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## **A stricter amortisation requirement for households with high loan-to-income ratios**

### **Summary**

Finansinspektionen decides to amend regulations regarding amortisation requirements.

The amendment entails that new mortgagors with mortgages that are greater than 4.5 times their gross income must amortise at least 1 per cent of the debt in addition to the existing amortisation requirement. The aim of the measure is to increase the Swedish households' resilience to shocks. The grounds for and design of the stricter requirement are presented in this Decision Memorandum. The amended regulations enter into force on 1 March 2018.

Mortgages serve an important function in the economy since they enable households to use their future income to pay for a home. Hence, households do not have to save for the entire expense of a home before acquiring it. However, household debt, which largely comprises mortgages, also creates risks for the Swedish economy. High house prices, low mortgage rates and a strong economy mean that households are borrowing a lot. The mortgages of Swedish households amount to approximately SEK 3,000 billion and constitute households' largest financial commitment. Mortgages also constitute almost half of the Swedish banks' lending. Future developments in the housing market and household debt are therefore of considerable importance for households and Sweden's economy.

The risks associated with household debt are primarily related to the possibility that highly indebted households may sharply reduce their consumption in the event of a macroeconomic shock. This development was noted in other countries during the financial crisis in 2008–2009. If many households reduce their consumption at the same time, this can amplify an economic downturn. Because loan-to-income (LTI) ratios are high and rising among many borrowers, they represent an elevated macroeconomic risk. The amortisation requirement introduced in 2016 was associated with the loan-to-value (LTV) ratio, i.e. the mortgage in relation to the value of the home. It lowered the size of the mortgages among new mortgagors and thus increased their resilience to macroeconomic shocks. However, many new mortgagors continue to have high debt in relation to their income, and the LTI ratio in the mortgage stock has

continued to rise. This means that household debt is continuing to increase significantly faster than income. Studies show that households with high LTI ratios are more sensitive to income shocks than households with lower LTI ratios. Finansinspektionen's analyses are also showing that there is a relatively weak connection between households' LTI ratios and LTV ratios. The determination has therefore been made that the amortisation requirement is not having enough of a slow-down effect on household LTI ratios over time.

Sweden currently does not regulate LTI ratios. This type of regulation is applied by Denmark, Norway and the UK. Finansinspektionen makes the assessment that a stricter amortisation requirement for mortgagors with high LTI ratios will gradually encompass more new mortgagors, reduce their debt and in the long run make households less vulnerable to shocks. More households will be affected if house prices continue to rise faster than income. If the price increase levels off, fewer households will be affected by the requirement. The requirement thus works as a stabilising mechanism. Finansinspektionen therefore makes the assessment that a stricter amortisation requirement will make the Swedish economy more resilient to macroeconomic shocks. The measure falls within the framework of Finansinspektionen's assignment to counteract financial imbalances, but it also promotes consumer protection. The measure is also judged to strengthen financial stability.

Finansinspektionen makes the assessment that the requirement ensures that mortgage firms, when granting loans, will apply terms which, as regards loan repayment, are consistent with a sound amortisation culture and prevent excessively high household debt. The advantages of the measure are deemed to be significantly greater than the costs.