Macroprudential strategy of the Board of the Financial Supervisory Authority

Macroprudential policy refers to measures directed at preventing systemic risks that threaten the stability of the financial system. The macroprudential strategy of the Board of the Financial Supervisory Authority (FIN-FSA) combines macroprudential policy objectives, indicators and instruments into a coherent whole. It describes how the various policy objectives are linked to systemic risks that jeopardise the attainment of the primary goal and how the instruments can be used to achieve the objectives. The strategy serves the work of the Board in its role as the national macroprudential policy decision-maker.

Macroprudential policy is forward-looking and predictable. In addition to decisions on macroprudential instruments, the macroprudential toolkit includes recommendations and raising issues for public discussion.

The FIN-FSA Board evaluates annually the success of the policy it practises, the effectiveness of the available tools, and whether the macroprudential strategy is up to date. Regular updates to the strategy ensure its effectiveness in a changing operating environment.

The primary goal of macroprudential policy is to reduce the probability and adverse effects of financial crises and other severe disruptions to the financial system on the real economy and thereby promote long-term economic growth by:

- preventing the build-up of systemic risks and vulnerabilities, and
- supporting financial intermediation in the event of disruptions to the economy or the financial system.

The primary goal of macroprudential policy is divided into intermediate objectives and operational policy objectives.

The FIN-FSA Board has specified ***four intermediate objectives for macroprudential policy:***

1. Preventing excessive growth of credit granted to households, non-financial corporations and the entire private sector and mitigating the consequent risks and excessive indebtedness.
2. Preventing systemic risks associated with the systemic importance of individual credit institutions and with the structural vulnerabilities of the financial system.
3. Improving the risk resilience of the financial system as a whole by also taking into account the risks to financial activity other than traditional credit institutions activity.
4. Supporting the lending capacity of the financial system if threatened as a result of severe distress in the economy or the financial system.

Macroprudential analysis identifies systemic risks which, if materialised, could jeopardise the achievement of the primary goal. Systemic risks can be broken down into cyclical and structural systemic risks. Cyclical systemic risks are typically linked to strong fluctuations in lending and asset prices. Structural systemic risks, in turn, are associated with long-term and slow-moving characteristics of the economy and the financial system. Such structural vulnerabilities are, for example, high private-sector debt and a large and concentrated banking system. On the other hand, severe disruptions to the economy and to the financial system, such as those stemming from external shocks, for example, can also jeopardise financial intermediation in the economy. In such cases, macroprudential policy can contribute to strengthening the supply of credit in the financial system. When strengthening credit supply, the estimated duration and severity of the disruption should be taken into account. Macroprudential stability assessments should also take into account new types of global risks, such as cyber and climate risks.

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

Communication allows macroprudential authorities to explain the rationale behind macroprudential policy and its objectives to the general public. Forward guidance on forthcoming macroprudential measures contributes to reducing market uncertainty. It can steer expectations of forthcoming macroprudential policy and thereby influence the behaviour of economic agents. Communication also ensures and strengthens the transparency and openness of decision-making.

The FIN-FSA Board pursues its four intermediate macroprudential objectives through the following four ***operational policy objectives:***

- The growth rate of loans to the household sector for house purchase and the growth rate of total household sector debt remain moderate. The achievement of the objective is assessed primarily on the basis of whether these growth rates exceed the growth rate of annual household disposable income over the medium term (intermediate objective 1).
- Systemic risks relating to credit granted to the private sector remain moderate in light of the risk indicators for setting the countercyclical capital buffer (CCyB) requirement. The achievement of the objective is assessed primarily on the basis of whether the growth rate of loans to the private sector exceeds the growth rate of nominal GDP over the medium term (intermediate objective 1).
- The capital adequacy, leverage and funding structure of systemically important credit institutions and of the entire credit institutions sector are strong relative to identified systemic risks and vulnerabilities (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 service providers other than credit institutions (intermediate objective 3).
- Macroprudential policy space is enhanced for example with releasable capital buffers and the policy space is used swiftly and in a temporary manner in the event of severe economic and financial market disruptions (intermediate objective 4).

The FIN-FSA Board’s macroprudential policy is forward-looking. Proactive macroprudential policy ensures adequate policy space in good time in the event of severe economic and financial market disruptions. The aspect of proactivity is emphasised especially when preventing cyclical risks. Proactive prevention of the build-up of risks also entails lower costs than addressing risks that have already materialised.

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. Ex-ante analysis assesses the effectiveness of different policy options in mitigating vulnerabilities, the calibration of the various instruments and, for instance, their impact on the MREL requirements of the crisis resolution framework. As a rule, the identified macroprudential risks or vulnerability should always be addressed with instruments that target risks most effectively and most directly. On the other hand, each systemic risk or vulnerability should principally be addressed by only one instrument.

After its policy decisions, the Board assesses the effects of the measures undertaken through ex-post evaluations. The purpose of these evaluations is to ascertain whether the measures undertaken had desired effects and whether they were calibrated correctly in relation to the identified vulnerability and to the state of the economy.

Instruments for achieving 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 (CCyB) requirement, the maximum loan-to-collateral (LTC) ratio and recommendations on household indebtedness and debt-service burdens.

