FINNISH BANKING 2020

An overview of the Finnish banking sector and its operating environment, the housing market, and household indebtedness in 2020.

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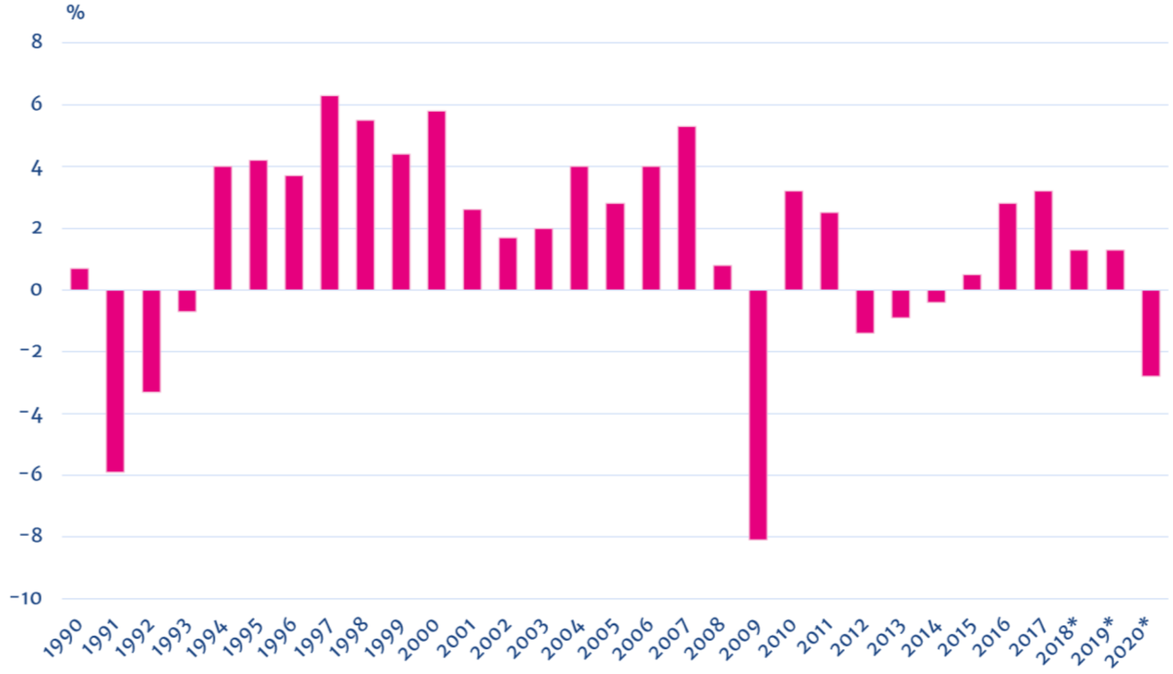
1 Economic environment

1.1 Economic development

The coronavirus pandemic spread across the globe in early 2020. As a result, countries imposed various economic and social restriction measures to slow down the spread of the virus. These measures and the changed behaviour of people had heavy repercussions. The global economy entered a deep financial crisis. Economic lockdowns were imposed especially in services sectors such as hospitality and tourism to discourage physical interaction between people. Office employees left their desks and switched to remote work in unprecedented numbers.

The Finnish gross domestic product (GDP) fell 2.8% in 2020 as a result of the coronavirus-induced financial crisis. The GDP in the euro area fell 6.6%, so in comparison, Finland managed relatively well. GDPs were affected especially by the fact that the services sector's value added fell as a result of the economic restrictions and cautious behaviour of consumers. In the early weeks of the coronavirus crisis, consumer confidence crashed, which was reflected in private consumption as a decrease of 5%. It will take time until Finland's key export partners recover from the coronavirus crisis, so the outlook of Finnish industrial trends and the growth of private investments depend on the recovery of international economy. According to latest forecasts and indicator data, economic growth may recover already during 2021.

Figure 1. Annual change of Finnish GDP (%)



Source: Statistics Finland

According to preliminary data, the value of Finnish exports totalled €85bn in 2020. Exports decreased by 11% and imports decreased by 12% compared to the previous year at current prices. The volumes of export and import both decreased 7%. The coronavirus pandemic was reflected especially in diminished export and import of service. Travel restrictions were globally imposed on all continents, which reduced the import and export of travel and transport services. Partial recovery of product exports towards the end of the year was due to an international shipbuilding order worth nearly one billion euros.

