

Briefing September 2019

## Swiss Regulator Further Restricts Mortgage Loan Requirements

The Swiss Financial Market Supervisory Authority (the “**FINMA**”) announced on 28 August 2019 that it had recognised as minimum standard the amended Guideline of the Swiss Bankers' Association (the “**SBA**”) on Minimum Requirements for Mortgage Financings of 27 August 2019 (the “**Amended SBA MR Guideline**”). The Amended SBA MR Guideline tightens up the rules applicable to the financing of investment properties. The maximum loan-to-value (“**LTV**”) ratio is set at 75%; a higher LTV ratio remains permitted, but it requires higher capital cover. The amortisation to 66,6% of the lending value must be completed within 10 years. The amendments do not affect owner-occupied residential properties. The other requirements of the prior version of the guideline remain applicable.

### The Amended Rules

The Amended SBA MR Guideline is the latest of the three successive versions of the self-regulation (the “**SBA MR Guideline**”) adopted since 1 July 2012 by the SBA. Each version has been recognised by the FINMA as minimum standard in accordance with article 72(5) of the Ordinance on Capital Adequacy Requirements and Risk Diversification of Banks and Securities Dealers (the “**Capital Ordinance**”). In its initial version, the SBA MR Guideline focused on the retail market, although it also applied to commercial credits. The new rules set out in the Amended SBA MR Guideline primarily relate to investment properties (*immeubles de rendement/Renditeobjekte*), i.e. properties held for investment purposes and rented out to third parties (by contrast with owner-occupied properties). Investment properties include residential and commercial properties as well as mixed-use properties. According to the FINMA, so-called “buy-to-let” properties, i.e. condominium units or single-family homes that are not (exclusively) self-

used by their owners but rented out (e.g. with Airbnb) are not explicitly encompassed by the definition of investment properties and consequently are not in principle subject to the Amended SBA MR Guideline. The FINMA, however, recommends that regulated banks extend their application of the Amended SBA MR Guideline to the buy-to-let sector, as it considers that buy-to-let and investment properties have a similar risk profile.

In accordance with the Capital Ordinance, the SBA MR Guideline limits to 10% the ability of retail borrowers to finance out of the Second Pillar (as defined below) the equity invested in the mortgaged property. As banks generally require a minimum equity of 20% (i.e. a maximum loan-to-value ratio of 80%), the SBA MR Guideline was generally interpreted to require a minimum equity of 10% in cash or marketable assets. Pursuant to the Amended SBA MR Guideline, the minimum equity to be contributed by the borrower in an investment property will be set at 25% of the lending value. The Amended SBA MR Guideline

expressly indicates that the possible difference between the purchase price and the lending value must be covered by equity. This results in an effective LTV ratio of maximum 75%.

In relation to the minimum 25% equity, we note that the Capital Ordinance only refers to the limitation of equity financed out of the Second Pillar or covered by it. This new requirement of the Amended SBA MR Guideline therefore falls beyond the scope of article 72(5) of the Capital Ordinance.

Under the SBA MR Guideline, in order to be eligible for capital relief under the Capital Ordinance, mortgage credits must be subject to linear amortisation down to two thirds (66,66%) of the lending value of the property over a predetermined period. The amortisation payment must start within the 12 months following the first drawdown of the credit. The amortisation period was set at 20 years in the initial version of the SBA MR Guideline, and then reduced to 15 years in July 2014. The amended rules shorten that period from 15 years to 10 years in relation to investment properties. If the term of the loan is shorter than the applicable amortisation period, the instalments are nevertheless calculated on the basis of such period.

Interestingly, the SBA MR Guideline did not apply to loans granted before it came into force in 2012. Such loans are grandfathered, in the sense that, even if they are extended or the applicable interest rate is reviewed after 2012, they are not subject to the SBA MR Guideline, provided that the principal amount of the loan is not increased. Similarly, the stricter conditions introduced by the successive amendments to the SBA MR Guideline in July 2014 and August 2019 do not apply to loans granted before these dates, which are also grandfathered to a corresponding extent.

The SBA MR Guideline applies irrespective of the amount of the loan, the type of borrower or the location of the financed property. Hence, not only are the loans granted on the Swiss retail market affected, but so are all loans granted by Swiss regulated banks, including in the event that the property is a commercial property or located in a foreign country.

By contrast, the SBA MR Guideline is not applicable to loans granted by Swiss insurance companies or non-regulated entities, such as investment funds.

The SBA MR Guideline must be interpreted in the light of the SBA guideline concerning the examination, assessment and treatment of loans secured by way of mortgage on real estate properties, which was also updated in August 2019 (the “**Mortgage Credit Guideline**”). For instance, during the 24 months following the acquisition, the lending value of the financed property is in principle to be determined by the lending bank as the lower of: (1) the purchase price and (2) the market value set out in the valuation of a real estate or an internal method or model complying with the respective provisions of the Mortgage Credit Guideline. The amount of the credit and the minimum 10% equity are calculated on the basis of that lower value. In an acquisition financing, the borrower will therefore be required to top up the equity invested in the acquisition if the purchase price exceeds the market value.

