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

At its meeting on 30 September 2024, the Board of the Financial Supervisory Authority (FIN-FSA) decided that the countercyclical capital buffer (CCyB) requirement referred to in chapter 10, section 4 of the Act on Credit Institutions (610/2014) will be kept at 0.0%. The Board also decided that the maximum loan-to-collateral (LTC) ratio referred to in chapter 15, section 11 of the Act on Credit Institutions and in section 14 of the Act on the Registration of Certain Credit Providers and Credit Intermediaries (186/2023) will remain at its standard level of 90%. The maximum LTC ratio for first-home loans will also be kept at its standard level of 95%.

In addition, the Board of the FIN-FSA has decided, in accordance with chapter 10, section 4d of the Act on Credit Institutions and section 10(1)(6) of the Act on the Financial Supervisory Authority, to adopt the sector-specific systemic risk buffer requirement (sSyRB) of 7.0% imposed on 26 April 2024 by the Danish macroprudential authority (Erhvervsministeriet) to be applicable, in accordance with the decision and subject to exceptions specified therein, to Finnish credit institutions’ exposures in Denmark to entities operating in the real estate sector. The requirement is applicable both at the consolidated and individual company level to consolidation groups and credit institutions with relevant exposures in Denmark in excess of EUR 200 million. Due to the overlap of the risks covered by the Danish sSyRB and the Finnish national systemic risk buffer (SyRB) (the requirements address the same exposures), pursuant to chapter 10, section 9(3) of the Act on Credit Institutions, credit institutions must only meet the higher of these requirements. The requirement will enter into force on 1 January 2025.

Keeping the countercyclical capital buffer requirement at the level of 0.0%

The global and euro area economies have shown signs of a recovery in the first half of the year. The Finnish economy saw mild growth in the first half of 2024. Nevertheless, the short-term cyclical outlook remains sluggish. The employment situation has weakened during the early part of this year, and inflation has slowed down significantly. According to the Bank of Finland's September interim forecast, the Finnish economy will begin to pick up gradually next year.

The forecasted development includes uncertainties. Geopolitical tensions create instability in the world economy, and if the tensions intensify, they could also be channelled into the Finnish economy and lead to disruptions in the financial markets. If financing conditions remain tight longer than expected, it could delay the recovery of the economy. On the other hand, economic growth may recover faster than expected if exports, investments and private consumption strengthen more than anticipated.

In light of indicators of private sector indebtedness and development of the credit stock, the financial cycle is very sluggish, but the contraction in lending appears to be ending. There are no signs of a strong cyclical upturn. The primary risk indicator – the deviation of the private sector credit-to-GDP ratio from its long-term trend, or the credit-to-GDP gap, remained clearly negative (-16.5 percentage points) at the end of June 2024. Trend deviation calculated with a more narrow concept of credit also remained clearly negative (-11.0 percentage points). The stock of household loans from financial institutions has contracted, but the stocks of loans to non-financial corporations and housing corporations have grown slowly.

The supplementary risk indicators do not point to a significant increase in the cyclical stability risks associated with total lending. Although the cyclical situation in the housing market remains sluggish, the decline seems to have levelled off to some extent. The current account is expected to remain negative over the following years but the deficit is estimated to decrease gradually. Hence, an overall assessment based on the risk indicators used does not support the application of a countercyclical capital buffer requirement.

Keeping the maximum LTC at standard level

The housing and mortgage markets remain sluggish, but the downward trend has shown signs of levelling off. Housing sales and new mortgage lending lagged behind last year's levels in the first year-half, but housing sales increased in July–August. In July, housing prices were slightly above their low at the beginning of 2024.

The housing markets are expected to pick up gradually in the second half of 2024 and in 2025. Developments consistent with economic forecasts and market interest rate expectations would improve households' purchasing power, facilitate debt servicing and gradually strengthen the demand for dwellings and mortgage loans. Banks' expectations of household credit demand increased in the survey conducted in the first half of 2024.

Household indebtedness has declined from the first quarter of 2022 in particular as new mortgage borrowing has decreased and disposable nominal income has grown rapidly. This has alleviated vulnerabilities related to mortgage lending and household indebtedness. Indebtedness is estimated to remain largely unchanged over the next few years if the economy and interest rates develop in line with forecasts and market expectations.

For the time being, there are no signs of overheating in the housing or mortgage markets. The downswing of the housing markets has shown signs of levelling off, and both housing sales and mortgage lending are expected to pick up gradually towards the end of the year if interest rates decline as expected and consumers' confidence in the economy strengthens.