The value of investments decreased by 3% to €55bn. Their volume sank by 5%, but public investment accelerated 3% compared to the previous year.

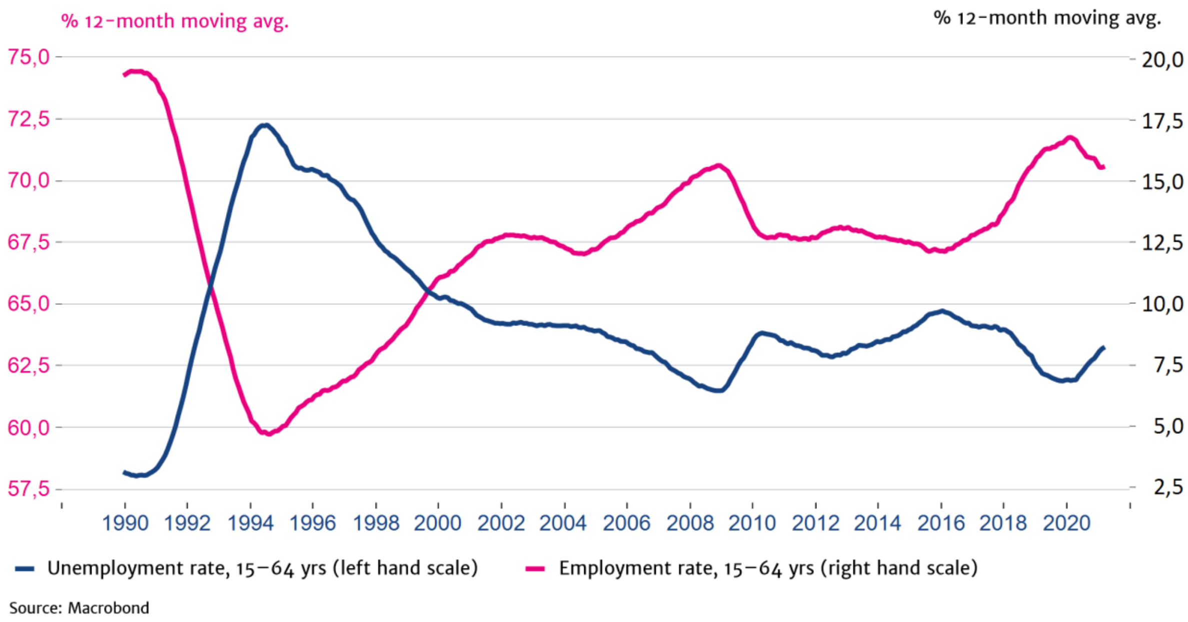
Consumer confidence plummeted in the first quarter of 2020 as a result of the coronavirus crisis. Confidence in the Finnish economy recovered after the first wave of the pandemic calmed down, but fell again when the second wave hit. Private consumption followed in a similar fluctuating trend. Consumers' confidence in their personal economy was faster to recover from the first wave of the pandemic and maintained at a relatively good level also through the second wave later that year. As consumers spent less money on garments and services and were unable to travel abroad, they had more to spend in saving, investing and domestic consumption. The aggregate amount of households' savings rose from the €1bn in 2019 to €6.9bn by the end of 2020. Households' saving rate climbed to 5.7%.

The long positive trend in the employment rate took a turn in the opposite direction in the second quarter of the year. According to Statistics Finland, the number of employed people decreased with 37,000 persons in 2020. The number of available jobs dropped the most in social and health care services, hotel and restaurant business, and in transport and storage services. The employment rate was on average 71.6%, which is one percentage point less than the previous year.

When the coronavirus crisis broke out, the number of temporary lay-offs soared, rising the highest in April 2020 with 164,000 persons. After April, the number of lay-offs began to fall rapidly and levelled out at 60,000 persons at the end of the year.

The wages and salaries received by households fell in nominal terms by 0.4% to €92.8bn. Unemployment benefits paid in Finland increased by 38% to a total of €5bn.

