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

At its meeting on 27 June 2022, 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% and that the period of validity of the decision on a lower maximum loan-to-collateral (LTC) ratio, taken on 28 June 2021 pursuant to chapter 15, section 11 of the Credit Institutions Act, will be extended. With the June decision, the maximum LTC ratio for new residential mortgage loans other than first-home loans was lowered by 5 percentage points, to 85%.

In addition, in accordance with chapter 10, section 8 of the Credit Institutions Act, the FIN-FSA Board has taken a decision on other systemically important credit institutions (O-SIIs) and their additional capital requirements (O-SII buffers), which are to be met through consolidated Common Equity Tier 1 (CET1) capital. Accordingly, the O-SII buffer rates will be set as follows:

- Nordea 2.5% (change +0.5 pp)
- OP Financial Group 1.5% (change +0.5 pp)
- Municipality Finance Plc 0.5% (unchanged)

The decision on O-SIIs will enter into force on 1 January 2023.

Furthermore, the FIN-FSA Board has decided on a recommendation on a maximum debt-servicing burden for housing loan applicants' loans and charges for financial costs associated with housing company loans. According to the recommendation, the 'stressed' debt-service-to-income (DSTI) ratio of a borrower should, as a rule, be no more than 60% of their net income. The stressed DSTI ratio should be calculated by taking extensively into account the applicant's housing loans, other loans and housing company-related charges for financial costs, and their stressed servicing costs. The stressed servicing costs should be calculated with a maturity of no more than 25 years and an interest rate of at least 6% (except for loans with long-term interest rate hedges and fixed-rate loans). If the institution deviates from the recommended maximum DSTI ratio, the customer's financial margin should be assessed with particular care with the customer, and the credit decision should be made on a higher management level. As a benchmark, new housing loans with a stressed DSTI ratio of over 60% should account for no more than 15% of the euro volume of new housing loans granted by the lender in a calendar year. The recommendation will enter into force on 1 January 2023.

The full text of the recommendation is attached at the end of this document.

Justification for the decision

Countercyclical capital buffer (CCyB) requirement

Russia's war in Ukraine and the COVID-19 pandemic are weighing on the Finnish and global economic outlook. Inflation is picking up and the economy is forecast to grow slowly. Financial markets have operated well despite strong reactions in places to the start of the war.

In spite of the sharp fall in economic growth, forecasts and scenarios have not so far pointed to a recession at the annual level. According to the Bank of Finland's baseline scenario published in June, Finnish GDP will grow by 1.7% in 2022 and by 0.5% in 2023. The forecast sees significant downward risks to economic growth. Consumer confidence in the Finnish economy and its prospects plummeted in March. Consumer expectations about their own financial situation did not deteriorate as drastically.

Risk indicators continue to suggest that the risks relating to total lending are moderate. The primary risk indicator – the private sector credit-to-GDP gap – has continued to fall deeper into negative territory, and the preliminary estimate for the gap for the end of December 2021 was -13.3 percentage points. The downward trend in the credit-to-GDP gap is partly due to the pick-up in inflation as the brisk growth of nominal GDP pushes the indicator down.

The other indicators measuring systemic risks relating to credit growth are not pointing to a substantial increase in the risks, either. Loans to households have continued to grow at a steady pace as a whole, but the growth of loans to housing corporations has gained renewed momentum. The annual growth rate of the stock of loans to non-financial corporations turned positive in the first half of 2022. The interest rate margins on bank loans are widening, and the current account is running a surplus. The upward trend in the Finnish financial cycle indicator, which captures fluctuations in the financial cycle, moderated in late 2021, and the level of the indicator is not pointing to a strong financial cycle for Finland. The financial market stress index has posted elevated levels in recent months on account of the geopolitical situation, but the index is lower than during the worst phase of the COVID-19 crisis. The war in Ukraine is not yet fully reflected in the indicators used for setting the CCyB requirement.