According to the FIN-FSA's assessment, no such significant changes have occurred in the macrostability environment that would lead to exceptional growth in financial stability risks and thereby warrant a readjustment of the maximum LTC ratio from its current standard level.

Reciprocation of the sector-specific systemic risk buffer requirement set by the Danish Ministry for Business, Industry and Financial Affairs

In October 2023, the Danish Ministry for Business, Industry and Financial Affairs (Erhvervsministeriet), which functions as Denmark's macroprudential authority, decided to activate an sSyRB requirement of 7.0% for certain exposures to Danish real estate companies. On 5 January 2024, the European Commission approved the requirement in accordance with favourable opinions by the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA).

On 26 April 2024, the Danish macroprudential authority respecified and confirmed its decision.[1] In the initial notification, the macroprudential authority requested the authorities of other EEA countries to reciprocate the systemic risk buffer requirement with respect to Danish exposures of these countries' credit institutions and the ESRB to recommend this. The notification was respecified on 10 June 2024.[2] The ESRB issued its recommendation concerning the Danish sSyRB requirement on 8 July 2024. The recommendation was published in the Official Journal on 16 August 2024.[3] The Danish supervisory authority (Finanstilsynet) provided guidance on the application of the sSyRB in a release dated 28 August 2024.[4]

The Danish Ministry for Business, Industry and Financial Affairs justifies the activation of a sSyRB requirement, in particular, by the size of the real estate company sector, risks of the sector's entities that threaten financial stability, and the interconnectedness of the entities with other financial market participants. Exposures to real estate companies make up 14% of total lending by Danish credit institutions and 37% of their lending to non-financial corporations. The operation of real estate companies is highly cyclical and sensitive to the level of interest rates. The high level of interest

[1] https://www.em.dk/aktuelt/nyheder/2024/apr/information-om-fastsaettelse-af-systemisk-buffer-maalrettet-udlaan-til-ejendomsselskaber
[2] https://www.eng.em.dk/Media/638597491082626421/DK%20revised%20Notification%20for%20activation%20of%20systemic%20risk%20buffer_2024-06-07_corrected.pdf
[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32024Y05044&qid=1724080903323
[4] https://www.finanstilsynet.dk/nyheder-og-presse/nyheder-og-pressemeddelelser/2024/jul/indberetning-af-den-systemiske-buffer

rates weakens these entities' financial position and increases the probability of them becoming unable to service their obligations. High interest rates also reduce the value of real estate as an asset. Historically, credit institutions have recorded large losses on loans to the real estate sector. Real estate companies account for approximately 20% of economic activity in Denmark, and developments in the sector can contribute to amplifying cyclical fluctuations, especially via construction activity. Furthermore, the sector is capital intensive and dependent on external financing such as that provided by the pension system.

Strengthening the capital position of the credit institutions sector increases the resilience of the sector and of individual credit institutions and reduces the probability that losses would affect other financial market participants and threaten broader financial stability. The Danish measure is assessed to have a positive impact on the functioning of the single market as it reduces stability risks. The Danish Ministry for Business, Industry and Financial Affairs also states, in line with the recommendation of the ESRB, that the sSyRB does not overlap with other applicable macroprudential instruments, such as the other systemically important institutions buffer (O-SII buffer).

The activation and calibration of the Danish sSyRB requirement are justified by a scenario-based quantitative sensitivity analysis, described in detail in the Recommendation of the Danish Systemic Risk Council (det Systemiske Risikoråd) to the Ministry for Business, Industry and Financial Affairs on the activation of a systemic risk buffer requirement.[5] The buffer rate has been set to a level sufficient to absorb losses arising in the real estate sector in a stress situation. Thus, market confidence in credit institutions would be maintained while allowing credit institutions to continue lending to the real economy.

The FIN-FSA finds that the notification issued by the Danish Ministry for Business, Industry and Financial Affairs describes in detail, as set out in Article 133(9) of the Capital Requirements Directive (CRD), the grounds for activating an sSyRB requirement, and that the notification includes the information specified in Article 133(13), which the FIN-FSA has taken into consideration. The recognition of the measure strengthens its effectiveness and also fosters a level playing field for credit institutions. For these reasons, it is warranted to adopt the Danish sSyRB requirement and apply it to Finnish credit institutions.