Figure 2. Employment in Finland



In addition to central banks' monetary policy stimulus, many countries around the world resorted to lending to finance their economies during the global coronavirus-induced financial crisis. Finnish public sector entities' deficit was €12.9bn when a year earlier it was €2.4bn. General government deficit was even bigger with €13.4bn (€2.7bn the year before). The aggregate deficit-to-GDP ratio of public sector entities was 5.4%. This deficit exceeds the 3% limit defined the EU Stability and Growth Pact. General government EDP debt, or consolidated gross debt, was 69.2% relative to gross domestic product at the end of 2020. This is above the 60% debt-to-GDP limit set in Stability and Growth Pact. The public deficit was increased by expenses related to the coronavirus pandemic, other additional public costs, and the smaller accumulation of tax income and social security payments.

Uncertainty resulting from the pandemic caused short-term market rates to rise in early 2020. Confidence in the most troubled member states' ability to cope with the financial crisis was reflected in the interest rate market. Interest rates fell when the 27 EU countries agreed on the €750bn stimulus package. The market was also stabilised by the European Central Bank's light monetary policy – especially the substantial bond purchases made by the ECB and national central banks.

Share prices crashed globally in February-March 2020. Soon after, central banks announced extensive recovery measures, as a result of which share prices took off anew, recovering to pre-COVID levels during the second half of the year. For share investors, the year 2020 was highly exceptional due to the fast nosedive and almost equally fast recovery of share prices.

At the start of 2020, Finland introduced a new kind of equity savings account, which quickly gained popularity especially among younger investors. Investing in shares was one of the main reasons for households' financial assets climbing as high as €354bn at the end of 2020 – this was €23bn more than the previous year.

ECB's quantitative easing and low key interest rates have maintained euro area market rates at a low level for a long time. The central bank's light monetary policy shows also in the increase of Finnish households' loan debt. Finnish households' loan debts totalled €163bn at the end of 2020, which is €6bn more than in 2019. Housing loans comprised the majority of this debt with €103bn. The debt-to-income ratio of the housing loan portfolio (investment property mortgages excluded) has continued to decrease since 2016. Households were liable for approximately €19bn in limited-liability housing company loans, which is €1.4bn more than at the end of 2019. Housing company loans have increased the overall indebtedness of households. The ratio of non-performing housing company loans has stabilised around 1%, however.

Households' liability for consumer credits has not continued to rise after the first quarter of 2020. Households had €23.7bn in consumer credits at the end of 2020. The growth rate of consumer credits granted by credit institutions has slowed down. Especially the use of credit cards has decreased. In July 2020, the Ministry of Justice imposed a temporary interest rate ceiling for the rest of the year in response to the coronavirus crisis. The 10% interest rate ceiling and the direct marketing ban of consumer credits have affected the operation of payday loan companies, who have charged the highest interest rates in the unsecured consumer credit market. The temporary interest rate ceiling did not apply to instalment purchases or credit card debt.

In 2018, the Ministry of Finance appointed a working group to examine ways in which the excessive indebtedness of individuals and households could better be controlled and macroprudential risks thus reduced. The working group published its report in October 2019. Legislative proposals are expected later in 2021.

1.2 Housing market

The effects of the coronavirus pandemic were also reflected in the housing market. When the crisis broke out, construction trends slumped but recovered fast and even surpassed pre-crisis levels in late 2020. According to Statistics Finland, construction was started on 40,900 new dwelling units, which is 8% more than in 2019. Slightly over 32,200 housing start permits were granted in 2020, which is 4% more than the previous year. A total of 39,600 building permits were granted in 2020. This is 6% more than the previous year. The highest number of new building permits was granted in 2017 with close to 49,100 permits. The number of completed dwelling units was 10% smaller in 2020 with 39,000 units.

Construction trends showed in the number of new housing corporation loans taken out. Between January and November 2020, housing companies withdrew 16% less loans than in the same period the previous year. The housing corporation loan portfolio was close to €37.2bn at the end of November 2020, growing 6.9% from 2019. According to statistics by the Bank of Finland, housing corporation portfolio has grown very strongly throughout the 21st century; at a yearly rate of about 10%. Although this growth is still quite strong, it has been slowing down since April 2020. The last time the housing corporation loan portfolio grew as slowly was in 2009.

