Dear Susan Wachter,

Thank you for your recent reply to our letter (19 April 2011). We are writing, because we have learned from Alan Boyce and Peter Wallison that you are quoted for the following statement on the Danish Mortgage System:

"How many people in this room know what happened to the Danish mortgage system starting in 2003? How many people on this panel? We're all assuming it's constant. The Danish fixed-rate mortgage system was given up. Denmark substantially moved to interest-only mortgages and variable-rate mortgages (now 42% of all mortgages) because housing prices in Denmark increased. It became politically pressured to move to a different system that was more affordable. The results of that were a housing boom and bust."

It is important for us to let you know that your statement that the Danish fixed-rate mortgage system was given up is entirely false. Let me clarify:

- The Danish fixed-rate mortgage system is in full function, and has been so without any disruptions for more than 200 years. In fact, Denmark ranks among the countries with the highest share of fixed-rate mortgage loans, measured to the stock of total lending. The mortgage banks make 30-year fixed rate mortgage loans every day.

- ARMs were introduced in 1996. Interest-only loans were introduced in 2003. This was not led by political pressure to move to a different and more affordable system. Politicians simply decided that this would secure a stronger degree of flexibility to the benefit of loan-takers - while keeping the Danish Mortgage System intact.

- ARMs and interest-only mortgage loans are funded with covered bonds, just like fixed-rate loans, and they are managed and issued in accordance with the balance principle. The balance principle is the cornerstone of the Danish Mortgage Model, and it ensures transparency and a market based prepayment system - also key features of the model. Thus, ARMs and interest-only mortgage loans are part of the Danish Mortgage System.
Some people believe that the Danish Mortgage System by definition only entails fixed rate loans issued according to the balance principle. Thus, the mere introduction of ARMs and interest-only loans means that the model is no longer applied. That is a misinterpretation. The point is that the Danish Mortgage System is in function when housing finance is supplied by the issuance of covered bonds using the balance principle, and you thereby have a market that offers transparency with a clear match between loans and bonds. Moreover, transparency prevails because the bonds are valued and traded on the exchange. Also the interest risk (and other risks) remains with the borrower, not with the mortgage bank which assumes the credit risk by keeping the loans on its balance sheet.

Yes, there are discussions about whether and to what extent in particular interest-only loans have contributed to a so called housing bubble - and also whether loan-takers are sufficiently able to handle the risk with variable rates and interest-only. No matter what one believes about these issues, it does not change the fact that the Danish Mortgage System is in full function! It is has nothing to do with this question.

That said, there was strong economic growth in Denmark during these years, and this has increased the demand on the housing market, leading to increased prices. This is the main reason - while the ARMs and interest-only loans have meant some - but not as much, as it sometimes are stated.

Moreover, the majority of loan takers with ARMs and interest-only loans are using the savings to save up money. This is proved in surveys, which agencies have conducted on our behalf.

The Danish mortgage market worked during the financial crisis. There was no need for government takeovers in Denmark or huge bills being passed on to taxpayers and society. Danish borrowers were not stuck with loans that could not be refinanced, nor were they hit by soaring interest rates. Danish mortgage banks’ net lending to homeowners and businesses remained positive before, during and after the financial crisis. Lending levels were lower than in the preceding years, but merely as a result of more subdued demand due to the lower economic growth. Mortgage banks have throughout the crisis been able to raise funding at reasonable prices.

The popularity and increasing use of ARMs in recent years are subject to public debate. Meanwhile, ARMs have contributed favourably to an economy characterised by recession and low growth. In 2010 Danish homeowners achieved total interest savings of DKK 20bn compared with 2009. At the same time, repayments on housing debt were DKK 2bn higher, which is due to the technical structure of ARMs. This has in particular benefitted homeowners and businesses with ARMs. It has also increased tax revenues as lower interest expenses have been deducted from taxable incomes. Also, the structure of ARMs means that the lower the interest payment, the faster the housing debt is repaid. It goes without saying that these economic gains would be smaller if the use of ARMs was subject to restrictions.
We would appreciate to hear, how you view these points, and whether this will lead to a future correction of statements. We also encourage you to read our latest annual report 2010, which come around several of these issues.

The Annual Report 2010 is found on this link: 

Yours sincerely

Ane Arnth Jensen
Managing Director

CC: Peter J. Wallison and Alan Boyce