The grounds for setting the CCyB requirement have also been assessed on the basis of the revised set of indicators introduced in the third quarter of 2022. The new set of risk indicators would not change the assessment of the current severity level of cyclical risks in Finland, since none of the new indicators is pointing to overheating.

Based on the primary and supplementary risk indicators and other available indicators and data, there are no such signs of a broad-based

overheating of the credit market as would require an increase in the CCyB rate.

Maximum loan-to-collateral (LTC) ratio

The initial effects of Russia's invasion of Ukraine on the Finnish housing market are assessed as moderate on the whole. According to data by the Central Federation of Finnish Real Estate Agencies (KVKL), sales of old dwellings through real estate agents contracted in March–May 2022 from a year earlier, when sales activity was distinctively more buoyant than in previous years. In January–May, house sales declined on a year earlier but were livelier than at the onset of the pandemic and before it.

In May, the number of homes listed for sale was roughly unchanged on a year earlier, and so was the typical time on the market. However, the number of one- and two-room flats for sale rose from the previous year. In addition, in the first quarter of 2022, the number of homes available to rent was higher than before the pandemic. These factors suggest that the demand for rental housing may have declined during the pandemic.

In January–April, drawdowns of housing loans contracted slightly from a year earlier. In April, new housing-loan drawdowns fell by 12% year-on-year. In March–May, fewer consumers considered the time favourable for taking out a loan, but house purchase and borrowing intentions remained more buoyant than in the pre-pandemic years.

In February–April, the average margin on new housing loans widened from January, which is assessed to at least partly reflect a wider use of interest rate hedges in housing loans. The average initial maturity was slightly above 21 years in January–April. The share of loans with a maturity of over 26 years in the euro volume of new housing loans reached a record level of 17.8% in April, and for the first time the share of loans with a maturity of over 30 years increased to over 12%. In the first quarter of 2022, new housing loans were larger on average than in the previous quarter.

The decision of the FIN-FSA Board to lower the maximum LTC ratio for new residential mortgage loans other than first-home loans from 90% to 85% entered into force at the beginning of October 2021. In the last quarter of 2021 and the first quarter of 2022, the share (in the euro volume) of loans with an LTC ratio of over 80% was notably smaller than before the tightening of the maximum LTC ratio. The share was roughly of the same magnitude as in the first half of 2020, i.e. before the maximum LTC ratio was eased on account of the pandemic. The share of first-home loans with an LTC ratio of over 90% grew in the first quarter of 2022 but has otherwise been on a declining path since summer 2020.

The economic outlook is surrounded by high uncertainty. Growth in housing expenditure and in other essential consumer spending, and expectations of a gradual increase in interest rates, may dampen

housing transactions and mortgage lending from the very buoyant activity levels observed in 2021. The rise in nominal house prices is expected to slow from the fast pace recorded last year. However, the prices are expected to keep rising in growth centres, where demand for housing relative to supply is higher than elsewhere in Finland.

In the fourth quarter of 2021, total household debt relative to annual income once again reached a new record high. Borrowing was chiefly driven by housing loans. However, debt relative to GDP decreased in response to the brisk growth of nominal GDP in late 2021. As a result, the household debt-to-GDP ratio fell further below its long-term trend. Debt contracted slightly also relative to household financial assets.

The financial stability risks stemming from the housing market and household debt have increased since the start of the war. Higher consumption spending and loan-servicing expenditure may put a strain on the finances of households that are heavily indebted relative to their income. However, the use of interest rate hedges in variable-rate housing loans will reduce the interest rate risk especially if interest rates were to rise more than expected. In the longer term, the effects of the war on the housing market will depend on the war’s duration and extent and on its consequences for the Finnish economy.

The key structural vulnerabilities in the financial system relate to the high and increasing level of household debt. The FIN-FSA Board’s decision of June 2021, effective in October, to set the maximum LTC ratio for new residential mortgage loans other than first-home loans to 85% remains justified in terms of curbing the number of large housing loans in relation to collateral. The maximum LTC ratio for first-home loans will not be adjusted at this stage.