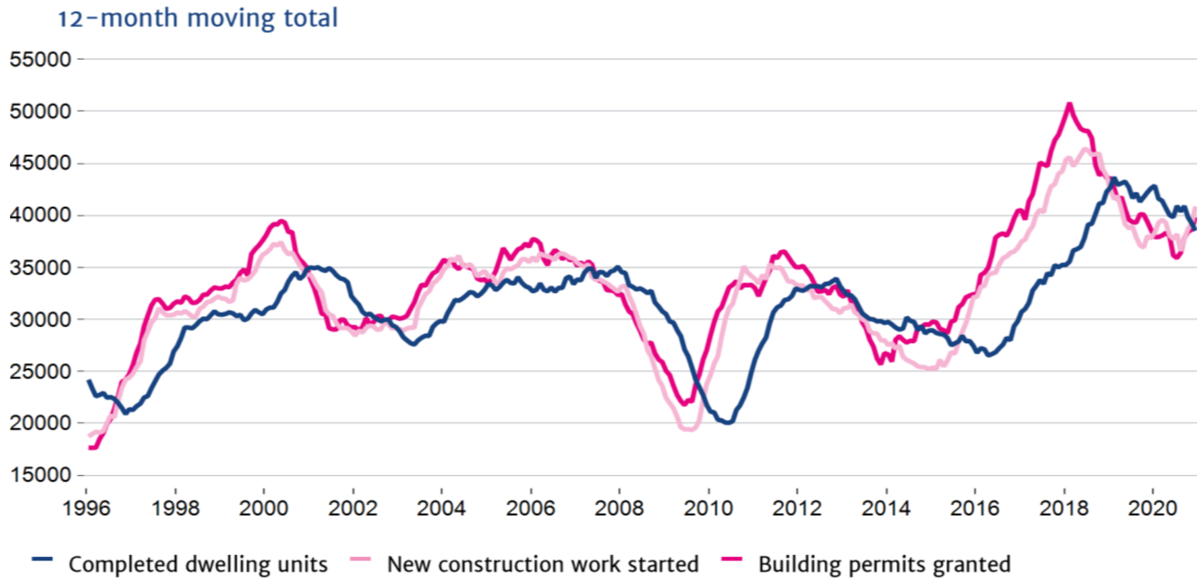
Finnish limited liability housing companies have certain unique characteristics that are also reflected in the credit statistics. In other countries, increased construction typically results in the corporate loan portfolio growing. Although Finland's housing corporation loans are included in the corporate loan portfolio in international statistics, in national statistics the corporate loans and housing corporation loans are separate categories, which means increased construction does not have the same effect on the corporate loan portfolio.

In general, loans taken out to construct residential buildings in Finland are recorded on the establishing housing company's balance sheet. The loan portfolio of housing companies therefore grows as a direct result of new construction. The term 'housing corporation' encompasses all corporation forms of housing units, not just limited-liability housing companies.

Some of this loan volume is held by households, some by housing investment funds and other housing investors, and some by companies. The exact division of each sector's responsibilities is impossible to measure, but Statistics Finland has estimated that households hold loans worth €19 billion. Statistics Finland revised its calculation model in late 2019 and updated the whole statistical time series. As a result of the revision, which introduced more data sources for accuracy, households' share of housing corporation loans decreased. Households' proportion of housing corporation loans has been one of the main factors for households' increasing indebtedness.

