FIN-FSA
FINANCIAL SUPERVISORY AUTHORITY

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Unrestricted

Macroprudential strategy of the Board of the Financial Supervisory Authority

The macroprudential strategy of the Board of the Financial Supervisory Authority (FIN-FSA) serves the work of the Board in its role as the national macroprudential policy decision-maker. Macroprudential policy is forward-looking and highly predictable. The strategy concretises the objectives, official responsibilities and measures by which the primary goal of macroeconomic stability will be achieved. In addition to decisions on macroprudential instruments, the macroprudential toolkit includes raising issues for public discussion.

The FIN-FSA Board evaluates annually the success of the policy it practices, the effectiveness of the available tools, and whether its strategy is sufficiently up to date. Regular updating of the strategy ensures its effectiveness in a changing operating environment.

The main objective of macroprudential policy is to reduce the probability and harmful effects on the real economy of financial crises and other disruptions to the financial system and thereby to promote long-term economic growth.

With macroprudential strategy, policy objectives, indicators and instruments are combined into a coherent entity. The strategy describes how the various policy objectives are linked to systemic risks that jeopardise the realisation of the primary goal and how the various instruments can be used to achieve the objectives.

On a general level, the primary goal of macroprudential policy is divided into intermediate objectives and operational policy objectives. Indicators and regular analyses are used to assess the risks to the intermediate targets and the severity of these risks.

The FIN-FSA Board has the statutory task of deciding on the application of macroprudential policy instruments in Finland. The FIN-FSA Board has specified for macroprudential policy three intermediate objectives:

1. To mitigate excessive growth of credit granted to households, businesses and the entire private sector as well as consequent risks and over-indebtedness.
2. To mitigate the systemic risks associated with the systemic significance of individual credit institutions and the structural vulnerabilities of the financial system.
3. To improve the risk resilience of the financial system as a whole.

Macroprudential analysis identifies systemic risks which, if realised, could jeopardise the attainment of the primary goal. Systemic risks can be divided into cyclical and structural systemic risks. Cyclical systemic risks are typically linked to strong fluctuations in lending and asset prices associated with economic and financial cycles. Structural systemic risks, in turn, are associated with long-term and slow-moving characteristics of the economy and the financial system. Such structural vulnerabilities include, for example, large private sector debt as well as a large and concentrated banking system.

The development of risks and vulnerabilities as well as the harmful effects of risks can be mitigated by macroprudential instruments. Instruments vary in terms of their type, transmission channel and effectiveness. Macroprudential policy is a rather new form of economic policy. As a result, new analytical methods are being developed to assess the impact of macroprudential instruments and to obtain a more comprehensive picture. Analysis supporting macroprudential policy increases the baseline information used in decision-making.

Macroprudential policy also has its limitations: macroprudential instruments alone cannot prevent the accumulation of economic imbalances. When assessing the success of macroprudential policy, the combined effect of other policy segments and regulation should also be taken into account.

Through communication, macroprudential policy and its objectives are made understandable and acceptable, despite the short-term costs associated with the policy. Moreover, communication can shape expectations of future macroprudential policy and thereby influence the behaviour of economic agents Communication is also central to strengthening the accountability of decision-makers and ensuring transparency in decision-making.

Economic and financial crises are often the result of overheating of the housing market and lending

In economic history, the most severe economic and financial crises have often been the result of overheating of the housing market and lending.

Over the past 20 years, household indebtedness has doubled in Finland. There is a risk that indebtedness will continue to grow. The magnitude and growth of indebtedness are significant risks to the stability of the Finland's financial system and the economy as a whole. High indebtedness amplifies shocks to the economy, because indebted economic entities typically reduce their consumption and investments sharply in response to adverse economic conditions.

The Board's decision-making in managing risks and vulnerabilities is supported by ex-ante analysis of the effects of the various alternative policies and instruments. The analysis assesses the effectiveness of different policy options in mitigating vulnerabilities, the evaluation of options and undesirable side effects. In principle, instruments that target risks most effectively and most directly should always be used to reduce the observed macroprudential risk or vulnerability.