Structural additional capital requirements

According to the FIN-FSA’s assessment, in an environment of average cyclical risks, the aggregate adequate level of additional macroprudential capital requirements imposed on the credit institutions sector is close to the pre-pandemic level or slightly above it. The assessment is based on stress testing of the credit institutions sector and on research literature on the adequate level of credit institutions’ capital requirements.

In the stress scenarios of a joint stress testing exercise[1] of the Bank of Finland and the FIN-FSA, the Finnish credit institutions sector faces a broad-based financial market disruption and a global recession. These will lead to a severe housing market-driven crisis in the Nordic countries in 2022–2024. The resulting losses to credit institutions are caused by external shocks to the Finnish financial sector, the effects of which are amplified by the sector’s structural vulnerabilities. The exercise does not

[1] Bank of Finland Bulletin 1/2022: Large structural risks require banks to hold buffers for a rainy day.

include an estimation of the scale of losses to the system from potential difficulties or disruptions of individual Finnish credit institutions. As a rule, the risks of losses from external shocks to the domestic financial sector are covered by an additional capital requirement imposed based on the structural characteristics of the financial system (systemic risk buffer, SyRB). The additional capital requirement imposed on O-SIIs (O-SII buffers), in turn, prevent the risks of individual systemically important credit institutions. In the event of a systemic crisis, both risks may materialise simultaneously.

Other systemically important credit institutions (O-SIIs) and their additional capital requirements

Under chapter 10, section 8 of the Credit Institutions Act, other systemically important credit institutions (other systemically important institutions, 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 on an annual basis. The identification of Finnish O-SIIs is based on the EBA Guidelines on the criteria for the assessment of O-SIIs[2] and on its four core criteria and more detailed related indicators. The FIN-FSA provides more detailed principles on the identification of O-SIIS on its website.[3]

Based on data as at end-2021, and as in the previous year, Nordea, OP Financial Group and Municipality Finance exceed the threshold for systemic importance (2.75%) and are therefore automatically designated as O-SIIs (Table 1). According to the FIN-FSA's assessment, there are no justifications to designate other credit institutions as O-SIIs.

Table 1 Finnish credit institutions' O-SII scores as at 31 December 2021

Banking group	O-SII score (%)	O-SII
Nordea	**64.11**	Yes
OP Financial Group	**11.75**	Yes
Municipality Finance Plc	**4.09**	Yes
Savings Bank Group	0.92	No
Aktia	0.85	No
S-Bank	0.71	No
Bank of Åland	0.64	No
Danske Mortgage Bank	0.47	No
POP Bank Group	0.41	No
Oma Savings Bank Plc	0.37	No
The Mortgage Society of Finland	0.22	No
Evli Bank	0.08	No

[2] EBA/GL/2014/10.
[3] Financial Supervisory Authority (2022) *Principles for identifying other systemically important credit institutions (O-SIIs) and setting additional capital requirements.*

In addition to identifying O-SIIs, the Credit Institutions Act obliges FIN-FSA to review the additional capital requirements of O-SIIs (O-SII buffers) on an annual basis. If the levels of O-SII buffers change, the FIN-FSA is required to take a decision on the matter.

The new Capital Requirements Directive[4] (CRD V) was brought into national law by amendments[5] to the Credit Institutions Act. The amendments entered into force in April 2021 and oblige the FIN-FSA to allocate O-SIIs into seven (previously five) buckets according to their assessed systemic importance. As a rule, the O-SII buffer rate of credit institutions (other than O-SIIs) in the lowest bucket is 0% of their total risk exposure amount. The buffer rates of credit institutions in the other buckets (O-SIIs) increase at intervals of 0.5 percentage point so that, as a rule, the O-SII buffer requirement of the institutions in the highest (seventh) bucket is 3%. O-SII buffers must be covered by Common Equity Tier 1 (CET1) capital.

