Decision of the Board of the Financial Supervisory Authority on the application of macroprudential instruments

At its meeting on 27 September 2023, the Board of the Financial Supervisory Authority (FIN-FSA) decided that the countercyclical capital buffer (CCyB) requirement, as referred to in chapter 10, section 4 of the Act on Credit Institutions (610/2014), will remain at 0.0% and that the period of validity of the decision on a lower maximum loan-to-collateral (LTC) ratio, taken on 28 June 2021 pursuant to chapter 15, section 11 of the Act on Credit Institutions, will be extended. With that decision, the maximum LTC ratio for new residential mortgage loans other than first-home loans was lowered by 5 percentage points, to 85%.

The Board of the FIN-FSA has also decided to extend the scope of application of its decision of 28 June 2021 under chapter 15, section 11 of the Credit Institutions Act to lower the maximum LTC ratio and the FIN-FSA's principles concerning the LTC ratio to also cover lenders defined in section 1 of the Act on the Registration of Certain Credit Providers and Credit Intermediaries, which entered into force on 1 July 2023 (section 14). The decision will enter into force on 1 January 2024.

In addition, the FIN-FSA has decided the reciprocate the credit-institution specific risk weight floors for corporate credit secured by real estate collateral set by the Swedish Finansinspektionen to be applied to credit institutions registered in Finland, pursuant to Article 458(5) of the Capital Requirements Regulation (the CRR) (EU) N:o 575/2013 and section 10, subsection 1, paragraph 6 of the Act on the Financial Supervisory Authority. The risk weight floor is set at 35% for corporate exposures secured by commercial real estate and 25% for corporate exposures secured by residential real estate, on a weighted average basis. According to Finanspektionen's notification, the floors apply in particular to such corporate credits granted by credit institutions applying internal models that are secured by real estate located in Sweden.[1] The floors apply, as of 30 September 2023, to credit institutions that have adopted IRB approaches for credit risk and whose exposure to relevant Swedish corporate credit exceeds 5.0 billion Swedish krona.

Justifications for the decision

Countercyclical capital buffer requirement

The growth prospects of the world economy remain sluggish. Industrial production has shown weak growth in all main economic areas, and economic growth has been mostly buoyed by the service sectors. In the second quarter of 2023, Finland's real GDP expanded by 0.6% on the previous quarter. Inflation continues to be relatively high but the rate of

[1] https://www.fi.se/en/published/news/2023/new-risk-weight-floors-for-bank-loans-to-commercial-properties/

growth of Finnish prices has slowed down throughout the spring. According to preliminary data, inflation in Finland stood at 3.1% in August as measured by the Harmonised Index of Consumer Prices. In July, the inflation rate was 4.2%. The slowdown of inflation was primarily driven by the year-on-year decline in energy prices.

According to the Bank of Finland’s September interim forecast, the Finnish economy will contract by 0.2% this year. In 2024, economic growth is forecasted to turn positive, albeit less so than in the previous forecast (+0.2%). Economic growth will accelerate in 2025 (+1.4%) as the number of the employed also starts rising.

The financial cycle has also continued to deteriorate further, and the risks of overheating of the financial system are low, according to the indicators. The primary risk indicator, the credit-to-GDP gap, stood at approximately -21 percentage points at the end of March, according to preliminary data. First and foremost, the decline of the primary risk indicator is due to the strong growth in nominal GDP driven by inflation. Household loans and of the entire narrowly defined private-sector credit stock have continued to grow sluggishly relative to nominal GDP. The stress index for the financial sector remains slightly elevated.

Similarly to previous quarters, the only risk indicator pointing to increased vulnerabilities is the current account deficit, which describes the external balance of the economy. However, the composite indicator of the current account deficit and the credit stock-to-GDP ratio does not imply that the current account deficit is associated with an overheating of the credit cycle. Neither do the supplementary risk indicators point to any overheating in the credit cycle. Hence, an overall assessment based on the risk indicators used does not support the application of a countercyclical capital buffer requirement.

Maximum LTC ratio

The downswing/slump of the housing markets continued in the summer of 2023 largely on similar lines as in early 2023 and the end of 2022. House sales remained clearly below their normal levels. Housing prices declined year-on-year throughout the country, and the decline steepened particularly in Helsinki and the Helsinki metropolitan area from the beginning of the year. In the summer, there was a large supply of dwellings for sale and rent. The number of new construction projects launched was lower than those completed, as measured by the number of dwellings.