Other instruments available are structural additional capital requirements and risk weight requirements. Key instruments whose binding application is not permitted under Finnish legislation are the maximum debt-to-income (DTI) ratio, the maximum debt service-to-income (DSTI) ratio and amortisation requirements.

For ***intermediate objective 2***, the primary instruments available are the additional capital requirements (G-SII/B and OSII buffers) imposed on global and other systemically important credit institutions, and the additional capital requirements imposed for structural systemic risks and vulnerabilities of the entire credit institution sector, i.e. the systemic risk buffer (SyRB).

Besides the capital conservation buffer (CCoB), other instruments available are Articles 458, 124 and 164 of the Capital Requirements Regulation (CRR).

For ***intermediate objective 3***, the FIN-FSA Board assesses in particular instruments that improve the risk resilience of the financial system outside the credit institutions sector. Instruments also with potential macroprudential effects are a leverage limit for alternative investment fund managers (AIFMs), instruments based on Solvency II and other instruments applicable to insurance institutions, and exceptional measures targeted at pension providers. In the absence of binding measures, the FIN-FSA issues, where appropriate, recommendations and warnings to financial market participants with respect to financial stability risks potentially emerging or building up outside the credit institutions sector.

For ***intermediate objective 4***, the instruments available are the countercyclical capital buffer (CCyB) requirement, the systemic risk buffer (SyRB) requirement and other additional capital requirements. The possibility to set a positive neutral CCyB rate, i.e. a buffer rate that is above zero in the normal “neutral” phase of the credit cycle, would help achievement of the intermediate objective but would require a legislative change.

As part of the annual evaluation of the macroprudential strategy, the FIN-FSA Board evaluates the instruments available and any related changes that may be required together with the experts of the FIN-FSA, the Bank of Finland, the Ministry of Finance and the Financial Stability Authority who participate in the preparation of the Board’s macroprudential decisions.

Macroprudential policy objectives and instruments in Finland

Primary goal	**Intermediate objectives**	**Operational policy objective**	**Instruments**
Reducing the probability and adverse effects of financial crises and other severe disruptions to the financial system on the real economy, thereby promoting long-term economic growth by: - preventing the build-up of systemic risks and vulnerabilities, and - supporting financial intermediation in the event of disruptions to the economy or the financial system.	Preventing excessive growth of credit granted to households, non-financial corporations and the entire private sector and mitigating the consequent risks and excessive indebtedness.	The growth rate of loans to the household sector for house purchase and the growth rate of total household sector debt remain moderate. The achievement of the objective is assessed primarily on the basis of whether these growth rates exceed the growth rate of annual household disposable income over the medium term.	Primary instruments *Maximum LTC ratio* *Recommendations on household indebtedness and debt-service burdens* Other instruments *CCyB* *Other additional capital requirements* *Maturity limit (forthcoming)* *Limitations to housing company loans in new housing construction (forthcoming)* Additional instruments requiring regulatory changes *Maximum DTI ratio or maximum DSTI ratio* *Amortisation requirement*
		Systemic risks relating to credit granted to the private sector remain moderate in light of the risk indicators for setting the CCyB requirement. The achievement of the objective is assessed primarily on the basis of whether the growth rate of loans to the private sector exceeds the growth rate of nominal GDP over the medium term.	Primary instruments *CCyB* Other instruments *Maximum LTC ratio* *Other additional capital requirements* Additional instruments requiring regulatory changes *Positive neutral CCyB rate*
	Preventing systemic risks associated with the systemic importance of individual credit institutions and with the structural vulnerabilities of the financial system.	The capital adequacy, leverage and funding structure of systemically important credit institutions and of the entire credit institutions sector are strong relative to identified systemic risks and vulnerabilities.	Primary instruments *G-SII/B and O-SII buffers (individual credit institutions)* *SyRB (credit institutions sector)* *CRR Article 458 (risk weights, capital and liquidity requirements) (credit institutions sector)* Other instruments *CCoB* *CRR Articles 124 and 164 (risk weight, LGD)* Additional instruments requiring regulatory changes *Development of EU-level legislation, e.g. with respect to leverage and liquidity requirements exceeding a minimum level*
	Improving the risk resilience of the financial	The effectiveness of macroprudential policy is	Instruments also with potential macroprudential effects

	system as a whole by also taking into account the risks to financial activity other than traditional credit institutions activity.	ensured and circumvention of policy measures prevented by imposing, if necessary, macroprudential requirements permitted by legislation also on financial service providers other than credit institutions.	*Leverage limit for AIFMs* *Instruments based on Solvency II and other instruments applicable to insurance institutions* *Exceptional measures targeted at pension providers (incl. regulatory measures)* *Maturity limit (certain creditors and credit intermediaries, forthcoming)* *Recommendations and warnings* Additional instruments requiring regulatory changes *Liquidity management tools for investment funds and open-ended AIFs*
	Supporting the lending capacity of the financial system if threatened as a result of severe distress in the economy or the financial system.	Macroprudential policy space is enhanced for example with releasable capital buffers and the policy space is used swiftly and in a temporary manner in the event of severe economic and financial market disruptions.	Primary instruments *CCyB* Other instruments *SyRB* *Other additional capital requirements* Additional instruments requiring regulatory changes *Positive neutral CCyB rate* *Capital requirement releasable at EU-level*