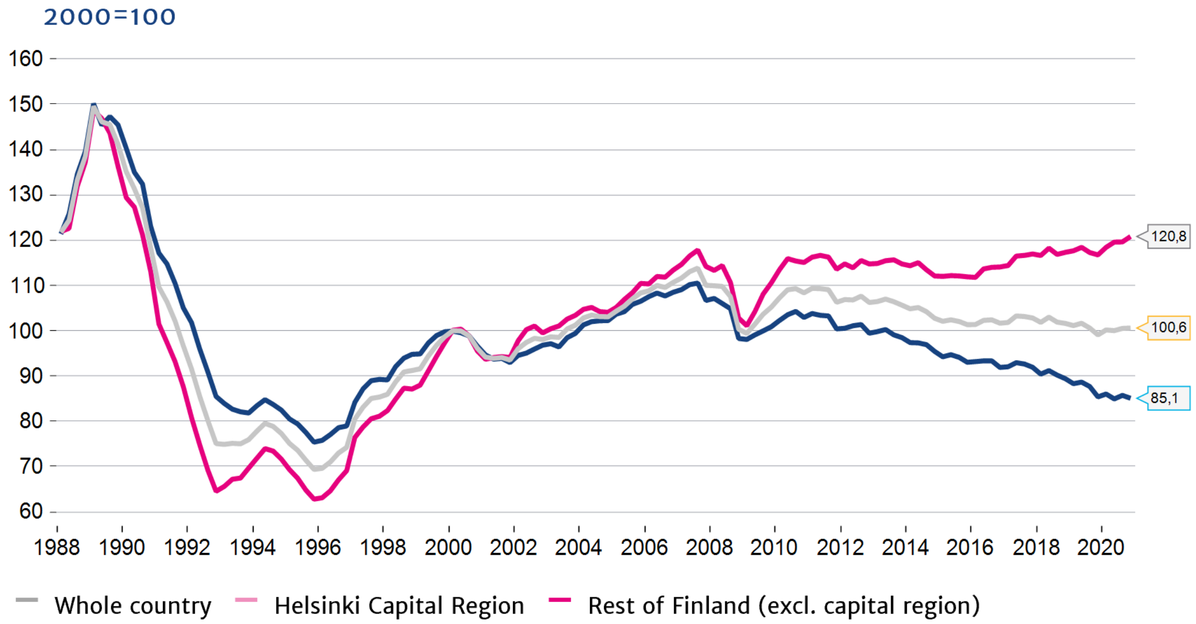
Overall housing prices in Finland went up by 1.4% in 2020. As a result of urbanisation, the housing market continued to diverge: in the capital region, housing prices went up by 3.5%, while elsewhere prices fell by 0.7%. Compared to households' income, housing prices have remained stable overall, but with regional differences. Outside the Helsinki capital region, relative prices have in fact fallen by roughly 15% in the past decade. The number of apartments sold through estate agents was the same as in 2019, but the coronavirus crisis affected the market's seasonal variation. Restrictions on foreign travel resulted in a highly active market for holiday homes in Finland.

Figure 3. Housing supply in Finland



Source: Macrobond, Statistics Finland

Figure 4. Housing prices in relation to income level



Source: Macrobond, Statistics Finland

1.3 Regulatory environment

The year 2020 was characterised by the coronavirus pandemic and the supervisory responses it spurred. The European Central Bank (ECB) and the European Banking Authority (EBA) took special action to maintain banks' lending capacity especially in the early stages of the pandemic. ECB and EBA relaxed requirements as permitted by banking regulation and issued recommendations for banks to ensure the measures would be focused on supporting the real economy. The Finnish Financial Supervisory Authority (FIN-FSA) applied similar principles in its own macroprudential supervision. It made decisions to lower Finnish credit institutions' capital buffer requirements and to restore the maximum loan-to-capital (LTC) ratio for residential mortgage loans other than first-home loans to 90%. In addition, the FIN-FSA decided to discontinue the minimum risk weight level for residential mortgage loans applicable to credit institutions that have adopted the Internal Ratings Based Approach for the calculation of capital requirements. The risk weight floor requirement expired on 1 January 2021. Although some of the banks' reporting obligations were relaxed with the pandemic, a number of new obligations were created at the same time, causing significant burden on banks.

Certain adjustments to EU banking regulation were done mid-2020 in response to the coronavirus pandemic. This so-called 'quick fix' package included, for example, a two-year extension to the IFRS9 transitional arrangements. In March, the European Securities and Markets Authority (ESMA) issued a public statement on some accounting implications of the pandemic. The statement provided guidance to issuers and auditors on the application of IFRS as regards the calculation of expected credit losses and related disclosure requirements.

ECB also published a recommendation asking banks not to pay dividends until at least 1 October 2020. The FIN-FSA issued a similar recommendation to the banks subject to its supervision. The decision was extended in July and again in December with a recommendation asking banks to exercise extreme prudence on dividends and share buy-backs until 30 September 2021.

The Finnish banking sector stood well-capitalised in the face of the risks caused by the coronavirus crisis. The easing of macroprudential requirements had only moderate influence on Finnish banks' capital adequacy, lending capacity and liquidity ratios. For example, Finnish banks were unable to apply EBA's guidelines regarding moratoria on loan repayments, because the grace periods granted voluntarily and independently by the banks did not fulfil the conditions specified in EBA's guidelines. As a whole, the Finnish banking sector has shown the adequacy of its capital and liquidity buffers as well as its strong resilience against crises.

One of the most significant national regulatory projects in 2020 was the EU Risk Reduction Package. Its legislative proposals involved diverse stakeholder groups, including Finance Finland, in a working group led by the Ministry of Finance. The package implemented the revised rules on EU capital requirements (CRR II/CRD IV) and resolution (BRRD 2/SRM 2).