In July, the housing loan stock was slightly smaller than a year earlier and at its peak in September 2022. In the summer, drawdowns of housing loans by households were clearly below their usual level. It is estimated that households have mostly continued to repay their loans regularly, but the rise of the interest rate may have reduced the euro volume of the monthly amortisation amount in a majority of the loans.

The use of grace periods may have become more common, but there are no indications of their widespread use.

For the time being, there are no discernible signs of a rapid recovery in the demand for housing and housing loans. Interest rates on new housing loans have risen further, and the interest expenses of many old households with outstanding housing loans will rise over the remainder of the year if the interest rates on loans linked to Euribor rates are updated in line with expectations. Furthermore, consumers’ confidence in the economy reduces their willingness to purchase a dwelling and take on debt. In the first half of 2023, households drew down not only fewer loans, but also on average in lower amounts than a year earlier.

The proportions of loan with the highest LTC ratios (over 90% for first-home loans and over 80% for other loans) were lower in the first half of 2023 than in the previous quarters. In July, fewer new loans longer than 30 years were granted than in the previous months. New legislation that entered into force in July 2023 allows lenders to deviate from the maximum repayment period in 10% of new housing loans by volume per quarter.

The protracted growth of household indebtedness relative to income peaked and started a slight decline in the second half of 2022, which continued in the first half of 2023. Indebtedness relative to income is estimated to decrease further in the course of 2023–2024, The household loan stock is estimated to grow at a slow pace this year and the next, whereas disposable nominal income is expected to continue fast growth. Credit demand is expected to recover in 2024, and indebtedness is expected to show positive growth in 2025.

Despite the decline, household indebtedness remains at a historically high level. Indebtedness is clearly higher than for example in 2007–2008 – the last time when interest rates rose substantially and stood higher than at present. Households are still expected to mainly cope with their debts but save on consumption and negotiate on changes to loan terms where necessary. In addition, savings accumulated during the coronavirus pandemic as well as solid employment and income developments are functioning as buffers in consumers’ and housing borrowers’ finances.

Risks concerning mortgage lending and affecting financial stability could materialise on a larger scale than expected if the ability of households to service their loans and maintain their previous consumption habits were to fall more severely under peril. Risks and the stability threat related to housing lending and indebtedness could materialise through the concurrent occurrence of several harder-than-expected macroeconomic setbacks. The situation of the construction industry also involves risks that make the prospects of the housing markets uncertain as a whole.

In summary, the high level of household indebtedness and great uncertainty surrounding the development of the housing market constitute such a risk of an exceptional rise in financial stability risks that it remains warranted to keep the maximum LTC ratio at its present level. Hence, the FIN-FSA Board's decision made June 2021 and effective as of October to adjust the maximum LTC ratio to 85% for new residential mortgage loans other than first-home loans remains justified so as to curb the growth in large housing loans relative to collateral and to ensure the resilience of new borrowers. No amendments are proposed to the maximum LTC ratio for first-home buyers.

Extension of the maximum LTC ratio to other lenders' housing loans

In accordance with the Act on the Registration of Certain Providers and Credit Intermediaries (186/2023), which entered into force at the beginning of July 2023, the maximum LTC ratio applies, in addition to credit institutions and their branches, to consumer credit secured by housing and real-estate collateral granted by lenders defined in said Act, where the credit is intended for the purchase or basic renovation of a dwelling or real estate. Similarly to the Credit Institutions Act, this new Act also provides that, in accordance with the maximum LTC ratio, the amount of loan granted may not exceed 90% of the current value of collateral posted at loan approval.

The amount of a loan taken out for a first-home purchase may be 95% of the current value of collateral posted at loan approval. In line with the the provisions of the Credit Institutions Act, to limit any exceptional increase in risks to financial stability, the FIN-FSA may decide to lower the above maximum amounts of credit granted by traders and secured by housing collateral by a maximum of 10 percentage points. In addition, the FIN-FSA may restrict the acceptance of collateral other than real security for the purposes of calculating the LTC ratio where necessary to manage these risks. A reduction of the maximum LTC ratio may enter into force at the earliest in three months from the decision.

Also according to the new Act, the FIN-FSA shall make a decision on an annual basis regarding the amendment or continuation of the validity of the maximum LTC ratio applicable to traders, and publish the principles applicable to the maximum LTC ratio on its website.

