Analysis

Banks' macroprudential buffer requirements lighter in Finland than in its peers

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The primary task of macroprudential buffer requirements is to promote financial stability, but significant cross-country differences in the calibration of the buffers may weaken the level playing field for banks. When comparing the size of macroprudential buffer requirements, account should be taken of the nature of systemic risks covered by the buffers. There are, namely, significant country- and bank-specific differences in the systemic risks underlying the buffer requirements. At present, the structural macroprudential buffer requirements imposed on the Finnish banking sector are lower on average than the buffers in peer countries with similar structural risks.



The primary task of macroprudential buffer requirements (hereinafter 'macroprudential buffers') is to promote financial stability. Macroprudential buffers strengthen credit institutions' loss-absorption capacity, thereby reducing the probability of financial crises and their negative impacts on the real economy and on the operation of the financial system. When setting macroprudential buffers, however, authorities should also assess the potential negative effects of the buffers on the functioning of the internal market. This obligation is based on the EU Capital Requirements Directive (CRD) and national credit institutions legislation. Significant cross-country differences in the calibration of macroprudential buffers may contribute to weakening the level playing field for banks in the EU, especially if these differences are not explained by differences in country-specific systemic risks.

This article compares the total level, or size, of structural macroprudential buffers of Finnish banks and banks in other European countries. Here, structural macroprudential buffers comprise the systemic risk buffer (SyRB) and the buffers for systemically important credit institutions (G-SIIs/O-SIIs). The SyRB is an additional capital requirement imposed on the basis of the structural characteristics of the financial system, while the G-SII/O-SII buffers are additional capital requirements for global systemically important institutions (G-SIIs) and for other systemically important institutions (O-SIIs).

Comparison covers peer countries with similar structural vulnerabilities to those in Finland

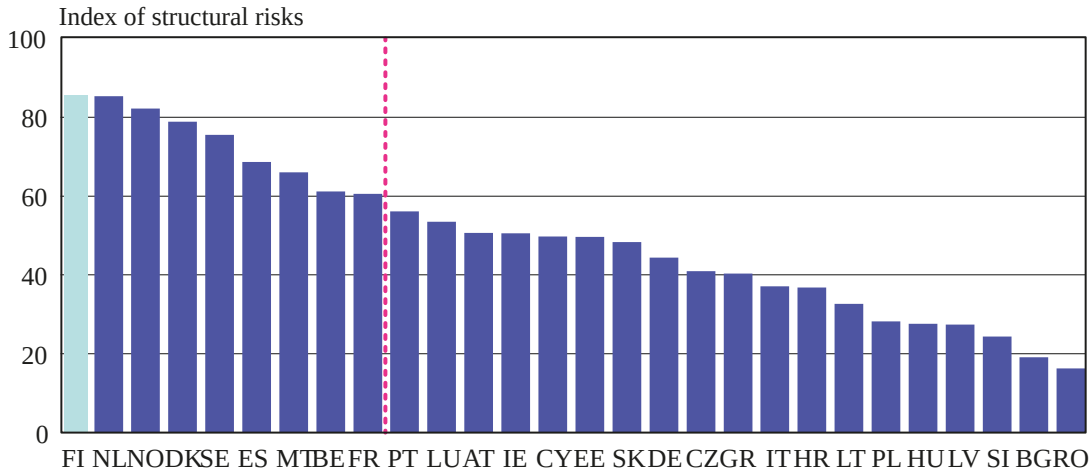
Prior to the COVID-19 pandemic, the macroprudential buffers of Finnish systemically important credit institutions were among the largest in the euro area. When comparing buffer levels between countries and banks, it should be noted that the systemic risks underlying macroprudential buffers differ from one country to another. The need to apply higher-than-average buffer requirements in Finland has been justified in particular by the structural risks of the financial system, which are above average in Finland.

The comparison of systemic risks among EU countries seeks to identify countries whose financial systems are subject to structural vulnerabilities similar to those in Finland.[1] Structural vulnerabilities are measured by risk indicators capturing (i) the size of the banking sector; (ii) the degree of its concentration; (iii) the extent of cross-border activities; (iv) the concentration and financing structure of banks' credit portfolios; and (v) household indebtedness. The indicators are presented in Table 1. The countries are scored and ranked on the basis of the values of each risk indicator.[2] The overall score indicating the level of structural risks is calculated as an average of the category-specific scores.

