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

At its meeting on 28 June 2021, 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 Credit Institutions Act (610/2014), will remain at 0.0%. The FIN-FSA Board also decided that the binding maximum loan-to-collateral (LTC) ratio, as referred to in chapter 15, section 11 of the Credit Institutions Act, will be lowered by 5 percentage points to 85% for residential mortgage loans other than first-home loans.

In addition, in accordance with chapter 10, section 8 of the Credit Institutions Act (amending Act 233/2021), the FIN-FSA Board has taken a decision on other systemically important institutions (O-SIIs) and their additional capital requirements (O-SII buffers) covered by consolidated Common Equity Tier 1 (CET1) capital. Accordingly, the O-SII buffer rates will remain as follows:

o	Nordea	2.0%
o	OP Financial Group	1.0%
o	Municipality Finance Plc	0.5%.

The decision on the lower maximum LTC ratio will enter into force on 1 October 2021 and the decision on O-SIIs will be effective immediately.

In the current exceptional and uncertain situation, careful assessment of borrowers’ ability to pay remains of prime importance. Lenders are justified in exercising restraint in granting loans that are very large with regard to the borrowers’ income and have a longer than usual repayment period.[1]

Justification for the decision

Countercyclical capital buffer (CCyB) requirement

The COVID-19 pandemic continues to strain both the global and the Finnish economy and create uncertainty. There are also positive signs, however. The growth prospects for the global economy are being

[1] By virtue of chapter 10, sections 4 and 6a of the Credit Institutions Act (610/2014), the FIN-FSA Board, at its meeting on 6 April 2020, decided to remove the additional capital requirement determined based on the structural characteristics of the financial system and covered by CET1 capital (systemic risk buffer) from credit institutions on account of the pandemic. The aim of the decision was to ensure that credit institutions’ ability to provide credit, especially to the corporate sector, would not be weakened due to the restrictive impact of the buffer requirement on the provision of credit.

According to Chapter 10, Section 4a of the Credit Institutions Act (amending Act 233/2021), the FIN-FSA Board shall, at least every two years, assess whether it is necessary to impose an additional capital requirement on the basis of the structural characteristics of the financial system, amend the existing requirement or keep it unchanged. A decision on the matter shall be taken within six calendar months from the end of each year.

supported by, for example, the increase in vaccination coverage and strongly expansionary economic policy. According to the Bank of Finland's June forecast, the Finnish economy will grow by 2.9% this year and by 3.0% in 2022.

The preliminary estimate for the primary risk indicator for setting the CCyB requirement – the private sector credit-to-GDP gap – was -4.7 for the end of the first quarter 2021. If calculated using the narrow definition of credit, with the latest available data from September 2020, the gap was close to zero. The primary risk indicator is less susceptible to revisions using the narrow definition of the credit stock, but the data are available with a lag.

The credit stock grew quite rapidly in 2020. In spring 2020, the COVID-19 pandemic fuelled the financing needs of non-financial corporations, in particular, and notably corporate funding from banks. Towards the end of 2020, however, growth in banks' corporate credit stock slowed markedly. Since then, corporate funding growth has increasingly based on non-bank credit. Since the end of 2020, residential mortgage lending has grown at a brisk pace considering the uncertainty surrounding the economic outlook.

Based on supplementary risk indicators and other available indicators and statistics, however, there are no clear signs of overheating in the credit market. It is still justified to maintain the CCyB requirement at 0%.

Tightening of the maximum loan-to-collateral (LTC) ratio

The Credit Institutions Act provides that the FIN-FSA Board may decide to reduce the maximum credit amounts conforming with the maximum LTC ratio by no more than 10 percentage points in order to limit any exceptional increase in risks to financial stability. In addition, the FIN-FSA Board has published the principles required by the Act for tightening the maximum LTC ratio. According to these principles, the level of the maximum LTC ratio may be lowered if, for example, factors are detected jeopardising the stability of the financial system and relating to growth in the stock of residential mortgages to households (taking also into account other household debt) or to other developments pertaining to the macro economy that may have an impact on residential mortgage or housing markets.[2]

At the end of March 2021, the household debt ratio, i.e. debt relative to disposable income, stood at 133.6%. The debt-to-income ratio was 5.1 percentage points higher than a year earlier. Household debt grew also in relation to GDP.

The growth of indebtedness picked up in 2020, as income growth decelerated notably more than growth in debt. At the end of March

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[2] https://www.finanssivalvonta.fi/globalassets/en/financial-market-stability/principles_for_tightening_the_maximum_loan_to_value_ratio_26062017.pdf.