The FIN-FSA finds that prudential requirements applied in Finland do not cover risks of the Danish commercial real estate (CRE) sector, with the

[5] Recommendation on activation of a sector-specific systemic risk buffer for corporate exposures to real estate companies, 3 October 2023, https://systemicriskcouncil.dk/Media/638319298754090882/Recommendation.pdf. See also https://systemicriskcouncil.dk/Media/638497215046779511/EN%20-%20DSRR%20-%20Considerations%20regarding%20sector-specific%20systemic%20risk%20buffer.pdf.

exception of the national systemic risk buffer (SyRB) requirement. Pillar 1 and 2 requirements are, by nature, microprudential measures with the objective of ensuring the capital adequacy of a credit institution in a crisis situation affecting a single institution, instead of preventing systemic risks. The O-SII buffer requirement applicable to other systemically important institutions is set based on general grounds laid down in the Credit Institutions Act. Due to the overlap of the risks covered by the Danish sSyRB buffer requirement and the national Finnish SyRB requirement (both address the same exposures), pursuant to chapter 10, section 9(3) of the Act on Credit Institutions, credit institutions must only meet the higher of these requirements. In accordance with Article 134(4) of the Capital Requirements Directive, where Member States recognise a systemic risk buffer rate for domestically authorised institutions, that systemic risk buffer may be cumulative with the systemic risk buffer applied in accordance with Article 133, provided that the buffers address different risks. Where the buffers address the same risks, only the higher buffer shall apply.

In accordance with the FIN-FSA's decision of 29 March 2023, the national Finnish SyRB requirement addresses a credit institution's all risks (except for those covered by other macroprudential instruments). The requirement was imposed on the basis of the high structural vulnerability of the Finnish credit institution sector arising in particular from the sector's large size, cross-country interconnectedness, large risk concentrations relating to residential mortgage and real estate lending, and, among key customer groups, the high indebtedness of households, in particular. The recommendation of the ESRB on the Danish sSyRB leaves it to the discretion of the EEA Member States' reciprocating authorities to assess whether buffers address same or different risks.

The Danish buffer requirement is, in accordance with the Danish notification and the ESRB's recommendation, applicable on both a consolidated and an individual company level to consolidation groups and credit institutions whose risk-weighted exposures located in Denmark exceed EUR 200 million.

With respect to the time of entry into force of the requirement, the FIN-FSA Board considered two options: (i) in accordance with the ESRB's recommendation, three months from the publication of the recommendation and (ii) longer entry into force period (12 months) as applied previously in connection with the reciprocation of the Norwegian systemic risk buffer requirement. The longer transition period would be consistent with the transition period of the national systemic risk buffer requirement applied in Finnish legislation and previous practice. In addition, the longer option would allow a longer period for credit institutions to adjust their activities before the entry into force of the requirement. On the other hand, the shorter 3-month transition period would be consistent with the ESRB's recommendation, support the functioning of the internal market within the European Economic Area and ensure a level playing field for credit institutions in different countries, in circumstances where the impact of the reciprocation of the requirement is more limited than that of the Norwegian requirement.

In accordance with the decision adopted by the Board, the Danish sSyRB requirement will be applicable to Finnish credit institutions from 1 January 2025, following a transition period of three months from the beginning of the quarter following the publication of the ESRB's recommendation. In its decision, the Board emphasises the importance of the functioning of the EEA's internal market in the context of reciprocation of requirements set by other EEA member states. According to the FIN-FSA's assessment, Finnish legislation does not require application of the 12-month transition period of the national SyRB to the reciprocation of a requirement imposed by another EEA member state authority. In the reciprocation of requirements from other EEA member states, the Board primarily seeks to comply with the ESRB's recommendations unless there are weighty reasons to deviate from them.

The entry into force of the requirement in the middle of a month and reporting period could be likely to cause additional administrative burden and technical challenges for credit institutions. Therefore, the entry-into-force period will be calculated from the beginning of the quarter following the publication of the ESRB's recommendation.

Responses to the hearing – In a hearing addressed at credit institutions under section 34 of the Administrative Procedure Act, Nordea Bank Abp submitted its written response to the FIN-FSA within the deadline of 9 September 2024. The FIN-FSA Board has taken the considerations presented in the response into account in its decision making regarding the reciprocation of the Danish sector-specific systemic risk buffer requirement.

In accordance with the response, Nordea Bank Abp opposes to the planned reciprocation decision. According to Nordea Bank Abp, the requirement cannot be approved for application in Finland on account of the following:

(i) The Finnish Credit Institutions Act does not acknowledge the justifications used in the notification for setting the Danish requirement, and the requirement is non-compliant with the EBA Guidelines on appropriate subsets of sectoral exposures in the application of a systemic risk buffer to the extent that they concern the definition of subsets.

(ii) Nordea Bank Abp's exposures to the Danish CRE markets do not involve such risk that is not covered by existing capital requirements at the time of the reciprocation decision.

