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

At its meeting on 19 December 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 maximum loan-to-collateral (LTC) ratio, as referred to in chapter 15, section 11 of the Act on Credit Institutions and section 14 of the Act on the Registration of Certain Credit Providers and Credit Intermediaries will be adjusted so that the LTC ratio applicable to non-first home buyers is restored to its statutory baseline level of 90%. The decision enters into force immediately. The maximum LTC ratio for non-first home buyers was lowered by 5% by a decision of 28 June 2021 on the maximum LTC ratio.

In addition, pursuant to Article 458(5) of the EU Capital Requirements Regulation (n:o 575/2013, the CRR) and section 10(1)(6) of the Act on the Financial Supervisory Authority, the FIN-FSA Board decided to reciprocate Finansinspektionen's (Sweden) decision of 14 December 2023 imposing a floor of 25%, entering into force on 31 December 2023, on the average risk weights for housing loans granted by credit institutions applying the IRB approach, to be applied to credit institutions registered in Finland.[1] According to Finansinspektionen's decision/notification, the floor would apply to credit institutions whose residential real estate exposures in Sweden exceed SEK 5 billion.[2] The decision is valid until 30 December 2025.

Justifications for the decision

Countercyclical capital buffer requirement

The development of the world economy has been modest this year, and the growth outlook remains sluggish. This year, the development of the world economy has been buoyed by the United States, where solid employment has sustained economic growth. According to Eurosystem staff projections, tight financing conditions, low consumer confidence and weak export developments dampen growth in the euro area this year. Growth is also forecast to remain rather modest next year as the transmission of tightening monetary policy into the economy continues.

According to the Bank of Finland's December 2023 forecast, Finland's economy will contract by 0.5% in 2023 as the weak second year-half drags the whole year down into negative territory. Next year, the economy is forecast to contract by a further 0.2%. Economic growth is estimated to recover as of the second half of 2024 onwards, and GDP is

[1] https://fi.se/en/published/important-memos-and-decisions/2023/fi-extends-the-risk-weight-floor-for-swedish-mortgage-exposures/
[2] https://www.fi.se/en/published/important-memos-and-decisions/2023/fi-notifies-the-eu-regarding-extension-of-the-existing-risk-weight-floor-for-swedish-mortgages/

forecast to expand by 1.5% in 2025. Inflation is expected to remain brisk at 4.4% this year but slow down to 1% in 2024 mainly due to declining energy prices. Inflation is forecast to return close to 2% by 2026.

Except for the current account deficit and the growth of the debt-servicing burden, all indicators of the financial cycle continue to point to a declining financial cycle. Risks of overheating of the financial system are low. The primary risk indicator, the credit-to-GDP gap, stood at approximately -15 percentage points at the end of June, according to preliminary data. The trend deviation calculated using a more narrow credit stock is also clearly negative and continues to decline, but the rate of decline has slowed down slightly from the preceding quarters.

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

In accordance with legislation, the maximum loan-to-collateral ratio for residential mortgage loans restricts the amount of a residential mortgage loan to 90% at most (in the case of the purchase of a first home to 95% at most) of the 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 a maximum of 10 percentage points. In addition, it may decide to restrict the acceptance of any other collateral security than real security in the calculation of the loan-to-value ratio.

According to Government Bill 39/2014, a tightening of the maximum loan-to-value ratio or restriction of collateral becomes applicable in situations where the housing market threatens to overheat in a manner that jeopardises the stability of the financial markets and macroeconomic stability. A key indicator for market overheating would be a rise in house prices relative to overall earnings developments. Other justifications to be taken into account include, in particular, significant growth in residential mortgage loans relative to disposable household income and significant threats to macroeconomic performance that affect the housing market.

On 28 June 2021, the FIN-FSA Board lowered the maximum LTC ratio for non-first home buyers by 5 percentage points to contain household debt accumulation. In the justifications for the decision, it was stated that the exceptionally strong momentum in the housing and mortgage markets relative to developments elsewhere in the economy is conducive to increasing structural risks in the markets in an exceptional way, especially in an environment where household indebtedness in relation to income is record high and growing further. The decision entered into force on 1 October 2021 and has remained valid ever since.

The extension of the decision to lower the maximum LTC ratio for non-first home buyers has been justified in previous quarters by the high level of indebtedness and major uncertainty associated with the development of the housing markets. The high level of indebtedness and uncertainty of housing market developments have posed such a threat of an exceptional increase in financial stability risks that it has been warranted to keep the maximum LTC ratio at a reduced level in order to ensure the risk-bearing capacity of new borrowers.

