Box 7

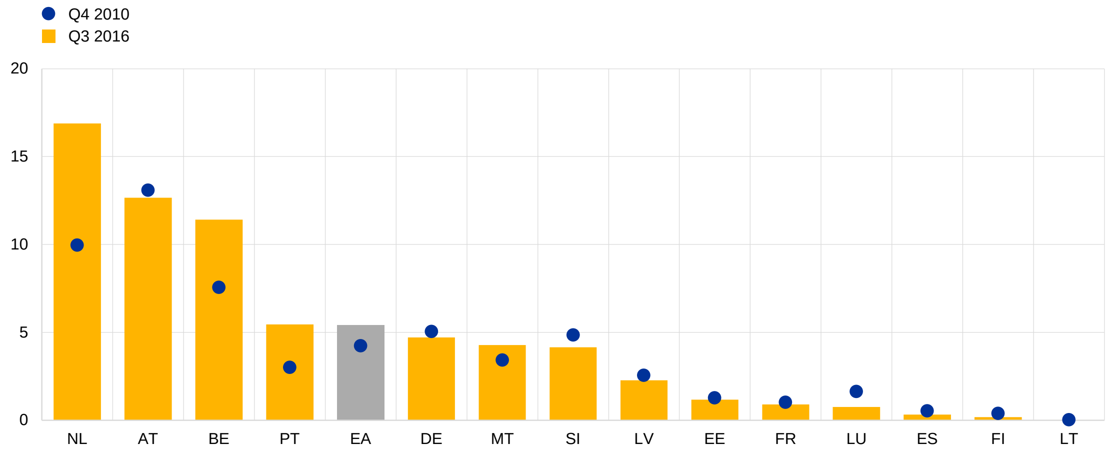
The growing role of non-bank lending to households – a case study on the Netherlands

Non-bank lending to households is increasing. In the euro area, the share of non-banks in long-term lending to households grew from 4.2% in 2010 to 5.4% in 2016. Behind this overall increase are large differences between countries, both in terms of the share of non-bank lending and in terms of its growth since 2010 (see **Chart A**). In most countries, the provision of long-term loans to households is still dominated by banks. In the Netherlands, where insurance companies have long since played a role in mortgage lending, non-banks provide a relatively large share of these loans. Based on joint analysis with De Nederlandsche Bank (DNB), this box describes the shift towards non-bank lending in the Dutch mortgage market and discusses the implications for financial stability and macroprudential policy.[65]

Chart A

Share of non-banks in domestic long-term household lending in selected euro area countries

(percentages)



Source: ECB quarterly sector accounts.
Notes: Non-bank lending refers to total economy lending minus loans from MFIs and OFIs (except investment funds). In the case of Austria, the high share of non-bank lending refers to the state and not to insurance companies.

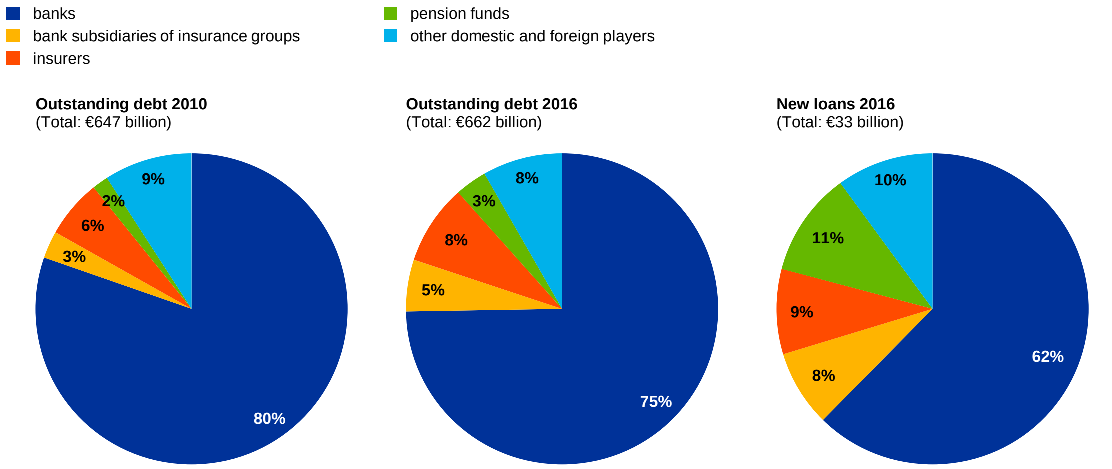
Insurance companies and pension funds (ICPFs) have recently become more active in the Dutch mortgage market.[66] ICPFs currently finance 28% of new mortgages in the Netherlands (see **Chart B**), either directly through dedicated mortgage originators or banking subsidiaries or indirectly through investments in mortgage funds. As a result, the (non-securitised) exposure of ICPFs to the Dutch mortgage market doubled from €35 billion in 2010 to €73 billion in 2016. These institutions mainly finance loans with fixed interest rate periods of more than fifteen years and have a relatively high share of loans covered by the Dutch National Mortgage Guarantee (NHG) scheme. Since banks and non-banks are subject to the same loan-to-value (LTV) and debt service-to-income (DSTI) regulations, the risk that ICPFs may try to gain market share through overly lax lending standards is limited. Nevertheless, it remains important to ensure that the lending of these new players is based on sound origination and risk management practices, especially in cases where the origination of loans is outsourced to third parties.

