Board of the Financial Supervisory Authority lowers maximum LTC ratio

At its meeting on 19 March 2018, the Board of the Financial Supervisory Authority (FIN-FSA) has decided to lower the binding maximum loan-to-collateral (LTC) ratio, as referred to in chapter 15, section 11 of the Credit Institutions Act, by 5 percentage points to 85% for residential mortgage loans other than those taken for first home purchases.

The decision will enter into force on 1 July 2018.

Justifications for the decision

In the third quarter of 2017, household indebtedness increased in Finland to a new record, to 128% of household annual disposable income. Indebtedness has more than doubled over the last twenty years, and is currently around 40 percentage points above the highest level seen before the banking crisis in Finland in the early 1990s.

Compared with the rest of Europe, Finland has a particularly high proportion of variable interest rate residential mortgage loans. In December 2017, Euribor-linked loans accounted for 92% of the stock of residential mortgage loans. In addition, the average maturity of new residential mortgage loans has grown in the period 2014–2017 from around 18 years to around 19.5 years.

Indebtedness is expected to increase further in the next few years, driven by, among other things, positive economic and employment prospects, strong consumer confidence, the low interest rate environment, easing of the terms of new residential mortgage loans, a buoyant housing market in growth centres, and increased demand for loans to housing corporations and consumer credit.

The magnitude and growth of household indebtedness are significant risks to the stability of Finland’s financial system and the economy as a whole. Growing indebtedness weakens the ability of households and the entire financial system to react to shocks to the financial system and the economy. High indebtedness amplifies shocks to the economy, because indebted economic entities typically reduce their consumption and investments in adverse economic conditions.

To reduce the systemic risks associated with the magnitude and growth of indebtedness, the Board of FIN-FSA has decided to lower the maximum LTC ratio for new residential mortgage loans by 5 percentage points to 85%. The decision will limit the granting of large residential mortgage loans relative to collateral and thereby reduce the incentive for households to take on more debt.

For residential mortgage loans taken for first home purchases, the maximum LTC ratio will remain as before at 95%. The decision will maintain access to the housing market for first-time buyers.

The loan-to-collateral ratios of first-time buyers' residential mortgage loans are typically large. First-time buyers and other households with large residential mortgage loans relative to collateral are, on average, most vulnerable to housing market shocks. Although the tightening of the maximum LTC ratio is not directly targeted at loans for first homes, the action will contribute to encourage households that have already bought a first home and are considering selling their home and buying a new one to pay down the residential mortgage loans they already have.

Opinions requested on the decision proposal

The FIN-FSA requested opinions from Finance Finland and OP Financial Group on its decision proposal to lower the maximum LTC ratio. Finance Finland states in its opinion that the preconditions laid down in law for tightening the maximum LTC ratio are not met. OP Financial Group's opinion is that, given the current growth rate of the residential mortgage loan stock, there are no grounds for tightening the maximum LTC ratio. OP Financial Group takes the view that to curb the development of household indebtedness it would be essential to address the regulation and restriction of payday loans, for example, instead of residential mortgage lending.

The FIN-FSA considers that the preconditions laid down in law for tightening the maximum LTC ratio are met. Under the Credit Institutions Act, the FIN-FSA may decide to reduce the maximum LTC ratio by a maximum of 10 percentage points in order to limit an exceptional increase in risk to financial stability. Even though the rates of growth in household indebtedness, residential mortgage lending and house prices are not currently exceptionally high, the historically record level of indebtedness as well as its continuing growth support the tightening of the maximum LTC ratio. The increase in risk arising from the combination of the level and growth of indebtedness may be considered to be an exceptional factor jeopardising the stability of the financial system.

The lowering of the maximum LTC ratio is the most suitable of the actions available to the FIN-FSA to limit the growth in household indebtedness. The significance of consumer credit in the growing indebtedness of households has also increased in recent times. The majority of household debt, however, is still in the form of residential mortgage loans. The use of macroprudential instruments directed at residential mortgage loans is the primary means of alleviating the systemic risks associated with the growth in household indebtedness.