Decision by the Board of the Financial Supervisory Authority on the application of macroprudential tools

At its meeting on 26 June 2017, the Board of the Financial Supervisory Authority (FIN-FSA) decided not to impose a countercyclical capital buffer requirement (variable capital add-on) as referred to in chapter 10, section 4 of the Credit Institutions Act (610/2014).

In addition, the Board of the FIN-FSA has decided to set a credit institution-specific minimum level of 15% for the average risk weight on residential mortgage loans[1] of credit institutions that have adopted the Internal Ratings Based Approach, with effect from 1 January 2018, by virtue of Article 458 of the Capital Requirements Regulation.[2] The entry into force of the decision is subject to the EU Council not objecting to the decision. Upon proposal by the Commission, the EU Council may reject a measure under Article 458 proposed by a Member State. The European Systemic Risk Board (ESRB) and the European Banking Authority (EBA) will issue opinions on the matter.

According to the current estimate, there is no need to reduce the maximum loan-to-value ratio for residential mortgage loans referred to in chapter 15, section 11 of the Credit Institutions Act, or to restrict the collateral to be taken into account in calculating the loan-to-value ratio, nor is there any need to apply other macroprudential tools not currently in use. Key indicators are not pointing to an immediate need to tighten the conditions for the maximum loan-to-value ratio.

Justifications for the decision

Countercyclical capital buffer requirement

The most recent observation from end-2016 for the credit-to-GDP gap, used as the primary indicator for setting a countercyclical capital buffer requirement, is negative, –2.9 percentage points, thus giving a reference value of 0.0% for the countercyclical capital buffer requirement. The credit-to-GDP gap has shown a downward trend since 2010, and the latest observation is the smallest since 2003.

Household indebtedness is still at a high level, although growth in indebtedness has faded. However, supplementary risk indicators are not, overall, signalling such an increase in financial system risks as would necessitate a higher countercyclical capital buffer requirement with a view to improving banks' cyclical risk resilience.

[1] In the application of the provision, a residential mortgage loan is to be defined in accordance with chapter 7a, section 3, subsection 1(2) of the Consumer Protection Act. The minimum level applies to housing units located in Finland.
[2] Regulation (EU) no 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

Minimum risk weight

In March 2017, upon proposal by the Director General of the FIN-FSA, the Board of the FIN-FSA decided to take measures for setting a minimum level of 15% for the average risk weight on residential mortgage loans of banks that have adopted the Internal Ratings Based Approach. According to the decision, the minimum risk weight would enter into force on 1 January 2018, which would allow banks sufficient time to implement the change. The minimum risk weight would be set by virtue of Article 458 of the Capital Requirements Regulation.

Average risk weights on residential mortgage loans according to the Internal Ratings Based Approach are in Finland relatively low, and risk weight levels vary significantly from one credit institution to another. The risk weights are low both from a risk perspective and if compared with risk weight levels applied in other relevant EU countries.

In setting the minimum level for risk weights, account was taken of second-round effects stemming from residential property and mortgage markets and amplifying shocks within the economy in crisis situations, and of other systemic risks relating to residential mortgage lending and household debt accumulation. The low level of interest rates, in combination with low risk weights, could lead to the elevation of housing prices in the future, to a level not corresponding to the state of the economy, either in general or regionally. A potential increase in the euro area interest rate level in a situation where there is no equivalent improvement in the Finnish economy may create pressures for a decrease in housing prices in Finland.

The suitability of alternative measures for strengthening the capital base required to cover the residential mortgage loan stock was analysed in connection with the preparation of the decision. The analysis showed that alternative measures would not enable adequate and effective management of observed systemic risks.

In order to ensure effective implementation of the decision, the FIN-FSA will request that macroprudential authorities of other EEA countries apply the measures to branches operating in Finland of credit institutions authorised in said countries and that this be recommended by the European Systemic Risk Board (ESRB) to the authorities concerned.

The decision on the minimum level of risk weights will be valid for two years, unless renewed. Renewal is possible for one year at a time.

Maximum loan-to-value ratio for residential mortgage loans

The maximum loan-to-value ratio for residential mortgage loans restricts the amount of a residential mortgage to 90% at most (in the case of a first home purchase, to 95% at most) of the current value of collateral posted at loan approval. In order to limit any exceptional increase in risks to financial stability, the Board of the FIN-FSA may decide to reduce these maximum amounts by not more than 10 percentage points. In addition, it may decide to restrict the taking into account of any other collateral security except real security in calculating the loan-to-value ratio.

In light of most recent information, growth in both the residential mortgage loan stock and household indebtedness has faded to some extent, and housing price developments have continued at a moderate pace, even if indebtedness is historically high. With this taken into account, key indicators are not pointing to an immediate need to tighten the conditions for the maximum loan-to-value ratio from their basic level.