In practice, the bucketing of Finnish O-SIIs and the calibration of O-SII buffers is based on the systemic importance of O-SIIs, which is primarily assessed by means of the O-SII scores of the EBA Guidelines. The setting of O-SII buffers is also guided by the ‘floor methodology’ of the European Central Bank (ECB). The ECB floor methodology establishes a minimum level for the buffer of each individual O-SII, against which the capital requirements of the national macroprudential authority are assessed when applying Article 5 of the SSM Regulation[6]. If the O-SII buffer falls below the floor, the ECB may raise the O-SII buffer requirement set by the national macroprudential authority.

The higher-than-average level of concentration of the Finnish banking sector and the big size of the largest credit institutions relative to the national economy support the application of O-SII buffer rates above the minimum level obtained under the ECB’s floor methodologies. Buffer requirements that are proportionate to systemic importance, and solid capital adequacy, also underpin credit institutions’ ability to raise market funding.

Based on the O-SII buffer calibration methods[7] applied by the FIN-FSA, it would be justified to raise the O-SII buffer for Nordea by 1.0 percentage points to 3.0%, and the O-SII buffer for OP Financial Group by 0.5–1.0 percentage points to 1.5% or 2.0%. Municipality Finance’s current O-SII buffer rate (0.5%) is in turn consistent with buffer guides.

Raising the O-SII buffers for Nordea and OP Financial Group by 0.5 instead of 1.0 percentage points would be justified based on an overall

[4] Directive (EU) 2019/878 of the European Parliament and of the Council.
[5] Following the amendments to the Credit Institutions Act (legislative amendment 233/2021), the maximum O-SII buffer rate rose to 3.0% (from 2.0%). Furthermore, the O-SII and the SyRB buffers will in future be applied cumulatively (previously only the higher of the buffers was effective).
[6] Council Regulation (EU) No 1024/2013.
[7] See the Financial Supervisory Authority (2022) *Principles for identifying other systemically important credit institutions (O-SIIs) and setting additional capital requirements*.

assessment of buffer requirements. If the O-SII buffers are increased moderately (0.5 pp), this would leave greater macroprudential policy space for building up buffers designed to be released in times of crises (e.g. the CCyB) – within the limits of the aggregate level of buffer requirements assessed as adequate. An increase in the share of releasable buffers would, in turn, improve the prerequisites for macroprudential policy to support financial intermediation in the event of severe disruptions to the economy or the financial system. In addition, if the O-SII buffers are raised moderately and, in particular, are not set to the highest level allowed by law (to 3.0%), this would leave macroprudential policy space for raising O-SII buffers if the systemic importance of O-SIIs increases. This would continue to motivate all Finnish O-SIIs to avoid raising their systemic importance.

The first pillar of the Banking Union – the Single Supervisory Mechanism (SSM) – has improved and harmonised supervisory tools and practices in participating countries and strengthened banks' balance sheets and loss-absorption capacity. The Single Resolution Mechanism (SRM), in turn, has improved the conditions for orderly and harmonised restructuring of banks operating in participating countries in crisis situations. Research shows that efficient and swift crisis resolution measures reduce the costs of financial crises to society. The minimum requirement for own funds and eligible liabilities (MREL) set for banks in connection with resolution planning and, ultimately, the Single Resolution Fund (SRF), which is funded by contributions raised from banks, promote investor responsibility ('bail-in') and reduce moral hazard related to banks' systemic importance (”too big to fail”). Hence, single banking supervision and crisis resolution reduce the probability of failures or difficulties of banks operating in the participating countries and lower the related costs to society. This, too, favours moderate increases in the O-SII buffer requirements.