2021, debts had grown by 3.7% on the previous year, while annual income had decreased by 0.2%.

Annual growth in the housing loan stock accelerated at the beginning of 2021 and was at its highest in April since July 2013. The growth of loans to housing corporations has slowed further.

Indebtedness rose also on account of the growing popularity of longer housing loans. New housing loans with a repayment period of over 26 years have become more common. In the first quarter of 2021, these loans accounted for 13,3% of the euro amount of new housing loans.[3] The corresponding figure for 2020 was 8,4 %.

The average (median) LTC ratio of new residential mortgages other than first-home loans rose in the first quarter of 2021. Loans with an LTC of over 85% accounted for 11.0% of the euro amount of new borrowing in this loan category, while in the previous quarter their share had been 11.5%.

In the case of new first-home loans, the proportion of loans with the highest LTC ratios decreased slightly. In the first quarter of 2021, loans with an LTC above 90% accounted for 22.6% of the euro amount of new first-home loans, compared with 23.4% in the previous quarter.

Pent-up demand accumulated in the housing market in spring 2020 has largely been released, and house sales and mortgage lending are livelier than in previous years. Since summer 2020, activity in the housing market has been exceptionally brisk relative to other economic activity. House prices have exhibited strong growth in the greater Helsinki area and other growth centres but have diverged regionally and developed moderately in Finland as a whole.

On 29 June 2020, the FIN-FSA Board decided to restore the maximum LTC ratio for residential mortgage loans other than first-home loans from 85% to its statutory standard level of 90%. The decision sought to counter the pandemic-induced cyclical risks jeopardising the smooth functioning of the housing market.

The FIN-FSA has requested an opinion on the planned tightening of the maximum LTC ratio from Finance Finland (FFI). In its statement, FFI notes that, according to its assessment, the conditions for lowering the maximum LTC ratio are not met. The FFI finds that there are no signs of general overheating in the Finnish housing market, nor has there recently been such an exceptional increase in risks to the financial stability as would justify a reduction in the maximum LTC ratio.

The housing and mortgage markets have recovered from the situation in the early stages of the COVID-19 pandemic and activity in the markets is brisk. For this reason, there are no longer cyclical

[3] The sentence has been revised on 30 June 2021. The earlier version was: For the first time, these loans accounted for over 13,3 % of euro amount of new housing loans in the beginning of the year 2021.

justifications for the relaxation of macroprudential instruments to support the housing market. The exceptionally strong momentum in the housing and mortgage markets relative to developments elsewhere in the economy are conducive to increasing structural risks in the markets in an exceptional way, especially in an environment where household indebtedness is record high in relation to income and is growing further. Therefore the maximum LTC ratio will be lowered by 5 percentage points, to the pre-pandemic level of 85% for residential mortgage loans other than first-home loans.

At this stage, it is justified to lower the maximum LTC ratio only for housing loans other than first-home loans. The exclusion of first-home loans from the scope of the measure will reduce potential undesirable side effects associated with first-time homebuyers' access to the housing market.

Additional capital requirements of other systemically important institutions (O-SIIs)

Systemically important credit institutions are those that pose a systemic risk so great that, if realised, it would have a highly negative impact on the entire financial system and the real economy.

Authorities seek to mitigate the risks of systemically important credit institutions for the entire financial sector and the economy by strengthening the institutions' loss absorbency, thereby reducing the probability of their failure. The objective of additional capital requirements imposed on O-SIIs (O-SII buffers) is to prevent macroprudential risks arising from structural factors in the financial markets.

Under chapter 10, section 8 of the Credit Institutions Act, other credit institutions significant for the financial system (i.e. O-SIIs) refer to credit institutions

- the balance sheet total of which is at least EUR 1 billion and
- the insolvency of which would jeopardise the stability of the financial markets in Finland or in another EU Member State.

The FIN-FSA is required to identify the group of O-SIIs and their O-SII buffers on an annual basis. The identification of O-SIIs is based on the Guidelines of the European Banking Authority (EBA) on the assessment of O-SIIs. The identification of O-SIIs is based on four core criteria and ten more detailed indicators describing them.

In accordance with the Credit Institutions Act, the FIN-FSA is required to apply the following grounds to the bucketing of O-SIIs and the determination of the O-SII buffer requirements:
1) the size of the credit institution measured by its total liabilities or the balance sheet total or consolidated balance sheet total;
2) the liabilities of the credit institution and undertakings within its consolidated supervision to other credit institutions and receivables from

other credit institutions as well as other direct connections with the financial system;
3) the substitutability of the critical functions of the credit institution and undertakings within its consolidated supervision in the event of an undertaking losing its capacity to continue its operations;
4) the extent and significance of cross-border operations of the credit institution and undertakings within its consolidated supervision in Finland and in the European Economic Area.