To ensure a level playing field and prevent the circumvention of regulation, it is warranted that the maximum LTC ratio applicable to credit institutions and traders defined in the Act on the Registration of Certain Credit Providers and Credit Intermediaries is based on the same justifications and principles pertaining to general risks to financial stability stemming from residential lending.

The justifications for extending the maximum LTC ratio to traders defined in the Act on the Registration of Certain Credit Providers and Credit Intermediaries are stated above in the justifications concerning the levels of the maximum LTC ratios. As regards credit institutions, the maximum LTC ratio applicable to non-first home buyers was lowered from its statutory level by 5 percentage points to 85% by a decision of the FIN-FSA Board of 28 June 2021.[2] On 26 June 2017, the FIN-FSA Board published principles for tightening the maximum loan-to-value ratio and restricting the collateral used in calculating the LTC ratio.[3] The updated application principles for the maximum LTC ratio are attached to this proposal.

On 24 August 2023, the FIN-FSA conducted a hearing concerning lenders defined in the Act on the Registration of Certain Credit Providers and Credit Intermediaries. One lender responded to the hearing letter, however, the response was based on a misunderstanding.

Risk weight floors set by Finansinspektionen

In May, Finansinspektionen, the Swedish macroprudential authority, notified the European Systemic Risk Board (ESRB) of its intention to introduce credit institution-specific minimum limits for the risk-weighted averages of corporate exposures secured by immovable property in accordance with Article 458 of the CRR as follows:

(i) a floor of 35 percent for the weighted average of the risk weights for corporate exposures secured by commercial properties, and
(ii) a floor of 25 percent for the weighted average of the risk weights for corporate exposures secured by residential properties.

The floors apply to such corporate credits granted by credit credit institutions applying internal models that are secured by properties located in Sweden. The application of the floors and the justifications are detailed in the notification issued by Finansinspektionen on the measure.[4]

According to Finansinspektionen, the objective of the risk weight floors is to strengthen the resilience of the Swedish banking sector in conditions of elevated risks in the commercial real estate sector. The floors replace Pillar 2 requirements imposed on credit institutions applying internal models on account of their low risk weights, since according to the CRR, these requirements are not intended to cover macroprudential risks and whose application would involve practical difficulties stemming from the IRB review of Swedish banks. Hence, the new risk weight floors do not materially increase Swedish banks' capital requirements in practice. The floors will take effect on 30 September 2023 and remain in force for a maximum of two years.

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2 https://www.finanssivalvonta.fi/contentassets/e8965e8cda614433a3f10f7da1bcfc5d/mv_28062021/macroprudential_decision_28062021_updated.pdf
3 https://www.finanssivalvonta.fi/globalassets/en/financial-marketstability/principles_for_tightening_the_maximum_loan_to_value_ratio_26062017.pdf
4 https://www.fi.se/en/published/news/2023/new-risk-weight-floors-for-bank-loans-to-commercial-properties/

In its notification, Finansinspektionen requested the ESRB to issue a recommendation on the reciprocation of the risk weight floors in other EEA countries. In July, the General Board of the ESRB issued a recommendation as requested.[5] According to the recommendation, other EEA countries should adopt the risk weight floors for such credit institutions registered within the EEA whose relevant Swedish corporate exposures exceed SEK 5.0 billion Swedish krona.

In preparing the decision, the FIN-FSA has, in accordance with Article 487(7) of the CRR and in line with the notification, taken into consideration the criteria set in paragraph 4 of said Article.

The hearing on the reciprocation of Swedish risk weight floors was limited to Finnish credit institutions which have, or may in the future have, Swedish corporate exposures secured by real estate in the scope of their current IRB methodology. Nordea Bank Abp submitted a response in the matter, dated 13 September 2023. According to the response, Nordea Bank Abp does not object to the planned decision. At a general level, Nordea Bank Abp finds it important that, in order to avoid overlaps when applying macroprudential instruments, the analysis is based on risks and not on the objectives of different instruments. Harmonisation in this respect is called for at the EU level. Furthermore, one of the inherent characteristics of the risk weight floors is their temporary nature. The risk weight floors should be abolished when the future risk weight floor (Basel III output floor, CRR 3) enters into force.

The application of the risk weight floors is not currently estimated to have direct effects on the capital requirements of Finnish banks, as the currently valid supervisory constraints related to IRB approaches for credit risk are tighter than the risk weight floors. However, the risk weight floors may become effective if amendments are made to credit institutions’ credit risk models and restrictions concerning these models.

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[5] https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation230913~b4dbd135b9.en.pdf