In setting O-SII buffers, it is also important to consider the current cyclical situation and the potential effects of increases in capital requirements on banks' lending capacity. Russia's war in Ukraine and the related economic sanctions have weakened the global and Finnish economic outlook and boosted financial market uncertainty. The impact of the war on the risk of credit losses for Finnish banks is still unclear in many respects and will depend above all on the duration and extent of the war and on how quickly economies can adjust to the war-related changes in e.g. foreign trade and energy consumption. If the war-related economic shock leads to significant credit losses and credit institutions' capital requirements are raised substantially at the same time, this could materially weaken banks' lending capacity. Hence, the considerable uncertainty surrounding the current cyclical situation favours moderate increases in the O-SII buffer requirements.

Before making a decision on O-SIIs and their buffers, the FIN-FSA Board, pursuant to section 34 of the Administrative Procedure Act (434/2003), provided Nordea, OP Financial Group and Municipality Finance Plc with an opportunity to express an opinion on the matter and

submit an explanation of any demands and information which might have an effect on the Board's decision. The responses received were taken into consideration in deciding on the matter.

For the above-mentioned reasons, it is justified to set the O-SII-buffer rate for Nordea at 2.5%, the rate for OP Financial Group at 1.5% and the rate for Municipality Finance at 0.5%.

Additional capital requirement imposed based on the structural characteristics of the financial system (systemic risk buffer, SyRB)

According to an assessment of the criteria for setting the SyRB, the risks and vulnerabilities to the Finnish financial system are substantial and above the average level in other EU countries or in Finland over the long term. The Finnish credit institutions sector is structurally vulnerable, specifically in terms of its large size, cross-country interconnectedness as measured by the size of its funding gap, high risk concentrations relating to residential and commercial property lending, and, among the sector's key client groups, particularly the high indebtedness of households. In addition, the credit institutions sector plays a major role in the provision of credit to the private sector, and also a greater role than credit institutions in Finland's peer countries on average. The FIN-FSA judges that the conditions prescribed by law for setting the SyRB (to a level above zero) are fulfilled.

However, Russia's war in Ukraine has weakened Finnish and European economic prospects, intensified the risk of credit losses and fuelled uncertainty about these prospects and about the functioning of the banking system to the extent that, for the time being, the FIN-FSA Board does not propose the application of the SyRB to Finnish credit institutions. It is justified to address this uncertainty with the SyRB instead of O-SII buffers because regulation and international guidelines provide more specific application criteria for O-SII buffers than for the SyRB. Maintaining the SyRB at 0% strengthens credit institutions' lending capacity in the prevailing uncertain situation. However, the level of the SyRB will be reviewed once the situation allows, and the intention is to set the SyRB rate to a level required by systemic risks and vulnerabilities as soon as possible.

Recommendation on a maximum debt-servicing burden for housing loan applicants' loans and housing company-related charges for financial costs

As part of its decision of 30 September 2020, the FIN-FSA Board recommended lenders to exercise restraint in granting loans that are very large in relation to the borrower's income and have a longer repayment period than usual. A corresponding recommendation has since been issued on a quarterly basis in connection with the publication of macroprudential decisions.

These recommendations have aimed to prevent excessive growth in household debt relative to income and to conform with Recommendation (2019/8) of the European Systemic Risk Board (ESRB), as part of which Finnish authorities were urged to introduce non-binding borrower-based measures to curb indebtedness.

Since then, a need has arisen to update the FIN-FSA's recommendation because (i) a follow-up assessment published by the ESRB considers that Finland is only partially compliant with the ESRB Recommendation and (ii) household indebtedness has continued to increase irrespective of previous recommendations.

It is justified to update the FIN-FSA's recommendation in order, on the one hand, to prevent excessive growth in household indebtedness and, on the other hand, to better conform with the ESRB Recommendation. Based on international practices, the alternatives for limiting debt relative to income in the form of recommendations are a cap on the debt-to-income (DTI) ratio and a cap on the debt service-to-income (DSTI) ratio. The DTI cap limits the maximum amount of total debt of a household in relation to income. The DSTI cap limits the maximum amount of total debt-servicing costs of a household in relation to disposable income (at loan origination). The DSTI cap can be applied in such a way that it must be fulfilled with a separately-specified maximum loan maturity and with an interest rate that exceeds the prevailing level and is assumed to apply in a stress situation.