A number of other technical changes in banking regulation were also implemented. The regulatory project was under discussion in 2020, and the legislative changes were approved by the Finnish Parliament in early 2021. For the most part, they entered into force on 1 April 2021.

Finance Finland (FFI) entered a dissenting opinion in the working group's report concerning setting systemic risk buffer. FFI criticised, for example, the fact that the financial impact assessments in the rationale of the legislative proposal had not been prepared with sufficient scope or detail. The overall impact of the changes was not sufficiently addressed. Furthermore, FFI considered it necessary to have clearer rules for the supervisor's powers and discretion, because the working group's report proposed increasing these powers in a manner that would enable the supervisor to raise buffer requirements significantly and thus affect the lending capacity of the Finnish banking sector.

The EU Risk Reduction Package included changes to EU's Capital Requirements Regulation, which is directly applicable legislation. The changes included a binding leverage ratio requirement, aiming to curb the over-indebtedness of banks, and a binding net stable funding ratio requirement, aiming to reduce banks' dependecy on short-term funding. Finnish banks have been preparing for new binding regulations for years, and they already fulfil these requirements by a wide margin.

European banks prepared to apply EBA's new guidelines on the definition of default in 2020. These guidelines harmonise the definition of customer default. As a result, defaults will be identified more quickly in the future, e.g. on the basis of public payment default records.

EU-level discussions on the completion of the banking union were suspended after the pandemic began in early 2020, but resumed later. FFI continues to hold the view that risk sharing in the EU should not be rushed. Problems in European banks must be solved and their risks must be reduced before it is sensible to proceed in completing the banking union.

Changes in the basis for calculating the ex-ante contributions to the EU's Single Resolution Fund proceeded in 2020 according to schedule. In practice, annual contributions collected from Finnish banks are increasingly dependent on the total amount of covered deposits in the entire banking union, not just in Finland. The size of the contributions will also be increasingly determined based on each institution's size and business risks relative to the size and risks of other institutions throughout the banking union, not just in Finland.

In the prevention of money laundering and terrorist financing, the most important regulatory project in 2020 was the European Commission's action plan adopted in May. Its main goals are the single EU rulebook, EU-level supervision, and a support and cooperation mechanism for financial intelligence units. Proposals for EU anti-money regulation will be published in 2021. In Finland, FFI's goal of improved information exchange was achieved when an expert group of authorities and parties under reporting obligation, led by the Finnish Financial Intelligence Unit, started its operations in October 2020.

In autumn 2020, the European Commission published a retail payment strategy for payment transactions. The strategy sets out the main direction and the Commission's action plan for the next four years. The key objectives of the strategy are to ensure high-quality payment services for citizens and businesses, to support Europe's economic independence and to strengthen the role of the euro in the world.

In September 2020, the Commission adopted a retail paments strategy for the EU, outlining the Commission’s plans for the next four years. The Commission’s goals are to ensure high-quality payment services for citizens and companies, to support EU’s financial independence, and to strengthen the euro’s global significance.

In addition to the coronavirus pandemic and its aftermath, sustainable development and the fight against climate change are emerging prominently on the regulatory agenda. Banks are directly and indirectly affected by climate risks, and will be subjected to new climate-related reporting requirements.