The downturn of the housing markets that begun in the second half of 2022 continued in the summer and autumn of 2023, but house sales picked up in November year on year,. As a whole, the number of sales of old dwellings in July–November was a good one-fifth (-22%) lower than in 2015–2019 on average, and the euro amount of new housing loans in July–October was almost one-third (-29%) smaller. In comparison with the unusually buoyant pandemic years, the change was even more drastic.

The decline of the prices of old dwellings in housing companies continued in the third quarter of 2023 and in October. In the third quarter, average prices in the Helsinki metropolitan area were about 8% lower than a year earlier, and in the rest of the country about 7% lower. The decline of the prices of new dwellings has been more moderate, but the volume of transactions in new dwellings has been exceptionally limited.

For the time being, there have been no signs of a recovery in housing transactions and lending to their customary levels. The rise of the average interest rate on new housing loans levelled off in the summer. Consumer confidence in the economy has remained very weak. The number of dwellings for sale and available for rent is high relative to the weak demand.

Household indebtedness relative to disposable income decreased in the second quarter of 2023 to 126% from its highest level at end-2021, now revised to 133%. Household debt grew more slowly than earlier in the year, particularly as the housing loan stock contracted year on year. In contrast, nominal income grew faster than before, and income for 2021–2022 was also revised upwards in statistics releases during the first half of this year.

Towards the end of 2022 and in January–September 2023, households drew down fewer housing loans and in smaller amounts than in the preceding years. The decrease in loan amounts was also reflected in mortgage borrowers' lower indebtedness relative to disposable income. The proportions of the largest housing loans by LTC ratio also decreased quarter-on-quarter in the first and second quarter of 2023. Nevertheless, the rise of loan interest rates increased new borrowers' loan-servicing costs relative to their income.

Recent revised statistics show that household indebtedness relative to income peaked at the end of 2021. Since the first quarter of 2022, indebtedness has declined due to sluggish credit demand, contraction of the housing loan stock and faster growth of households' nominal income. Household indebtedness is estimated to decline further, reflecting continuing weak housing loan demand and higher interest rates.

Due to the decrease in realised and expected household indebtedness, the vulnerabilities of the financial system are considered to have decreased and to continue to decrease further. The FIN-FSA Board decision on the maximum debt-servicing burden for housing loan applicants' loans and housing company-related charges for financial costs, issued on 27 June 2022 and in force as of 1 January 2023, also contributed to the reduction. Furthermore, new restrictions on housing and housing company loans that entered into force in July 2023 limit households' direct and indirect indebtedness and thereby reduce financial stability risks associated with the accumulation of household debt.[3]

Hence, overheating of the housing markets or growth of the housing loan stock as referred to in the rationale of the Credit Institutions Act and the FIN-FSA principles for tightening the maximum LTC ratio do not pose further risks to financial stability at present.

In an environment of the expected economic development and interest rate level, households' debt-servicing capacity is anticipated to remain mostly adequate. Risks related to lending for house purchases as well as household indebtedness could materialise in a more pronounced manner than anticipated, particularly if the interest rate level would rise further, unemployment would increase substantially and house prices would continue to fall. Professional real estate investment activities and the construction sector also involve risks and second-round effects which, if realised, could weaken housing market conditions overall.

Due to the downturn of the housing market and the housing loan market, realised and anticipated reduction in household indebtedness as well as the implementation of other macroprudential instruments that limit the growth of household indebtedness, it is warranted to amend the FIN-FSA Board's decision taken June 2021 and in force since October, and its decision of September 2023 concerning other lenders than credit institutions to the effect that the maximum LTC ratio for non-first home buyers is restored to its statutory baseline level of 90%. The maximum LTC ratio for first home buyers is not changed in this instance.

Risk weight floor set by Finansinspektionen

In 2018, pursuant to Article 458 of the CRR, Finansinspektionen decided to set, until the end of 2020, a minimum level of 25% for

[3] The maximum repayment period of 30 years of housing loans and housing company loans as well as the prohibition of grace periods and restriction of the maximum amount to 60% of the debt-free price of the dwellings to be sold.

average risk weights on housing loans granted in Sweden by credit institutions applying the internal ratings based approach. Subsequently, in December 2020, Finansinspektionen decided to extend the validity of this minimum level until the end of 2021 and again in December 2021 until the end of 2023.

In turn, in December 2018, the FIN-FSA Board decided to reciprocate the abovementioned floor level with respect to Finnish credit institutions whose housing loans granted in Sweden exceed SEK 5 billion. After this decision, the FIN-FSA made further decisions in February 2021 and February 2022 to extend the application of the risk weight floor to Finnish credit institutions in accordance with Finansinspektionen's decisions. The decisions to reciprocate the minimum level were in line with recommendations of the European Systemic Risk Board (ESRB).