Since the purpose of the recommendation is to contain, in particular, the growth of indebtedness of households whose loan-servicing burden would be very high in a stress situation, it is justified to implement the recommendation as a 'stressed' debt service-to-income (DSTI) ratio. The stress scenario follows the recommendation issued by the FIN-FSA in 2010 (Regulations and guidelines 4/2018), according to which lenders should also carefully assess the loan applicant's repayment capacity in a situation where the loan interest rate is 6% and the maturity is 25 years. The level of the interest rate corresponds to the historical maximum level of the Euribor, and the maturity to the typical maximum loan maturity (median) available in the market. The recommendation allows for a limited deviation from the application of the stressed DSTI ratio upon fulfilment of specific criteria.

The impact analyses conducted and the resulting calibration of the FIN-FSA's recommendation build on the premise that the criteria of the recommendation for limiting residential mortgage lending allow for unchanged activity in the housing loan market when assessing the criteria in light of the FIN-FSA's most recent collection of data on housing loans. The uncertain situation for the financial system and the economy caused by the war in Ukraine emphasises the need for a neutral calibration of the recommendation and that it does not materially tighten current credit practices.

According to the recommendation:

1. As a rule, a housing loan applicant's debt service-to-income (DSTI) ratio should be no more than 60% in terms of the applicant's net income. The stressed DSTI ratio should be calculated by taking extensively into account the applicant's housing loans, other loans and housing company-related charges for financial costs, and the stressed servicing costs of all of these.
2. In the stressed calculation of housing affordability the maturity of a loan should be no more than 25 years and the loan interest rate no less than 6%.
3. If the loan applied for or any other loan included in the calculation of housing affordability has an interest rate cap of below 6%, the term of which is at least 10 years, or if the loan applied for or any other loan included in the affordability calculation is tied to a fixed rate of at least 10 years and is repaid according to the repayment schedule during the term of the fixed rate, the interest rate applied in the calculation to such a loan should be the interest rate cap or the fixed rate.
4. In the calculation of housing affordability, an applicant's stressed DSTI ratio should include the stressed servicing costs of the housing loan applied for and of the applicant's existing housing loans, the stressed housing company-related charges for financial costs the applicant is obliged to repay, and the stressed servicing costs of the applicant's other debts.
5. If the stressed DSTI ratio is more than 60% in terms of the applicant's net income, the credit decision should be preceded by a particularly thorough assessment of the customer's repayment capacity together with the customer, and the credit decision should be made on a higher management level. As a benchmark, new housing loans with a stressed DSTI ratio of over 60% should account for no more than 15% of the euro volume of new housing loans granted by the lender in a calendar year.

The FIN-FSA will supervise compliance with the recommendation and will monitor the share of new housing loans with a stressed DSTI ratio of over 60% and the reasons why such loans have been granted. The FIN-FSA will specify the recommendation and the related definitions and will assess the need for further measures on the basis of available data.

The FIN-FSA consulted credit institutions, branches, Finance Finland, consumer authorities and consumer associations on its draft recommendation. The main comments in the statements received were:

- There are several regulatory projects ongoing at present to prevent excessive household indebtedness. These should be considered in their entirety before the introduction of new regulation / recommendations.
- Finland has made a political-level decision not to introduce an income-based measure to contain indebtedness. Issuing a recommendation against the political-level decision is not justified.
- There is no impact assessment provided on the draft recommendation.