## Looking Back

Since the beginning of the 2010s the Swiss National Bank (“**SNB**”) and the FINMA have frequently expressed concerns about the increase in market prices on the real estate market and the resulting risks for lending banks and for the Swiss economy in general. As a result of such concerns, the following measures have been implemented:

- By way of reminder, regulated banks are subject to capital adequacy requirements when granting credit. These mean that a bank incurring a credit exposure to a third party must allocate capital to cover such exposure. The required capital is determined in accordance with the Capital Ordinance and the relevant Circulars of the FINMA. In this respect, the SNB may activate, after consulting with the FINMA, an anti-cyclical capital buffer, which results in the increase of the required capital for lending banks (see article 44 of the Capital Ordinance). Each activation of the buffer requires the approval of the Federal Council (Swiss government) in order to come into effect. The SNB has

activated this buffer twice, by setting a 1% buffer in February 2013 and increasing it to 2% in June 2014. Consequently, banks must allocate capital (CET<sup>1</sup>) equal to 2% of the risk weighted exposure relating to mortgage credits.

- Regulated banks that grant credit secured by way of a mortgage over real estate properties may in principle reduce the amount of required capital. Such capital relief is subject to the lending banks' compliance with self-regulations recognised by the FINMA as minimum standard (see article 72(5) of the Capital Ordinance). Such self-regulations can only be recognised if (i) they limit the equity invested in the financed property which is financed out of the anticipated drawing of retirement benefits (as contemplated by articles 30b and 30c of the Federal Act on Professional Old-Age, Survivors' and Disabled Persons' Pension Plans, so-called "**Second Pillar**") or that is covered by a pledge of such benefits, and (ii) the repayment of the mortgage loan is subject to an appropriate amortisation schedule. The SBA MR Guideline constitutes a self-regulation as referred to in article 72(5) of the Capital Ordinance.
- Regulated banks that comply with the SBA MR Guideline may obtain capital relief in connection with the grant of mortgage credits. In the event of non-compliance, the full amount of the credit must be covered by the required capital.
- In addition to the Amended SBA MR Guideline, regulated banks must comply with the Mortgage Credit Guideline. The Mortgage Credit Guideline implements in relation to mortgage loans the general requirement to identify, measure and monitor adequately credit risks as set out in article 12 of the Ordinance on Banks and Savings Banks. While the Mortgage Credit Guideline had been

initially enacted prior to 2012, it was fully revised at the time of the adoption of the first version of the SBA MR Guideline, particularly to set out more precisely how banks must determine the lending value of financed properties and the extent to which credits may include exceptions-to-policy.

### Outlook: Consequences for the Swiss Market

We do not expect that the amendments to the SBA MR Guideline will significantly affect most investors. The majority of investors in the Swiss real estate market are institutional investors, such as Swiss insurance firms, retirement benefit institutions or real estate funds, which, by virtue of their investment guidelines, are already subject to tighter loan-to-value ratios. The investors that will most likely be affected are wealthy non-institutional investors (e.g. high net worth individuals and their investment vehicles) investing in commercial or large residential properties.

As the Amended SBA MR Guideline does not apply to Swiss insurance companies acting as mortgage lenders, these actors may benefit from a level of competitive advantage over regulated banks in certain segments of the market affected by the stricter lending rules.

Last but not least, we note that foreign lenders may be required to comply, indirectly, with the Amended SBA MR Guideline: if they lend against residential properties, the terms of the respective mortgage loans would have to be in line with the terms on which a Swiss bank would grant a similar loan (i.e. notably in compliance with the Amended SBA MR Guideline) under the Federal Act on the Acquisition of Real Estate by Persons Abroad (so-called "Lex Koller").

<sup>1</sup> CET<sup>1</sup> comprises the registered capital and statutory reserves of the bank as well as its retained earnings.

## Authors



**Frédéric Bétrisey**  
Partner  
T: +41 58 261 57 00  
frederic.betrisey@baerkarrer.ch



**Charles Gschwind**  
Associate  
T: +41 58 261 56 43  
charles.gschwind@baerkarrer.ch

## Further Contact

**Dr. Corrado Rampini**  
Partner  
T: +41 58 261 52 83  
corrado.rampini@baerkarrer.ch

**Bär & Karrer Ltd.**  
Brandschenkestrasse 90  
CH-8002 Zürich  
Telefon: +41 58 261 50 00  
Fax: +41 58 261 50 01  
zurich@baerkarrer.ch

Quai de la Poste 12  
CH-1211 Genf  
Telefon: +41 58 261 57 00  
Fax: +41 58 261 57 01  
geneva@baerkarrer.ch

baerkarrer.ch  
Zürich, Genf, Lugano, Zug

