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

At its meeting on 16 December 2021, 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 tighter 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%.

Lenders should carefully assess borrowers' ability to pay and exercise restraint in granting loans that are large with regard to the borrowers' income and have a longer than usual repayment period. In addition, lenders should particularly take into account potential future changes in total debt-servicing costs so that any increases in interest rates or disruptions in borrowers' debt repayment would not threaten their ability to service their debts or maintain consumption.

The FIN-FSA Board will specify the aforementioned recommendation in the first half of 2022 and will elaborate on, for example, the types of loans lenders should exercise restraint in granting. In the context of issuing the recommendation, the Board will assess the need to impose, by virtue of chapter 10, section 4a–c of the Act on Credit Institutions, a targeted additional capital requirement on the basis of the structural characteristics of the financial system (sector-specific systemic risk buffer) on housing loans where the borrower's debt-to-income (DTI) ratio or debt service-to-income (DSTI) ratio is particularly high.

In the second quarter of 2022, taking into account developments in the economy and financial stability, the FIN-FSA Board will update its macroprudential strategy and will decide on the application of structural macroprudential buffer requirements (systemic risk buffer and a buffer requirement for other systemically important institutions, O-SIIs).

Justification for the decision

Countercyclical capital buffer (CCyB) requirement

The economy has continued to recover from the COVID-19 crisis, both in Finland and globally. The recovery has been supported by a reduction in the economic impact of the health crisis amid improving vaccination coverage and the continuance of a highly accommodative monetary policy. The Finnish business cycle strengthened faster than expected in the early part of 2021, and, according to the Bank of Finland's September forecast, GDP will grow by 3.5% in 2021 and by 2.8% in 2022.
The economic outlook continues to be surrounded by uncertainty, however. New COVID-19 waves may weaken consumer confidence and economic prospects. The Finnish labour market is rebounding,

although the unemployment rate is still higher than prior to the pandemic.

According to a preliminary estimate, the primary risk indicator, i.e. the private-sector credit-to-GDP gap, was –3.6 percentage points at the end of June 2021. The rise in the primary risk indicator witnessed during the pandemic has reversed following the recovery of economic growth from the dip during the COVID-19 crisis. If calculated using the narrow definition of the credit stock, with the latest available data from the second quarter of 2021, the gap was close to zero. The primary risk indicator is less susceptible to revisions using the narrow credit stock, but the data are available with a lag.

In addition, based on supplementary risk indicators and other available indicators and statistics, there are no signs of such a broad-based overheating of the credit market as would require an increase in the CCyB rate. The stock of loans to non-financial corporations is contracting, but the stock of loans to households is growing. In the near future, growth in the corporate loan stock may be supported by the expected recovery in investment.

Extension of the decision on a tighter maximum loan-to-collateral (LTC) ratio

The decision of the FIN-FSA Board of June 2021 to lower the maximum LTC ratio for new residential mortgage loans other than first-home loans from 90% to 85% became effective at the beginning of October. This adjustment is expected to increase the relative share of loans with an LTC ratio of 80–85% in the euro amount of new non-first-home loans in the final quarter of 2021.

From the perspective of Finland's financial stability, the key vulnerabilities are related to the high and rising household indebtedness and the increasingly larger new housing loans with longer maturities. Household indebtedness increased during the pandemic, as debts continued to grow while household income simultaneously decreased. According to most recent data, the rise in indebtedness over the past year has been mainly due to housing loans, whereas loans to housing corporations have played a more minor role. Overall, the growth rate of housing finance has remained more-or-less unchanged. Households' borrowing and home purchase intentions together with favourable financing conditions indicate that housing market activity will remain brisk.

In the second quarter of 2021, the ratio of total household debt relative to disposable income (debt-to-income ratio, DTI) grew to 135.3%, once again a new record level. The DTI ratio was boosted by both the weak development of disposable income and by housing loans. This differs from the pre-pandemic years, when housing loans grew at roughly the same pace as income and indebtedness grew largely on account of loans via housing corporations and consumer credit from outside the Finnish credit institutions sector. Total household debt at the end of

June 2021 was 3.7% up on the previous year, while annual income remained unchanged. Debt decreased slightly relative to GDP, which grew faster than income.