- The new recommendation on a maximum debt-servicing burden duplicates the existing established practice and the FIN-FSA's previous recommendation and is therefore unnecessary.
- A percentage-based cap such as the DSTI does not sufficiently take into account the customer's actual financial margin at different income levels. What matters is the euro amount available to the customer after deduction of debt-servicing cost.
- The entry into force of the recommendation should be postponed. This would provide an adequate transition period for lenders complying with the recommendation (e.g. required changes in IT systems).

The statements included comments on the details of the recommendation which were taken into account in the draft recommendation.

Despite several ongoing projects to prevent excessive indebtedness, the recommendation in question does not duplicate other projects but instead supplements them. The purpose of the recommendation is to prevent excessive growth of household debt relative to income and to conform with the ESRB Recommendation (2019/8). The Bank of Finland, the Ministry of Finance and the Ministry of Social Affairs and Health were consulted on the draft recommendation. The authorities did not suggest changes to the draft recommendation.

The FIN-FSA's activities are aimed at ensuring financial stability. The FIN-FSA acts as an independent body.

An impact assessment has been carried out for the draft recommendation. The impact assessment and the resulting calibration of the FIN-FSA's recommendation build on the premise that the criteria of the recommendation for limiting residential mortgage lending allow for unchanged activity in the housing loan market. The impact assessment-based calibration of the recommendation is designed to prevent household debt relative to income from growing excessively from its current level. The more detailed impacts of the recommendation will be analysed regularly – at least once a year – and the recommendation will be adjusted in light of these analyses, if necessary. In addition, the possibility for a deviation to be included in the recommendation gives flexibility to lenders and mitigates any side effects that diverge from the objectives of the recommendation at the level of individual borrowers.

The recommendation supplements the FIN-FSA's previous recommendation on the calculation of housing affordability, and therefore it does not replace it. By supplementing our recommendation on the affordability calculation we promote financial stability.

Even though a percentage-based cap cannot in all respects take into account borrowers' financial margin at different income levels, as a whole, it is assessed to constitute a more balanced indicator than a cap based on the euro amount available to the customer after deduction of

debt-servicing costs. The possibility for a deviation to be included in the recommendation improves the possibilities for lenders to consider borrowers’ financial margin and other borrower-specific factors in their credit decisions.

To ensure sufficient transitional period for lenders complying with the recommendation (e.g. required changes in IT systems), the entry into force of the recommendation will be postponed to 1 January 2023.

Appendix

RECOMMENDATION OF THE FINANCIAL SUPERVISORY AUTHORITY ON A MAXIMUM DEBT-SERVICING BURDEN FOR HOUSING LOAN APPLICANTS' LOANS AND HOUSING COMPANY-RELATED CHARGES FOR FINANCIAL COSTS

The Financial Supervisory Authority (FIN-FSA) recommends that supervised entities conduct a stressed calculation of housing affordability for all housing loan applicants and take these calculations into account in their credit decisions. As a rule, lenders should tailor the size of a housing loan to be granted so that borrowers can also service the interest and capital of the loan and those of their other debts, and their housing company-related charges for financial costs in the stress scenario as constructed in the stressed calculation of housing affordability.

The stressed interest rates on housing loans, on charges for financial costs and on other debts are set in the calculation to no less than 6%, and the maturity to no more than 25 years. The stressed interest rates and maturities are the same as those in the FIN-FSA Regulations and guidelines 4/2018 on the management of credit risk and assessment of creditworthiness by supervised entities in the financial sector.

If a loan applied for or housing company-related charges for financial costs or other debts are linked to an interest rate cap of below 6%, the term of which is at least 10 years at the moment of loan origination and the repayment schedule for the loan, charges for financial costs or other debts requires regular repayment during the term of the interest rate cap, the interest rate applied to any of these is that specific interest rate cap. If the loan applied for is a fixed-rate loan in which the interest is fixed for at least 10 years and the repayment schedule for the loan requires regular repayment during the term of the fixed rate, the stressed interest rate applied to the loan is the fixed rate set in the agreement. If a housing loan applicant has other fixed-rate debts or housing company-related charges for financial costs, the interest of which, at the origination of the loan applied for, is fixed for at least 10 years and the repayment schedule for the debts or charges for financial costs requires regular repayment during the term of the fixed rate, the stressed interest rate applied to such debts and charges for financial costs is the fixed rate set in the agreement.

