Analysis

# Finland's neighbours rein in lending for house purchase

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Finland's neighbouring countries have actively adopted macroprudential instruments to counter stability risks relating to lending for house purchase. Sweden and Norway are taking strong measures to restrain housing credit growth and the associated risks. Of the Baltic States, Estonia and Lithuania, in turn, have imposed limits on the maximum loan servicing costs and length of housing loans so as to prevent risks proactively. Finland has adopted new macroprudential instruments more slowly. The loan-to-value cap that will enter into force in Finland in summer 2016 is more lenient than the requirements imposed in neighbouring countries.



## Macroprudential instruments tightening capital adequacy requirements for banks

The macroprudential instruments that affect housing credit can be broken down into three groups: instruments that tighten banks' capital adequacy requirements, those that strengthen the balance-sheet position of households with housing debt and those that ensure an adequate debt-servicing capacity in households with housing debt.

*Macroprudential instruments that tighten banks' capital adequacy requirements*, such as risk weights for housing loans, are primarily aimed at ensuring banks have sufficiently large capital buffers against unexpected losses on housing loans in crisis situations.

Sweden and Norway have increased the minimum risk weights on housing loans. Sweden's authority in charge of financial and macroprudential supervision – *Finansinspektionen* – raised the average risk weight floor for housing loans for banks using the Internal Ratings Based approach, initially to 15%, and later to 25%. In Norway the risk weight requirements were practically doubled by raising the minimum value of the loss given default parameter (LGD floor) used in the calculation of risk weights from 10% to 20%.

Large Finnish banks' average risk weights for housing loans have been under 10%, i.e. low by

international comparison. Finland's macroprudential authority – the Financial Supervisory Authority (FIN-FSA) – announced in December 2015 that it had commenced preparations for raising the risk weights.

## Macroprudential instruments ensuring adequate loss tolerance of households with housing debt

The maximum loan-to-value (LTV) ratio (loan cap) for housing loans partly resembles banks' capital adequacy requirements: the loan cap helps to ensure that households that have taken out a housing loan have sufficient loss buffers (net equity, self-financing share) at the time the loan was granted to cover them against falling house prices, unemployment and other serious financial risks.

The loan cap is the most used macroprudential tool among the Nordic countries and the Baltic States (see Table). Finland and Iceland are the only ones among these countries that have not yet enforced a loan cap. In Finland, the loan cap will become effective in July 2016 and in Iceland, in 2017.

The level of loan cap ranges between 85% and 95% in the Nordic countries and the Baltic States (Iceland has not yet decided on its level). In Finland, the cap on new housing loans will be 90% and for first-time homebuyers, 95%. The Board of FIN-FSA has the right to reduce the LTV ratio by 10 percentage points, if necessary.

Table.

**Macroprudential instruments in the Nordic countries and the Baltic States**

| Instrument | Country | Level, % |
|---|---|---|
| Risk weights on housing loans | Norway | 0.2, 20[1)] |
| | Sweden | 25 |
| Loan-to-value (LTV) ratio (loan cap) | Iceland | Not yet decided |
| | Latvia | 90 |
| | Lithuania | 85 |
| | Norway | 85 |

***Source: Nordic-Baltic Macroprudential Forum.***

| Macroprudential instruments in the Nordic countries and the Baltic States | | |
|---|---|---|
| | Sweden | 85 |
| | Finland | 90 / 95 (2016/III) |
| | Denmark | 95 |
| | Estonia | 85 |
| Amortisation requirements | Norway | LTV > 70%: 2.5% p.a. |
| | Sweden (2016) | LTV > 70%: 2% p.a.<br>70% > LTV > 50%: 1% p.a. |
| Debt service-to-income (DSTI) ratio | Lithuania | 40 |
| | Estonia | 50 |
| Maximum loan maturity | Lithuania | 30 yr |
| | Estonia | 30 yr |
| 1) Probability of default (PD) floor 0.2% (2015). Loss given default (LGD) floor 20% (2013). | | |

*Source: Nordic-Baltic Macroprudential Forum.*

How stringent loan cap regulation is depends on the level of the cap and the calculation method. In most countries, the loan cap limits the maximum size of a housing loan relative to the value of the house purchased and used as collateral for the loan.

In Finland, the method for calculating the loan-to-value ratio of a borrower is exceptionally lenient: besides the house to be purchased, a wide range of other collateral offered by the borrower (and accepted by the lender) can also be taken into account in calculating the maximum loan amount (loan-to-collateral, LTC). Consequently, the LTV ratio (as typically calculated) may be fairly high in the case of some borrowers and exceed the value of the housing. However, it should be noted that the FIN-FSA Board has the right to restrict the type of collateral accepted in calculating the loan-to-value ratio.[1]

The ability of households with housing debt to withstand shocks to housing markets and their own finances improves as they repay their debts and thus ease their debt burden. Average housing loan maturities are considerably shorter in Finland than in e.g. Sweden and Denmark, and households also typically amortise their loans on a monthly basis.

In Sweden, *Finansinspektionen* has finally, after sustained efforts, won the right to impose amortisation requirements for housing loans with an LTV ratio of at least 50%.[2] The related Act entered into force in May 2016 and the actual amortisation requirements started to apply as from June 2016. Norway has also imposed an amortisation requirement for housing loans with an LTV ratio of over 70%.

Regulation on the maximum length of loans can pursue the same objectives as loan amortisation requirements. Estonia and Lithuania have imposed a maximum maturity of 30 years on new housing loans.

## Macroprudential instruments ensuring adequate debt-servicing ability of households with housing debt

The third group of macroprudential tools influencing housing credit aims to ensure that the debt-servicing ability of households with housing debt is sufficient even under straining conditions. Such instruments can e.g. limit the maximum amount of housing loan relative to a household's annual income (loan-to-income ratio, LTI) or the household's maximum debt servicing burden per month relative to available income (debt service-to-income ratio, DSTI).

At least so far, there has been little use of these instruments in the Nordic countries and the Baltic States. Exceptions are Lithuania and Estonia, which have adopted DSTI ratios of 40% and 50%, respectively. The DSTI requirement limits the maximum size of new housing loans so that debt servicing does not require a higher share of a household's monthly available income than determined in the requirement.

## Notes

1. See FIN-FSA regulation on the calculation of loan-to-value ratio (issued in November 2015): http://www.finanssivalvonta.fi/en/Regulation/Regulations/New/Pages/03_2015.aspx. ↑
2. See Finansinspektionen's press release (20 April 2016): http://www.fi.se/Folder-EN/Startpage/Press/Press-releases/Listan/Amortisation-requirement-for-new-mortgages1/. ↑

## Keywords

Baltic States, housing loans, macroprudential instruments, Nordic countries