Category	*Indicator*	*Source*
Size of the banking sector	*Consolidated balance sheet of the banking sector / GDP*	*ECB, Eurostat, Norges Bank*
Concentration of the banking sector	*Herfindahl index*[1]	*ECB*
	Total market share of five largest banks[2]	*ECB*
	Maximum value of individual banks' O-SII scores	*EBA*
Extent of cross-border activity	*Average of the relative shares of cross-border claims and liabilities*	*ECB*
Concentration of the credit portfolio	*Herfindahl index calculated over sector- and industry-specific relative shares in credit portfolio*	*EBA*
Dependence on market funding	*Loans to households and non-financial corporations as a ratio of deposits by households and non-financial corporations*	*EBA*
Household indebtedness	*Ratio of household debt to disposable income*	*Eurostat*

Chart 1.

Financial systems of Nordic countries, the Netherlands, Spain, Malta, Belgium and France exposed to structural risks similar to those in Finland



Sources: European Central Bank, EBA, Eurostat, Norges Bank and calculations by Financial Supervisory Authority.

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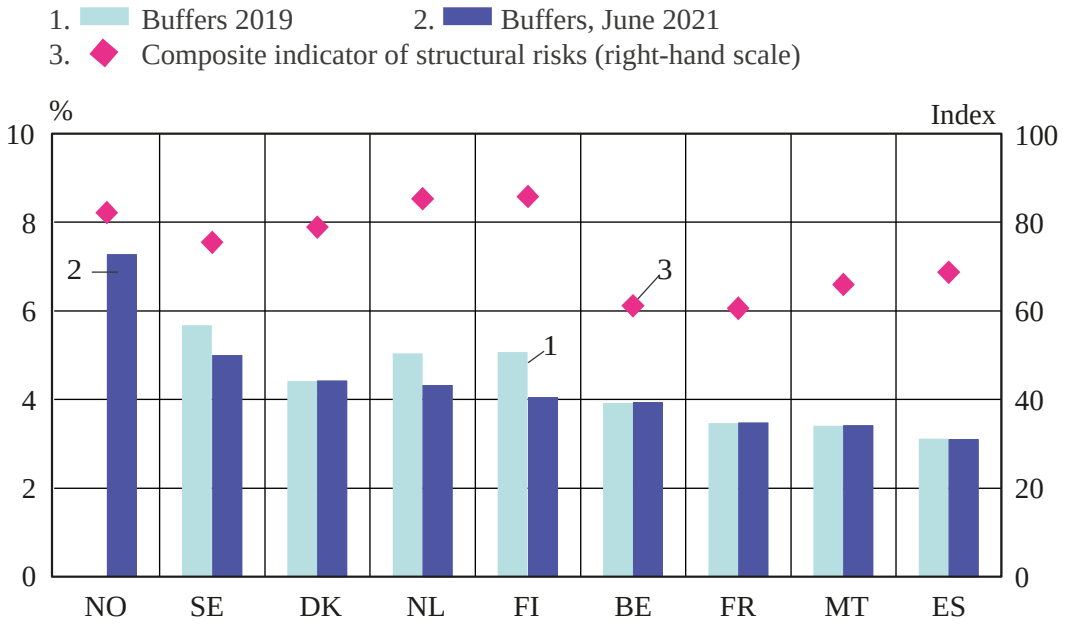
Peer country	*Structural risks in the financial system*
Netherlands	*Household indebtedness, cross-border activity, concentration of credit portfolios, large size and concentration of banking sector, dependence on market funding*
Norway	*Household indebtedness, dependence on market funding, concentration of banking sector, concentration of credit portfolios*
Denmark	*Household indebtedness, dependence on market funding, cross-border activity, large size of banking sector*
Sweden	*Concentration of credit portfolios, dependence on market funding, household indebtedness, cross-border activity*
Spain	*Cross-border activity, large size of banking sector*
Malta	*Concentration of credit portfolios, cross-border activity, large size of banking sector*
Belgium	*Household indebtedness*

France	*Large size of banking sector, cross-border activity, household indebtedness, dependence on market funding*

Among the peer countries, the level of structural systemic risks is closest to Finland in the other Nordic countries and the Netherlands, with the level of these risks being slightly higher for Finland. However, as for the size of the banking sector's structural macroprudential buffers,[3] the most recent comparison indicates that the buffers are smaller in Finland than in these countries (Chart 2). Prior to the pandemic, the buffers were closer in size to each other than at present.[4] In the rest of the peer countries, both the level of structural systemic risks and the size of banks' structural macroprudential buffers were lower than in Finland.

Chart 2.

Structural macroprudential buffers smaller in Finland than in its most relevant peers



Sources: European Central Bank, ESRB, EBA, Finanstilsynet and calculations by Financial Supervisory Authority.

