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

At its meeting on 30 September 2019, 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%. The FIN-FSA Board also decided not to extend the validity of the minimum level of 15% for the average risk weight on residential mortgage loans applicable to credit institutions that have adopted the Internal Ratings Based Approach for the calculation of capital requirements, imposed pursuant to Article 458 of the Capital Requirements Regulation. The current risk weight floor requirement expires on 1 January 2021.

There have been no changes in the economic and housing market outlook since the previous macroprudential decision of the FIN-FSA Board on maximum loan-to-collateral (LTC) ratios that would support a deviation from the standard levels, pursuant to chapter 15, section 11 of the Credit Institutions Act, of the maximum LTC ratios for first-home loans or other than first-home loans.

In the current uncertain situation, careful assessment of borrowers' ability to pay is important. The FIN-FSA Board urges lenders to exercise restraint in granting loans that are very large in relation to the applicant's income and have a longer maximum repayment period than usual.

Due to the exceptional situation caused by the coronavirus pandemic, the FIN-FSA Board will place greater emphasis on the cyclical development of the economy and the financial system in its future decision-making on macroprudential instruments. In decisions on the dimensioning of structural macroprudential instruments, the aim is to ensure that their dimensioning supports the recovery of the economy and the financial system in a sustainable manner.

Justifications for the decision

Countercyclical capital buffer requirement

According to the Bank of Finland, based on current data, the economic downturn in 2020 will be smaller than previously assumed. The Finnish economy is forecast to contract by 4.7% in 2020. According to the forecast, the economy will grow by 2.7% in 2021 and by 2.4% in 2022. There is still a great deal of uncertainty associated with the forecasts, but it is clear that the crisis will have a long-term impact on the economy. The negative economic effects of the coronavirus pandemic will also contribute to weakening conditions for financial stability.

The latest value of the primary risk indicator – the private sector credit-to-GDP gap – was clearly negative (−7.2 percentage points) at the end of March 2020. The impact of the coronavirus crisis on the development of the private-sector loan stock was still small in the first quarter of 2020. Corporate loans granted by domestic credit institutions grew more quickly in April–May. The increase in corporate credit, however, is particularly related to increased working capital needs and financial restructurings as a result of the coronavirus crisis, due to which the sharp growth in corporate loans may prove to be temporary.

Of the supplementary macroprudential indicators, the financial market stress index reacted quickly to the coronavirus crisis and rose in April to its highest level since the euro area debt crisis. The stress index fell in May–June from its peak level but remains high.

Based on the available indicator and statistical data, there are no signs that the credit cycle will overheat in the near future, which, together with the weak economic outlook, supports maintaining the CCyB rate at 0%.

Maintaining maximum LTC ratios at their statutory standard levels

At its meeting on 29 June 2020, the FIN-FSA Board decided to restore the maximum LTC ratio for residential mortgage loans other than first-home loans from 85% to its statutory standard level of 90%. The decision sought to counter the cyclical risks arising from the coronavirus crisis that jeopardise the stable functioning of the housing market. The maximum LTC ratio for first-home loans has been at its standard level of 95% since the entry into force of the statutory requirement.

In April–May, the coronavirus crisis reduced significantly the volume of housing sales and new residential mortgage loan drawdowns. In April and May, approximately one third fewer sales of old housing corporation apartments were made than a year earlier. Moreover, drawdowns of new residential mortgage loans were 11% fewer in April and 22% fewer in May than in the previous year. In April–May, on the other hand, house prices remained almost unchanged on average compared with the situation in previous months.

Household indebtedness relative to disposable income rose to a record high level (129.4%) in the first quarter of 2020. The significant number of instalment-free periods granted to households is maintaining growth of the household loan stock. Growth of household income, on the other hand, is expected to slow in the coming years due to the negative labour market effects of the coronavirus crisis, as a result of which the relative indebtedness of households is expected to increase in the next few years.

Recent data on housing sales suggest a pick-up in sales. However, there have been no changes in the economic and housing market outlook since the previous macroprudential decision of the FIN-FSA Board on maximum LTC ratios that would support a change of the maximum LTC ratios for first-home loans or other new housing loans.

Discontinuation of minimum level of risk weights on residential mortgage loans

In June 2017, the FIN-FSA Board decided to impose a credit institution-specific minimum level of 15% for the average risk weight on residential mortgage loans applicable to credit institutions that have adopted the Internal Ratings Based Approach. The minimum level was imposed as a national macroprudential measure pursuant to Article 458 of the Capital Requirements Regulation. The measure was valid from 1 January 2018 to 31 December 2019. In June 2019, it was decided to extend the validity of the requirement until the end of 2020. The decisions were based on the low level of risk weights for residential mortgage loans, both from a risk perspective and compared to the risk weights levels in other EU countries, and on the fact that the risk weights did not sufficiently take into account the multiplier effects of economic disruptions in crisis situations.

High household indebtedness, the large relative share of total bank lending accounted for by residential mortgage loans and the significant proportion of banks' funding accounted for by mortgage-backed market financing continue to be key structural vulnerabilities of the Finnish banking sector. Compared to the situation in 2019, the structural risks in the Finnish housing and residential mortgage market have largely remained unchanged or have slightly increased as a result of the growth in household indebtedness.

At the end of June 2020, the average risk weight of the Finnish residential mortgages of credit institutions that have adopted the Internal Ratings Based Approach was 19.0%, excluding the risk weight floor. The increasing effect on risk weight floor capital requirements was a total of approximately EUR 106 million at the end of June 2020.

The main reason for discontinuing the use of the risk weight floor in the current situation is the small, and in the coming years further declining, actual impact of the instrument on banks' capital requirements. The discontinuation of the risk weight floor is also supported by the need to reduce constraints on banks' ability to provide credit due to the negative effects of the coronavirus crisis.

The small actual impact of the risk weight floor is explained in particular by the fact that the microprudential model constraints and additional requirements imposed on some credit institutions are stricter than the risk weight floor. The impact of the risk weight floor is expected to further decline in 2021 as credit institutions introduce in their IRB models the new definition of default according to EBA guidelines. The EBA's other guidance and regulations on the use of internal models, the ECB's and the FIN-FSA's model audits, and the annual model monitoring of ongoing supervision are also likely to reduce in the near future the effectiveness of the risk weight floor and, more generally, the unjustified variation of risk-weighted items. In addition, future reforms of EU legislation, such as the minimum leverage ratio requirement that enters into force in June 2021 and the minimum level for risk-weighted items included in the Basel III reforms to be implemented later, will limit the capital benefits obtained from internal models and reduce the significance of the risk weight floor.

The requirements imposed pursuant to Article 458 of the EU Capital Requirements Regulation should, in principle, only apply in exceptional cases where other alternative measures do not adequately counter or mitigate systemic risks or where there are problems with the targeting of alternative means. Due to the very small, and in the coming years further declining, actual impact of the risk weight floor for residential mortgage loans, it is no longer appropriate to extend the validity of the requirement.