

# Reciprocity for the macro-prudential measure imposed by the Finanssivalvonta (Finland)



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On 27 June 2017 the Finanssivalvonta notified the European Parliament, the Council, the Commission, the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA) of its decision to impose a minimum weight floor for the average risk weight on residential mortgage loans secured by a mortgage on housing units in Finland. This floor will be applied to credit institutions using the internal ratings based approach (IRB) for estimating said weight and was introduced under Article 458 of Regulation No 575/2013 on prudential requirements for credit institutions and investment firms.

Upon notification of the measure, the Finanssivalvonta requested that the ESRB issued a recommendation with the purpose of encouraging the other European Union (EU) Member States to reciprocate this measure. It was included in Recommendation ESRB/2018/1 of 8 January 2018 amending Recommendation ESRB/2015/2 (Recommendation C of Section 1 and Annex).

Paragraph 2 (d) (vi) of Article 458 of the CRR lays down the possibility of EU Member States changing risk weights for targeting asset bubbles in the residential property sector.

This Article lays down the conditions and the procedure to be followed by the national authorities seeking to obtain authorisation for its use. Among other requirements, it empowers the ESRB and EBA to prepare opinions that will sustain the European Commission's proposal to the European Council on the tacit approval of the measure or the implementation of an act to reject it. As regards the Finnish macroprudential measure in question, none of the mentioned authorities expressed their opposition, and thus it entered into force on 1 January 2018.

The Finanssivalvonta justified imposing a minimum weight floor of 15% for the credit institution specific average risk weight with a series of structural vulnerabilities and risks, in particular:

- high household indebtedness, particularly as regards residential mortgage loans. In fact, the debt-to-income ratio

rose to 126.9% at the end of 2016, against 67.5% at the end of 2000, thus standing at historical highs.

- In parallel with the rise in indebtedness, the average maturity of loans and their average amount have also been rising, accounting for additional risk factors. Moreover, most agreements are variable-rate, which enhances household exposure to changes in macroeconomic conditions.
- In addition, around one quarter of loans were granted to households with high debt-to-income ratios, and thus the risks are not homogeneously distributed.
- High exposures of banks to the residential real estate sector, in particular institutions that estimate risk weights using the internal ratings based approach (IRB). Given that there have been no recent real estate crises in Finland, the average risk weights obtained are very low.
- Banks' dependence on market financing collateralised by covered bonds. These bonds are issued against the residential mortgage loans granted by banks.

Furthermore, this measure is an indirect response to the ESRB's warning published in November 2016 on vulnerabilities in the residential real estate sector in Finland, namely the high and rising indebtedness of households, especially in a specific sub-group.<sup>1</sup>

According to the Finnish macroprudential authority, no corrections were proposed to the IRB approach used by institutions, given that the computed low average risk weights were considered not to stem from inadequate model calibration, but rather from the fact that there have been no recent crises in the Finnish real estate sector.

The reciprocity of macroprudential measures applied to specific exposures concerns exposures to Finland held directly or through Finnish located branches of Portuguese banks.

Banco de Portugal has assessed the materiality of the Portuguese financial sector's exposures to Finland, and concluded that these are not significant, both as a percentage of the Portuguese banking system's total assets and as a percentage of the Finnish banking system's total assets (both ratios amount to 0%, according to FINREP data for June 2017).

Although there are currently no material exposures, Banco de Portugal has decided to reciprocate the measure as a matter of principle, as provided for in paragraph (15) of Recommendation ESRB 2015/2.

This decision will remain in force for as long as the measure applied by the Finanssivalvonta is in place, including any reviews thereof.

Given that the measure imposed by the Finnish macroprudential authority is provided for in the Portuguese legal framework, reciprocity will be operationalised through the same measure.

## Notes

1. *ESRB warnings – Vulnerabilities in the EU residential real estate sector*. Available at: <https://www.esrb.europa.eu/news/pr/date/2016/html/pr161128.en.html>