of continuing house prices rises – implied greater risk-taking of both households and credit institutions.

The suggested amendment limits the product supply for homeowners with a total debt-to-income, DTI, of more than four and a loan-to-value, LTV, of more than 60 per cent. These homeowners will not be able to obtain adjustable-rate mortgages with interest-rate fixation of less than five years. Deferred amortization loans will, however, still be possible for 30-year fixed-rate mortgages.

Danmarks Nationalbank finds it positive that the rules apply to all homeowners with high debt in proportion to income, regardless of the zip code of the property. It ensures consistent underwriting standards and reduces the risk of artificial and unintended spillover effects to geographical areas not covered by the rules. The exception of wealthy homeowners with an LTV below 60 per cent of the value of the property seems rea-

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sonable. It is also positive that the implementation through the Executive Order on Good Business Practice ensures that lending from foreign branches in Denmark is also covered by the rules.

On the other hand, Danmarks Nationalbank finds it inappropriate that highly indebted homeowners will still be able to finance housing purchases using deferred amortization loans. Irrespective of the interest-rate fixation profile, deferred amortization loans imply a significantly lower debt service amount in the first year of the mortgage, which makes high leverage possible, especially with the current interest-rate levels. A 30-year fixed-rate mortgage loan with deferred amortization and an LTV ratio of 80 per cent implies a liquidity relief in the first year of 50 per cent compared to an equivalent without deferred amortization. Conversely, the difference in the first year debt service between a fixed-rate annuity and a variable-rate annuity is only approximately 10 per cent.

New mortgage lending to households with high DTI ratios, high LTV ratios and deferred amortization loans are increasing, especially in the urban areas. Restricting the possibility to obtain deferred amortization financing would reduce the vulnerability of homeowners to negative economic shocks such as declining house prices and unemployment, just like a higher monthly debt service would reduce the risk of short-sightedness due to low interest rates.

In this light, Danmarks Nationalbank urges that lending developments be monitored closely and that credit institutions report the level of risky new lending, including deferred amortization loans to households with a high DTI ratio.

In international comparison, Danish homeowners rank among the most indebted in the world. The International Monetary Fund and the European Systemic Risk Board have often highlighted the high debt levels and have amongst other measures suggested introducing stricter rules for obtaining loans with deferred amortization. In Sweden and Norway the authorities have imposed minimum amortization requirements for borrowers with high LTV ratios.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K. Bilotft', with a stylized flourish at the end.

Karsten Bilotft