6 February 2014

Agreement between the parties comprising the Danish Government (the Social Democratic Party and the Social-Liberal Party) and the Liberal Party, the Socialist People's Party and the Conservative People's Party concerning the regulation of refinancing risks relating to the granting of variable-rate loans secured on real property.

The term of variable-rate loans granted by mortgage-credit institutions is typically 30 years, but the loans are financed by bonds with a far shorter term, e.g. one-year or three-year bonds (hereinafter "variable-rate bonds"). This means that the loan must be refinanced at regular intervals. In the wake of the financial crisis, ratings agencies and the European Union have focused on how, in a critical situation, there is a risk of not being able to sell a sufficient number of new bonds to refinance the underlying loans. In this event, there is a risk that the mortgage-credit institution will be unable to repay the bond holders as promised and as a consequence will have to be winded up. This could incur significant financial costs for the borrower, investors and society in general. The ratings agencies have imposed requirements on the institutions to reduce this refinancing risk, and the European Union has similar requirements in the pipeline.

In the light of this, the Danish Government submitted a bill on 28 November 2013 which aims to remove the refinancing risk faced by mortgage-credit institutions. The bill means that, in the future, the refinancing risk will have to be borne by the investors, not the mortgage-credit institutions.

Specifically, the bill imposes requirements whereby the conditions attached to the variable-rate bonds must stipulate that the bond may be automatically extended by one year at a time if the institution is unable to sell a sufficient number of new bonds to refinance the underlying loans.

Furthermore, the bill requires that conditions for variable-rate bonds with a term of up to three years must stipulate that if the interest rate at the refinancing becomes more than five percentage points higher than the interest rate the previous year, the bond will be extended by one year, and the interest-rate increase will be limited to five percentage points (interest rate trigger). At the next refinancing after the expiry of that year, there will be no limitations on the interest rate.

For a mortgage-credit institution under winding up, the bill proposes that if the refinancing fails, or if the interest rate rises by more than five percentage points, the bonds that are intended to replace the bonds which are maturing will be converted to a long term bond with a term and repayments corresponding to the underlying loans.

Banks also issue covered bonds to finance loans secured on real property. In the event that covered bonds at maturity are not replaced by a new issue of covered bonds, it will be possible for the bank to repay the principal of the matured bonds from other sources of funding, e.g. deposits. The refinancing risk for banks is therefore primarily relevant in a winding up situation where there is no access to other sources of funding. As a consequence hereof the bill determines that bonds issued by a bank under winding up will be prolonged by one year at a time if a bond cannot be refinanced.

Pursuant to the bill, the Act will enter into force on 1 April 2014 for loans with financing up to 12 months. For other loans, the Act will enter into force on 1 January 2015.

The parties to the agreement agree to support the bill with the adjustments and acknowledgements specified below.

1. Interest rate trigger

The bill is revised so that the interest rate trigger for mortgage-credit institutions' issuances is limited to all loans that are not pre-financed and which are funded by fixed-rate or floating rate bonds and where the bonds have a term of up to and including 24 months (F1 (one-year) and F2 (two-year) loans, and one-year and two-year loans based on the CITA (Copenhagen Interbank Tomorrow/Next Average) rate, and similar). In addition, the bill specifies that banks' issuances of covered bonds must have a term of more than 24 months. This ensures that banks do not derive an advantage from being able to issue covered bonds without an interest rate trigger for terms, where the bill requires mortgage-credit institutions to have an interest rate trigger.

2. Winding up

The bill is being adjusted to align the treatment of mortgage-credit institutions' bond issuances and banks' issuances of covered bonds under winding up. The adjustment means that a mortgage-credit institution's bonds are to be extended by one year at a time in instances where a trustee assesses that he would not be able to fulfil his obligations vis-à-vis all the existing bond investors if refinancing bonds are issued, or if there is an insufficient number of buyers for the bonds. The trustee sets the interest rate of the extended bond as one-year reference rate (e.g. CITA) with the addition of up to 5 percentage points. This can continue for the entire residual maturity of the loan. Borrowers with variable-rate loans in a mortgage-credit institution under winding up will continue to be able to redeem their loan at face value at the time of the refinancing of their loan.

3. Committee on equal terms of competition

The Minister for Business and Growth will appoint a committee on equal terms of competition between banks and mortgage-credit institutions.

The committee will be charged with monitoring whether the bill alters the competitive relationship between banks and mortgage-credit institutions in the market for loans secured on real property. The committee is also charged with monitoring trends in the market for loans secured on real property for the purpose of identifying any shifts in the balance in the market between banks and mortgage-credit institutions. This identification must also include bank loans financed by a mortgage-credit institution which are included on the balance sheet of a mortgage-credit institution (joint funding). Finally, the committee shall monitor whether the bill promotes, or could promote in the future, business models that cannot withstand stressful scenarios and/or lead to risk movements within the financial sector which could lead to new systemic risks.

If the committee discovers that the bill alters the terms of competition, the committee must present proposals to counteract this wherever relevant.

The committee is to be composed of representatives of relevant public authorities, banks, mortgage-credit institutions and external experts. The chair will be held by one of the external experts.

The committee must submit a preliminary report before 1 September 2014. The parties also agree to assess the impact of the bill before the end of 2014. An analysis of the consequences of the bill will be carried out three years after the entry into force of the bill.

6 February 2014

Transparency concerning the costs of mortgages

The Danish Government will take the initiative to improve transparency concerning the costs of mortgage loans secured on real property granted by banks and mortgage-credit institutions with a view to intensifying the competition and making it easier for consumers to find the most advantageous mortgage. Consumers must have the information required for determining which mortgage loan costs the least. A public website is to be set up to continuously show the actual yearly costs (inclusive of charges, etc.) of mortgage loans secured on real property granted by mortgage-credit institutions and for mortgage loans granted by banks.