(iii) No evidence has been presented to the effect that the potential reciprocation decision would ensure a level playing field for banks. [redacted]

[redacted] Nordea Bank Abp is also subject to the high Finnish national O-SII buffer and SyRB requirements that cover all risks.

(iv) A decision on the reciprocation of the Danish sSyRB requirement, which in practice only concerns Nordea Bank Abp, should be based on a thorough assessment by all relevant authorities of an appropriate and fair capital requirement. Such an analysis has not been provided to Nordea Bank Abp as part of the hearing documentation.

(v) The FIN-FSA should take into account the EBA opinion addressed to the EU Commission on the Danish requirement as well as the provisions of the Credit Institutions Act stating that reciprocating authorities should avoid covering the same risks concurrently with different capital measures.

Should the FIN-FSA decide to approve the Danish sSyRB for application to Nordea Bank Abp, the requirement should have an entry into force period of at least 12 months from the date the FIN-FSA's decision.

[redacted] Nordea Bank Abp does not see a need to impose macroprudential requirements on these exposures, especially considering the current weak phase of the economic cycle. According to Nordea Bank Abp, neither overheating nor a systemic risk concentration can be seen in the Danish CRE sector. [redacted]

[redacted]

[redacted]

[redacted] Nordea Bank Abp is adequately capitalised with respect to the risks, both on a solo basis and at the consolidation group level. Reciprocation of the Danish sSyRB would, de facto, only apply to Nordea Bank Abp among Finnish credit institutions. Therefore, it is necessary for the FIN-FSA in its decision making to consider the bank's individual risk profile and business operations.

According to Nordea Bank Abp's view, the high O-SII buffer requirement and SyRB requirement established by the FIN-FSA, Nordea Bank Abp already holds, at the consolidation group level, more capital than is required by the risks. [redacted]

According to Nordea Bank Abp, the potential reciprocation decision by the FIN-FSA would bring along overlaps of covering the same risks with different macroprudential instruments. However, the hearing letter received by Nordea Bank Abp does not include any quantitative analysis of the risks. The hearing letter only refers to the intent statements of the different instruments and does not consider the actual overlaps between the instruments, which are substantial, according to Nordea Bank Abp. The national SyRB requirement was set for credit institutions' residual risk based on stress tests to complement other requirements. In combination with the reciprocation of the Danish requirement, the national SyRB would lead to capital requirements excessive from a risk perspective and create a non-level playing field, an issue also addressed in the EBA opinion on the Danish macroprudential measure. In Nordea Bank Abp's view, the justification of setting the national SyRB should also be reconsidered. In the event that the FIN-FSA reciprocates the Danish requirement, this should be reflected in the level of the national SyRB. As regards the O-SII buffer requirement, Nordea Bank Abp points out that, in universal banking, the amount of CRE exposures correlates with the size of the bank, as a result of which, these risks are already covered by the O-SII requirement.

According to Nordea Bank Abp's response, Danish cyclical risks should be covered using the countercyclical buffer (CCyB) requirement. In Nordea Bank Abp's opinion, in the notification submitted by Danish authorities to the ESRB, the Danish sSyrB acts incorrectly as a negative CCyB for the CRE sector, increasing capital requirements when there is a risk of adverse developments. This leads to higher buffers regardless of the phase of the cycle, amplifying the procyclicality of the capital requirements.

[redacted]

[redacted] Nordea Bank Abp expects the FIN-FSA, in cooperation with the ECB and Danish authorities, to make a holistic effort to ensure a level playing field between Nordea Bank Abp and its competitors in circumstances where reciprocation decision would de facto only impact Nordea Bank Abp.

Nordea Bank Abp states it is not clear whether the sensitivity analysis applied by the Danish authorities in the calibration of the sSyRB takes into account Nordea Bank Abp or any of its subsidiaries. If not, the results of the analysis may not reflect the reality from the perspective of Nordea Bank Abp. The supervision and operations of Nordea Bank Abp differ from those of Danish credit institutions, and therefore the capital impacts of the sensitivity analysis are different. Furthermore, the sensitivity analysis provided demonstrates several weaknesses. In Nordea Bank Abp's understanding, the stress calculations made by the FIN-FSA in 2023 to calibrate the level of the national Finnish systemic risk buffer requirement already accounted for the risks of the Danish CRE sector. Nordea Bank Abp also notes that the FIN-FSA has not presented an analysis of the costs associated with the reciprocation decision to the economy at large. The FIN-FSA should present quantitative risk analyses to support the planned reciprocation decision.