The FIN-FSA recommends that, as a rule, the total amount (stressed DSTI ratio) of the stressed monthly servicing costs of a housing loan granted to an applicant and of the applicant's other housing loans, the applicant's stressed housing company-related charges for financial costs, and the stressed monthly servicing costs of the applicant's other debts, is no more than 60% of the applicant's monthly net income.

If an applicant's stressed DSTI ratio is greater than 60% in terms of the applicant's net income, the credit decision should be preceded by a particularly thorough assessment of the customer's repayment capacity with the customer. The FIN-FSA recommends that in such cases lenders make the credit decision on a higher management level. The FIN-FSA expects that, as a benchmark, new housing loans with a stressed DSTI ratio of over 60% should account for no more than 15% of the euro volume of new housing loans granted by the lender in a calendar year.

The purpose of the recommendation is to contain excessive household indebtedness and to contribute to preventing imbalances in the residential property and mortgage market without limiting overall access to housing loans. The recommendation also strengthens the resilience of households to interest rate increases and to shocks affecting personal finances and the macroeconomy, thereby improving the risk resilience of the economy as a whole. Although the stressed calculation of housing affordability technically tests loan applicants' resilience to interest rate rises, the broader objective of the recommendation is to ensure that borrowers and the national economy are better prepared for various unexpected shocks.

The FIN-FSA will supervise compliance with the recommendation and will monitor the share of new housing loans with a stressed DSTI ratio of over 60% in new housing loans granted by the lender and the reasons why such loans have been granted.

The FIN-FSA will specify the recommendation and the related definitions, as necessary.

For the purposes of this recommendation:

- **Housing loan** means a credit granted for the acquisition of a residential asset or for retaining the title to it as referred to in the Consumer Protection Act. If a borrower applies for several loans to acquire a dwelling, the recommendation pertains to all of these. The recommendation does not apply to:
  - situations where a loan applicant transitions from one dwelling to another and the new dwelling is purchased mainly or entirely with short-term bridge funding;
  - short-term bridge funding taken out for building or carrying out a basic renovation of a dwelling; and
  - situations where additional financing is used to prevent or rectify a material decline in the value of collateral.
- **Housing loan applicant** means a person applying for a housing loan or persons applying for a joint housing loan. Also referred to as 'borrower'.
- **Debt-servicing burden** means the aggregate amount of the monthly servicing costs of the following items for which the applicant is liable: the loan to be granted, any other housing loan, charges for financial costs and other debts.
- **Stressed debt-service-to-income (DSTI) ratio** means a housing loan applicant's debt-servicing burden which is calculated by applying the stressed interest rate of each of the applicant's individual loans and the maturity used in the stressed calculation of housing affordability.

- **Stressed loan interest rate**: in the stressed calculation of housing affordability, the stressed interest rate is set at no less than 6% (excluding loans with long-term interest rate hedges and fixed-rate loans), or, if the interest on the loan is above 6%, no less than the nominal interest rate on the loan.
- **Loan maturity**: in the stressed calculation of housing affordability, the maturity is no more than the maturity specified in the loan agreement if that maturity is less than 25 years. In other cases, the maturity is no more than 25 years.
- **Charge for financial costs** means the share of the loans of a housing company which is allocated to the loan applicant's apartment, the capital and interest of which the applicant is obliged to repay to the housing company as a monthly fee.
- **Servicing costs of a housing loan** mean monthly instalments of a housing loan consisting of repayments of capital and interest.
- **Net income** means an applicant's disposable monthly monetary income.
- **Other debts** means debts of the applicant other than housing loans and charges for financial costs the applicant is liable for.