65 This box is based on *Loan markets in motion*, DNB, November 2016.

66 See also the article entitled “Non-banks shake up Dutch mortgages”, *Financial Times*, 27 December 2016.

Chart B

Overview of shifts in the Dutch mortgage lending market



Source: DNB.

The growth in mortgage investments by institutional investors is partly driven by a search for yield and changes in regulatory frameworks. With interest rates at historically low levels, mortgage lending activities offer institutional investors an attractive risk/return profile.[67] Moreover, given their long investment horizons, pension funds and insurers have an advantage when it comes to bearing the liquidity risk of investments in mortgage loans. There is evidence that the portfolio choices are to some extent driven by changes in and differences between regulatory frameworks. For example, under Solvency II, capital requirements for an investment in a portfolio of non-securitised mortgage loans are lower than for an investment in a similar portfolio of securitised loans. This may explain the increasing interest of insurers in investing in direct mortgage loans rather than in securitisations. In addition, stricter capital requirements for banks and uncertainty about possible future increases in risk weights for mortgages may have induced banks to reduce their mortgage lending. However, other factors also play a role. Insurers and pension funds invest to a large extent in NHG mortgages, even though banks typically have lower capital requirements for guaranteed loans. This may be driven by differences in risk appetite.

The increased competition from ICPFs has some important ramifications for financial stability and macroprudential policy. In the short run, increased competition puts downward pressure on interest margins and hence on bank profitability. So far, banks have been able to maintain their margins by benefiting from the increase in demand for loans with longer fixed interest rate periods, which typically have higher margins. However, given the dominant role of ICPFs in this market segment, it is unlikely that this strategy will continue to work for banks going forward. From a longer-term perspective, a larger role for institutional investors may be beneficial to the financial system. It could contribute to a more diverse financial system with less maturity transformation and leverage, and help to reduce the funding gap in the banking sector. However, the growing role of non-banks also poses important challenges. First, a shift in lending may potentially lead to accumulation of credit risk for parties who are not equipped to manage or fully understand the risks

[67] For an international perspective, see *Global Financial Stability Report*, IMF, April 2016, Chapter 3.

that they are exposed to. Second, banks must take account of the potential impact of lending market shifts on their business models. And, third, the growing market shares of non-bank players may limit the effectiveness of some macroprudential measures that apply only to banks. For example, an increase in risk weights applied to mortgage loan exposures for the calculation of bank capital ratios, intended to address a build-up of vulnerabilities in the mortgage market, could lead to an increase in mortgage lending by ICPFs. This underlines the importance of taking a cross-sectoral view when it comes to supervision and macroprudential policies. The cross-sectoral nature of LTV and DSTI limits in the Netherlands prevents such “leakage” between banks and ICPFs.

It remains to be seen whether the role of ICPFs in lending to households will continue to grow. On the one hand, mortgage loans offer an attractive yield for ICPFs, whose solvency is under pressure from current low interest rates. Moreover, Dutch ICPFs have room to further increase their exposure to Dutch mortgages, which currently correspond to 15% (insurers) and 1.8% (pension funds) of their total assets. In principle, this also holds for other euro area ICPFs. On the other hand, institutional investors may be reluctant to engage in direct lending to households, especially in countries where credit risk is higher or where it is more difficult to outsource the origination and servicing of the loans to reliable third parties.