House sales and residential mortgage lending moderated somewhat in the summer and autumn compared with the liveliest period in the spring. In March–October, the stock of housing finance grew in euro terms by far the most on account of owner-occupied residential mortgages. In relative terms, however, buy-to-let mortgages and loans to housing corporations grew at a faster pace (statistical data collection on buy-to-let mortgages commenced in March). Loans with a longer-than-usual repayment period, i.e. a maturity of over 26 years, accounted for some 14% of the euro amount of all new housing loans, or slightly above the average for earlier in the same year. The majority of these loans have a maturity of about 30 or 35 years, and they have also typically been larger than other new housing loans. In the first half of 2021, both first-home loans and other new housing loans were larger than on average, but in the second quarter the situation remained largely unchanged.

The share of loans with an LTC ratio of 80–85% or above 85% in new residential mortgage loans other than first home loans was slightly higher (10.8% and 11.2% respectively) in the second quarter of 2021 than in the first quarter (10.5% and 11.0% respectively). Over the same period, the share of loans with an LTC of over 90% in the euro volume of new first-home loans declined and was notably smaller than the highest level recorded in the third quarter of 2020 (24.9%).

Households' financial assets have grown faster during the pandemic than liabilities, and in the second quarter of 2021 net financial assets grew by about 5% from the preceding quarter. The recent growth in deposits will support households' debt-servicing capacity and consumption in a potential stress situation. The significance of financial assets in countering stability threats is partly reduced by the uneven distribution of assets and liabilities among households. According to Statistics Finland's survey on household assets, 59% of households had debts at the end of 2019. Over one-fourth of household debts were held by households that were heavily indebted relative to income. While the income and wealth level of the most indebted households was relatively high, the amount of financial assets relative to their debts was, however, rather small.

The decision taken by the FIN-FSA Board in June 2021 and effective in October to tighten the maximum LTC ratio to 85% for new residential mortgage loans other than first-home loans is still 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 tightened at this stage.

Update of the FIN-FSA Board recommendation and other measures

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 applicant's income and have a longer maximum repayment period than usual. A corresponding recommendation has since been issued on a quarterly basis in connection with the macroprudential decision.

The recommendation aims at preventing excessive growth in household indebtedness in relation to income, and it complies with Recommendation ESRB/2019/8 of the European Systemic Risk Board, as part of which Finnish authorities are urged to introduce non-binding borrower-based measures to curb indebtedness.

In the course of 2021, the need to update the recommendation of the FIN-FSA Board has emerged because: (i) the proposal to limit the debt-to-income (DTI) ratio put forward by the Ministry of Finance working group on tools limiting household indebtedness is not planned to be included in the forthcoming government proposal to Parliament and (ii) a follow-up assessment published by the ESRB considers that Finland is only partially compliant with the ESRB Recommendation.

It is justified to update the recommendation of the FIN-FSA Board so that it would, on one hand, prevent excessive growth in household indebtedness and, on the other hand, better correspond to the ESRB Recommendation. In addition to avoiding large DTI ratios, it is justified that the FIN-FSA Board's recommendation pay attention to the careful assessment of borrowers' debt-servicing capacity and the fact that debt-servicing expenditure would not reach too high a level in relation to income, as required by the ESRB Recommendation.

It is necessary to specify the FIN-FSA Board recommendation in the course of 2022 in the light of updated credit data and based on a careful further analysis. It would be justified to specify in the recommendation the types of loans lenders should exercise restraint in granting and how compliance with the recommendation will be monitored. The revised recommendation would also take into account the possibility for creditors to deviate from the recommendation in a certain part of the volume of lending.

Going forward, instead of a binding DTI ratio for households, other measures could also be considered in order to prevent excessive growth in household indebtedness. Such measures could include the imposition of a sector-specific systemic risk buffer on housing loans where the debtor's DTI ratio or the debt-service to income (DSTI) ratio is high. The need for these measures will be assessed in connection with the adoption of the specified recommendation.

The assessment/decision on the structural macroprudential buffer requirements in line with the amendments to the Credit Institutions Act and the update of the macroprudential strategy of the FIN-FSA Board are scheduled to take place in the second quarter of 2022.