In September 2023, Finansinspektionen made a tentative decision to extend the validity of the risk weight floors by a further two years in 2024–25, and it notified EU authorities of this decision.[4] The final decision on the risk weight floor for housing loans was made on 14 December 2023. In its opinion on the measure to the Commission, dated 10 October 2023, the ESRB recommended that the previous recommendation on the reciprocation of the measure in other EEA countries be extended to Finansinspektionen's new decision. The EU Commission decided on 6 November 2023 not to propose to the Council to reject the measure.

Finansinspektionen's measure is based on Article 458(2)(d)(iv) of the CRR, according to which a competent authority may implement stricter risk weights for targeting asset bubbles in the property sector to prevent macroprudential risks in the financial system. According to the notification, it is crucial for the stability of the Swedish financial system that banks operating in Sweden have adequate own funds to cover risks related to mortgage loans and those stemming from developments in house prices. In Finansinspektionen's view, capital levels implied by IRB credit risk models as such are inadequate to mitigate prevailing stability risks. Materialisation of the risks would also be likely to endanger economic growth. Finansinspektionen's decision applies to individual credit institutions on a solo and a consolidated basis.

In accordance with Article 458(5) of the CRR, other member states may recognise measures adopted in accordance with said Article and apply them to domestically authorised institutions, which have branches or exposures in the member state authorised to apply the measure. The continued application of the requirement ensures that adequate capital is reserved for risks associated with Swedish housing loans and supports a level playing field in the Swedish housing loan markets. In preparing the decision, the FIN-FSA has, in accordance with Article 458(7) of the CRR, taken into consideration the criteria set in paragraph 4 of the Article as specified in the notification.

[4] https://www.fi.se/en/published/important-memos-and-decisions/2023/fi-notifies-the-eu-regarding-extension-of-the-existing-risk-weight-floor-for-swedish-mortgages/

The hearing under section 34 of the Administrative Procedure Act on the reciprocation of minimum level was limited to Finnish credit institutions that have or may in the future have Swedish housing loans in the scope of their current IRB approach to credit risk (Nordea Bank Abp). The hearing period ended on 8 December 2023.

In its response, Nordea Bank Abp states that credit risk models approved by the ECB ensure that the prudential requirements applicable to Nordea Bank Abp are adequate and appropriate. Measures based on Article 458 of the CRR are of a temporary nature, and the floor is now being applied for the third time. Furthermore, upcoming amendments to the CRR (CRR3) will impose a minimum for the risk weights, whereby there will be no grounds for a minimum level based on Article 458. The minimum level also increases the complexity of regulation. In the event that the floor is reciprocated, Nordea Bank Abp expects that it will be phased out gradually when CRR3 enters into force. The FIN-FSA should take a position on this in its decision.

According to Nordea Bank Abp, its prudential requirements are higher in comparison to other Nordic banks even though its risk level is lower. At present, macroprudential capital requirements for banks operating across borders are complicated, and they have been recently tightened significantly. It is important to understand the joint impact of capital requirements and risk weights in order to determine the right capital level as well as the systemic and procyclical effects of various macroprudential instruments. Nordea Bank Abp wishes that measures taken by authorities were based on existing risks and not on the objectives of micro- and macroprudential instruments, and in this context, it emphasises the importance of EU-level harmonisation.

With respect to the response, the FIN-FSA states that regulation requires Nordea Bank Abp to meet, in all respects, both microprudential and macroprudential capital requirements imposed on it. Regulation concerning credit institutions in EEA countries constitutes a uniform regulatory and supervisory basis that treats credit institutions in different countries similarly. The output floor included in the CRR may make certain risk weight floors or other restrictions pertaining to risk models partly redundant in the future. On the other hand, more focused risk weight floors or limits concerning specific exposure categories may still be necessary after the entry into force of the output floor, since the output floor neither directly intervenes in specific risk areas or exposure categories nor considers systemic risks that may be associated, for example with low risk weights. The FIN-FSA acknowledges the need to review the appropriateness of countercyclical capital buffers and risk weight floors based on macroprudential grounds at a more general level, as required by upcoming regulation, once the output floor enters into force. The FIN-FSA also points out that the entry into force of the output floor involves transitional provisions extending at the maximum to year 2032. The output floor is not estimated to increase the capital requirements on Finnish credit institutions during the validity of the presently adopted risk weight floor based on Article 458 of the CRR.

In accordance with Article 458(6) of the CRR, the FIN-FSA will notify the adoption of the decision to the Council, the Commission, the European Banking Authority (EBA), the ESRB and Finansinspektionen.