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

At its meeting on 27 March 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 commence preparations for setting a credit institution-specific minimum level of 15% for the average risk weight on residential mortgage loans of credit institutions that have adopted the Internal Ratings Based Approach. The aim is to have the minimum risk weight in force as from 1 January 2018, by virtue of Article 458 of the Capital Requirements Regulation. The decision replaces a previous decision of the FIN-FSA from 14 June 2016.

The preliminary results of a market impact analysis regarding the maximum loan-to-value ratio referred to in chapter 15, section 11 of the Credit Institutions Act have become available. A possible tightening of the maximum loan-to-value ratio or restriction of collateral to be taken into account in calculating the ratio will, however, require further analysis.

Justifications for the decision

Countercyclical capital buffer requirement

The credit-to-GDP gap, used as the primary indicator for setting a countercyclical capital buffer requirement, has declined. The most recent observation for the third quarter of 2016 is −1.3 percentage points and still gives 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 its latest observation is the smallest since 2003. Nor does the credit-to-GDP gap calculated using an alternative, narrow definition of credit indicate growth in systemic risks related to the credit cycle.

Household indebtedness has continued to grow. However, other supplementary risk indicators (among other things, the development of the macro economy and the current account, the growth rate of credit, house price developments, risk pricing and banks’ vulnerabilities) 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.

Minimum risk weight

In June 2016, upon proposal by the Director General of the FIN-FSA, the Board of the FIN-FSA decided to take measures to introduce a minimum level of 10% 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 level would come into force on 1 July 2017 at the latest.

In November 2016, the European Systemic Risk Board (ESRB) warned Finland of the high level of household indebtedness. The ESRB paid attention to the fact that the indebtedness may constitute a risk for the stability of the financial system and for the development of the real economy over the medium term. Household debt has continued to grow since June 2016.

In order to prevent growing medium-term risks, it is justified to set a minimum level of 15% for the average risk weight on residential mortgage loans of credit institutions that have adopted the Internal Ratings Based Approach. The aim is to have the minimum level in force as from 1 January 2018. This would allow banks sufficient time to implement the change. Setting the minimum level at 15% would strengthen the risk resilience of the Finnish credit institutions sector in a situation where indebtedness is still growing.

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 loan 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.

The preliminary results of a market impact analysis regarding the maximum loan-to-value ratio have become available. A possible tightening of the maximum loan-to-value ratio or restriction of collateral to be taken into account in calculating the ratio will, however, require further analysis.

The FIN-FSA is pursuing intensified monitoring of developments in indebtedness. The structural vulnerabilities related to household debt have remained at a historically high level, and the ongoing growth of indebtedness underscores the medium-term stability threats to the financial system and the macro economy.