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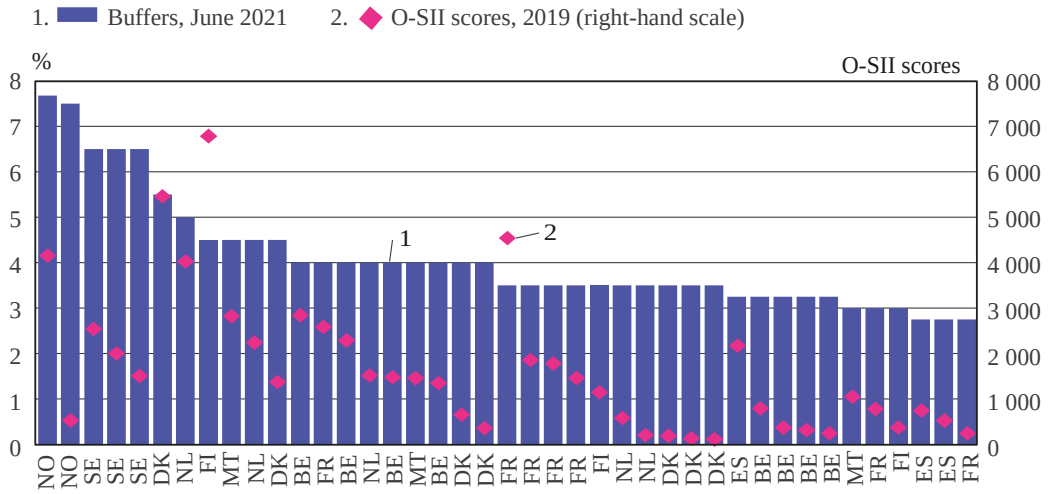
In Chart, the size of Norway's structural buffers has been assessed based on buffer requirements imposed at the end of 2020. However, the new SyRB requirement of 4.5% for Norwegian credit exposures will not enter into force for some Norwegian banks until the end of 2022. In addition, when calculating the average buffer requirements, it has been assumed that, with the exception of Norwegian banks classified as systemically important, Norwegian banks only have domestic credit exposures. In practice, these assumptions somewhat overestimate the actual average buffer requirements for the Norwegian banking sector.

In addition to the size of macroprudential buffers applicable in each country, the average country-specific macroprudential buffer requirements are also fundamentally affected by the degree of concentration of the banking sector. Therefore, it is also justified to compare the level of structural macroprudential buffers on a bank-by-bank basis. Measured by O-SII scores, Nordea is systemically the most significant banking group among all the countries compared (Chart 3). Nevertheless, Nordea's structural buffers are smaller than the respective buffers of the largest banking groups in Finland's most relevant peers. In the case of OP Financial Group, in turn,

structural buffers are slightly smaller than in the case of Danish, Dutch and Belgian banks of similar size or systemic importance. On the other hand, the OP Financial Group's structural macroprudential buffers are of the same size as those of the Spanish and French banks that are considerably larger than OP and are identified as G-SIIs.

Chart 3.

Nordea's structural macroprudential buffers smaller than those of largest banking groups in Finland's most relevant peers



Sources: ESRB, EBA and calculations by the Financial Supervisory Authority.

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Notes

1. Bank-specific countercyclical capital buffer (CCyB) requirements are excluded from the comparison, as the CCyB requirement imposed in a certain country also automatically applies to the exposures of foreign banks in that country. Hence, the bank-specific CCyB requirement is not as strongly dependent on the macroprudential policy of a bank's country of residence as the level of structural buffers is. ↑
2. The risk indicator-specific scores have been scaled between 0 and 100 so that the country with the largest structural vulnerabilities, as indicated by the value of the risk indicator, takes the value 100. Correspondingly, the country with the lowest level of vulnerabilities takes the value 0. Other countries receive a value between 0 and 100 according to their order number, determined based on their risk indicator values. ↑
3. In addition to O-SII buffers and the SyRB, structural buffers include in this comparison the capital conservation buffer (CCoB). ↑
4. The pre-pandemic situation is a poor reference point due to both regulatory changes and ↑

potential changes in the objectives targeted by a certain buffer composition. Among the countries compared, Finland is the only country where structural buffers have been lowered primarily on account of the pandemic. In Sweden, changes in structural buffers during the pandemic were solely due to amendments to the Capital Requirements Directive CRD IV (with the adoption of CRD V). In the Netherlands, the changes were due to both the pandemic and CRD V. On the other hand, changes in buffer compositions have also been justified by the aim to increase the share of the CCyB in future. For these reasons, it is justified to assume that Sweden and the Netherlands are not intending to raise their structural buffers to their pre-pandemic levels.

Keywords

banks, macroprudential buffers, macroprudential policy