Following amendments relating to macroprudential buffers, made to the Credit Institutions Act to implement the new Capital Requirements Directive (CRD5), the upper limit for the O-SII buffer requirement is 3.0% (previously 2.0%). The FIN-FSA is required to sort Finnish O-SIIs into seven (previously five) buckets. As a rule, the O-SII buffer rate for credit institutions in the lowest bucket is 0% of their total risk exposure amount. The amendments to the Credit Institutions Act relating to macroprudential buffers entered into force on 1 April 2021 (233/2021).

The bucketing of O-SIIs and the calibration of O-SII buffers is based on the systemic importance of O-SIIs, primarily assessed by means of the O-SII scores under the EBA Guidelines[4]. The proportionality of the additional capital requirements for Finnish O-SIIs is also assessed by comparing the O-SII buffers to the requirements imposed on other O-SIIs within the euro area representing similar systemic importance and to the requirements based on the ECB's so-called floor methodology. The ECB floor methodology provides a minimum level for each credit institution's O-SII buffer.

On the basis of the data as at end-2020, Nordea, OP Financial Group and Municipality Finance exceed, as in the previous year, the threshold for systemic importance (2.75%) and are therefore automatically designated as O-SIIs.

Table: Finnish credit institutions' O-SII scores as at 31 December 2020

Banking group	**O-SII score (%)**	**O-SII**
Nordea	**65.52**	Yes
OP Financial Group	**11.70**	Yes
Municipality Finance Plc	**4.03**	Yes

In spring 2020, the FIN-FSA Board decided to lower the structural macroprudential buffer requirements for all credit institutions by one percentage point. The aim of the decision was to mitigate the negative effects of the COVID-19 pandemic on the stability of the financial markets and promote credit institutions' ability to finance the economy. The systemic risk buffer requirement was removed from all credit institutions, and the O-SII buffer requirement was lowered in the case of OP Financial Group so that, following these changes, the applicable O-

[4] EBA/GL/2014/10.

SII buffer requirements have been as follows: Nordea (2.0%), OP Financial Group (1.0%) and Municipality Finance (0.5%).

In the light of the risk analysis conducted, the Finnish financial system is subject to significant structural risks and vulnerabilities. The systemic importance of Finnish O-SIIs has not changed substantially from the situation prior to the pandemic. Considering also the amendments to the legislation on credit institutions' structural additional capital requirements, it would be justified to set the buffer requirements higher than at present. However, the pandemic continues to cause significant uncertainty about economic developments and the evolution of banks' credit risks. For this reason, the assessment is that, for the time being, it is justified to keep Finnish banks' O-SII buffer requirements unchanged.

The O-SII buffer requirements for Finnish O-SIIs exceed the minimum requirements calculated based on the floor methodology and the average level of banks in the SSM area. The application of O-SII buffers in excess of the average level is justified because the Finnish banking sector is highly concentrated and the most important credit institutions are large in relation to the size of the Finnish economy.[5]

Table: Comparison of additional capital buffer requirements for Finnish O-SIIs and minimum requirements based on the floor methodology

Banking group	**O-SII buffer (previous buffer rate)**	**Minimum requirement based on the floor methodology[6]**
Nordea	2.0% (2.0%)	1.0 / 1.5%
OP Financial Group	1.0% (1.0%)	0.5%
Municipality Finance Plc	0.5% (0.5%)	0.5%

The adequate levels of Finnish credit institutions' O-SII buffers and other macroprudential buffers and their sufficiency in relation to the identified systemic risks should be assessed comprehensively and taking account of regulatory changes once the uncertainty related to the economic impact of the pandemic has decreased and a clearer picture can be gained of banks' credit risks.

[5] See e.g. EBA/Rep/2020/38.
[6] Based on the ECB's current floor methodology, Nordea's O-SII buffer requirement should be at least 1.0%. Based on a more recent alternative floor methodology, the minimum requirement rises to 1.5%. For OP Financial Group, the minimum O-SII buffer requirement is 0.25% under the current floor methodology and 0.5% under the newer methodology. For Municipality Finance, each methodology gives a minimum level of 0.25%. Considering that the Credit Institutions Act stipulates the application of O-SII buffer rate increments of 0.5 percentage points and that a buffer rate of 0% would be contrary to the spirit of the regulations and the ECB floor methodology, 0.5% can, in practice, be considered as the minimum O-SII buffer rate for OP Financial Group and Municipality Finance.