With respect to the application of legislation, Nordea Bank Abp emphasises not only compliance with national legislation but also the guiding role of EU-level regulation. The FIN-FSA should make an independent decision as to whether the macroprudential instruments already being applied are sufficient to address the risks intended to be covered and whether there are overlaps in the application of the macroprudential instruments. In Nordea Bank Abp's understanding, the Ministry of Finance Decree (409/2021) on the additional capital requirement for a credit institution and investment firm based on the structural characteristics of the financial system should be applied in connection with the potential reciprocation decision. Denmark's notification explicitly refers to cyclical risks as a basis for the activation of the requirement. Since Finnish regulation concerning the systemic risk buffer requirement, in contrast with EU regulation, does not recognise cyclical risks as a basis for the activation of the systemic risk buffer requirement, the Danish requirement cannot be approved for application in Finland.

Nordea Bank Abp also finds that the Danish requirement contradicts with the EBA Guidelines on the appropriate subsets of sectoral exposures in the application of a systemic risk buffer, to the extent that the recommendation concerns the definition of subsets of sectoral exposures. The FIN-FSA has announced it applies the Guidelines to Finnish credit institutions.

FIN-FSA's assessment of the responses - In accordance with section 4d of the Credit Institutions Act, the Financial Supervisory Authority may decide on the application of an additional capital requirement as referred to in section 4b set by the supervisory authority of another EEA country to a credit institution's balance sheet items and off-balance sheet commitments located in that country. In the FIN-FSA's opinion, the hearing concerning the reciprocation of the Danish sector-specific systemic risk buffer requirement was carried out in accordance with section 34 of the Administrative Procedure Act.

The FIN-FSA sees that the notification and decision of the Danish authorities regarding the sector-specific systemic risk buffer requirement list and describe in detail the structural risks that endanger the stability of the Danish commercial real estate sector and financial markets. The Danish Ministry for Business, Industry and Financial Affairs justifies the activation of a sSyRB requirement, in particular, by the size of the real estate company sector, risks of the sector's entities that threaten financial stability, and the interconnectedness of the entities with other financial market participants. The notification also refers to cyclical risks that could be amplified by structural risks, but in the FIN-FSA's view, the risks listed are primarily structural on account of their relative persistence. In addition, according to the Finnish Act on Credit Institutions, the FIN-FSA's reciprocation decision is concerned with a similar, not identical, systemic risk buffer requirement of another EEA country. The FIN-FSA also considers that section 4d of the Act on Credit Institutions, which provides on the reciprocation of another EEA member state's systemic risk buffer requirement, does not contain a reference to the Ministry of Finance Decree (409/2012) or provide the power to issue a decree, and therefore the Decree is not applicable to the reciprocation of a requirement imposed by another EEA member state. According to information received from Danish authorities, Nordea Bank Abp with its subsidiaries have been taken into consideration in the sensitivity analysis to calibrate the level of the Danish requirement.

According to Nordea Bank Abp, the requirement contradicts with the EBA Guidelines on the appropriate subsets of sectoral exposures in the application of a systemic risk buffer to the extent that the Guidelines concern the definition of subsets of sectoral exposures. This is because of the selections and exclusions made in respect of the subsets. In the FIN-FSA's opinion, this guidance involves ambiguity, and the Guidelines are intended for the activation, and not the reciprocation, of an sSyRB requirement.

The decision on the reciprocation of the Danish sSyRB requirement provides an explanation above as to why the risks for which the Danish systemic risk buffer requirement was set are not covered by other additional capital requirements. [redacted] The FIN-FSA agrees that the Danish and Finnish systemic risk buffers partly address the same risks. Due to the partial overlap of the risks covered by the Danish sector-specific systemic risk buffer requirement and the Finnish national systemic risk buffer requirement, a credit institution must only meet the higher of these requirements (chapter 10, section 9(3) of the Act on Credit Institutions).

The micro- and macroprudential capital requirements currently applicable to Nordea Bank Abp are based on valid national and EU regulation. National and EU regulation concerning credit institution activities establish a level playing field for credit institutions operating in the EEA. EU regulation and national Finnish regulation specify in detail how decisions on the application of macroprudential instruments are to be made when the FIN-FSA applies valid regulation in its decision making.

The FIN-FSA considers the impacts of its decisions on the operation of credit institutions, the stability of the financial system and, where relevant, to the national economy. The assessments of impacts on financial stability in general and the economy are primarily qualitative. Regulation concerning the FIN-FSA’s activities does not include an obligation to conduct quantitative impact assessments. The impacts of the reciprocation of the Danish requirement concerned are minor in all respects.

The decision on the reciprocation of the Danish sector-specific systemic risk buffer requirement above lays out the justifications why the FIN-FSA has decided that the requirement shall enter into force on 1 January 2025.