The FIN-FSA Board assesses its three intermediate objectives in the current situation with the aid of the following operational policy objectives:

- Growth in loans to households (including loan-servicing costs) does not exceed growth in household disposable income over the medium term (intermediate objective 1);
- Growth in loans to the entire private sector does not exceed growth in nominal gross domestic product over the medium term (intermediate objective 1);
- The capital adequacy, leverage, liquidity and funding structure of systemically important financial institutions and the entire credit institution sector are strong relative to identified systemic risks and stronger than in EU countries on average (intermediate objective 2);
- The effectiveness of macroprudential policy is ensured and circumvention of policy measures prevented by imposing, if necessary, macroprudential requirements permitted by legislation also on financial services providers other than credit institutions (intermediate objective 3).

The Board's macroprudential policy is forward-looking. The delays in instruments taking effect may be long, and the impact of decisions is actively monitored. Proactive mitigation of the accumulation of risks can also be implemented more softly than the removal of already realised vulnerabilities.

Ex-post evaluations of measures are carried out after policy decisions are made. The purpose of these evaluations is to ascertain whether the effects of the measures undertaken correspond to the desired outcomes and whether the dimensioning of measures was correct in relation to the identified vulnerability and the state of the economy.

Instruments available to achieve the intermediate objectives

The decision-maker should have at least one instrument available for each intermediate objective of macroprudential policy.

For intermediate objective 1, the primary instruments available are the countercyclical capital buffer and maximum loan-to-collateral (LTC) ratio.

Other instruments available include structural additional capital requirements and risk weight requirements. Key instruments whose binding application is not permitted under Finnish legislation include maximum debt-to-income ratio, debt service-to-income ratio, amortisation requirements and maturity restrictions.

For intermediate objective 2, the primary instruments available are the G-SII/B and O-SII capital buffer requirements imposed on global and other systemically important institutions as well as the additional capital requirements imposed for structural systemic risks and vulnerabilities of the entire credit institution sector.

Other available instruments include risk weight requirements and maximum LTC ratio.

For intermediate objective 3, Finnish legislation does not currently include macroprudential instruments for financial institutions other than credit institutions. In the absence of binding instruments, the FIN-FSA issues, where appropriate, recommendations and warnings to financial market participants with respect to risks to stability that may emerge or grow outside the credit institution sector.

As part of the annual evaluation of the strategy, the FIN-FSA Board and the experts of the FIN-FSA, Bank of Finland and Ministry of Finance who prepare decisions evaluate the instruments available and any related changes that may be required. The most significant instrument changes require amendments to legislation.

Macroprudential policy objectives and instruments in Finland

Primary goal	Intermediate objectives	Operational policy objective	Instruments
To reduce the probability and harmful effects on the real economy of financial crises and other disruptions to the financial system and thereby to promote long-term economic growth	To mitigate excessive growth of credit granted to households, businesses and the entire private sector as well as consequent risks and over-indebtedness	Growth in loans to households (including loan-servicing costs) does not exceed growth in household disposable income over the medium term	Instruments available *Maximum LTC ratio* *Countercyclical capital buffer* *Other additional capital requirements* Possible additional instruments *Maximum debt-to-income ratio (DTI) or maximum debt service-to-income ratio (DSTI),* *Maturity restrictions - and amortisation requirement*
		Growth in loans to the entire private sector does not exceed growth in nominal gross domestic product over the medium term	Instruments available *Countercyclical capital buffer* *Other additional capital requirements* *Maximum LTC ratio*
	To mitigate the systemic risks associated with the systemic significance of individual credit institutions and the structural vulnerabilities of the financial system	The capital adequacy, leverage, liquidity and funding structure of systemically important financial institutions and the entire credit institution sector are strong relative to identified systemic risks and stronger than in EU countries on average	Instruments available *Capital conservation buffer* *G-SII/B and O-SII buffers* *Systemic risk buffer* *CRR Articles 124, 164 (risk weight, LGD) and 458 (risk weights, capital and liquidity requirements)* Possible additional instruments *Developing EU-level legislation, for example with respect to leverage and liquidity requirements exceeding a minimum level*
	To improve the risk absorbency of the financial system as a whole	The effectiveness of macroprudential policy is ensured and circumvention of policy measures prevented by imposing, if necessary, macroprudential requirements permitted by legislation also on financial services providers other than credit institutions	Instruments available *Recommendations and warnings* Possible additional instruments *Extending appropriate macroprudential instruments to all financial market participants*