2 Banks operating in Finland

2.1 Banking group employees and offices

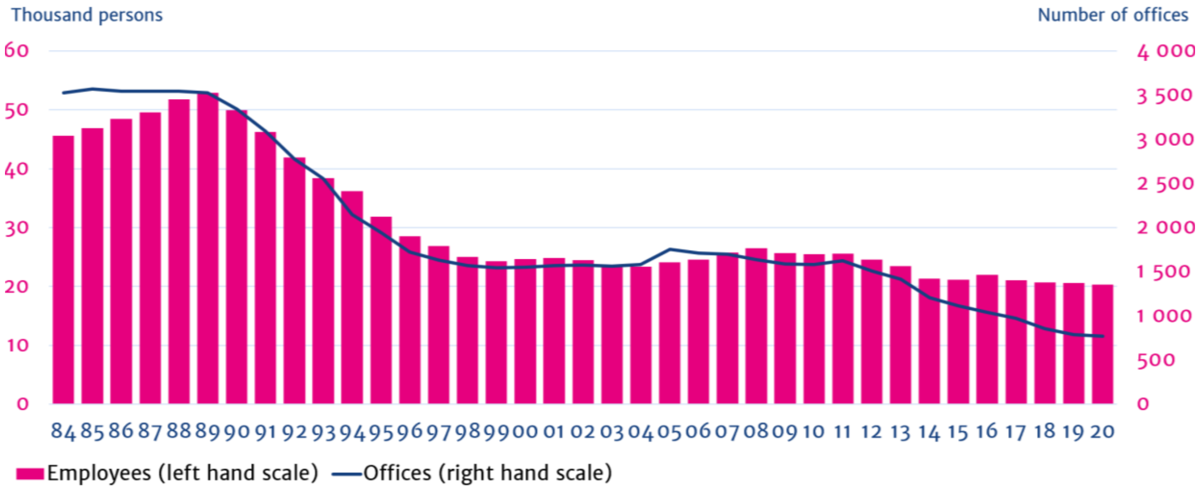
At the end of 2020, there were 228 credit institutions operating in Finland if group structures are ignored. This was 18 credit institutions fewer than at the end of 2019. The reduced number was mainly the result of in-group mergers. Credit institutions include deposit banks and other credit institutions that do not take deposits, such as finance houses, credit card companies, mortgage credit banks, and Municipality Finance plc.

Most Finnish credit institutions belong in a banking group or amalgamation. Calculated by group (foreign branches excluded), there were 12 Finnish banking groups or amalgamations at the end of 2020.

Nordea, OP Financial Group and Municipality Finance are under direct supervision of the ECB, while other credit institutions in Finland are supervised by the Finnish Financial Supervisory Authority (FIN-FSA).

Finnish banking groups and foreign deposit-taking banks’ Finnish branches employed a total of 20,317 people at the end of 2020. This is 327 employees fewer than the previous year. Finnish banking groups had 769 offices in Finland, which is 21 fewer than the year before. Compared to 2019, the number of employees and offices both reduced at a slower rate. The reductions are the result of customer service moving to digital channels, increased automation, improved efficiency of functions, and mergers.

Figure 6. Bank employees and offices



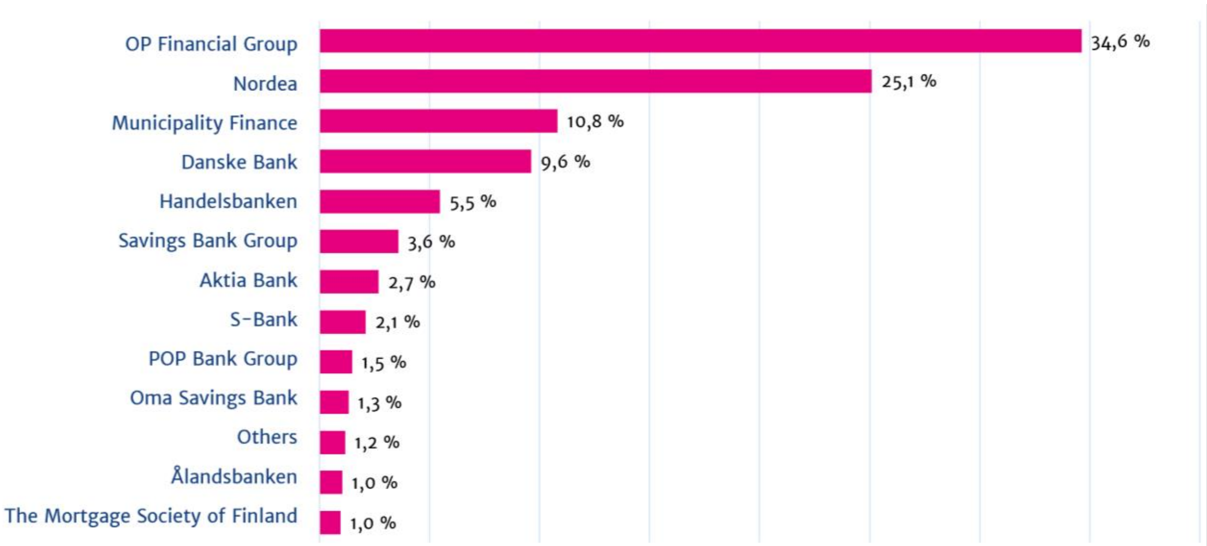
Source: Statistics Finland, FFI, Bank of Finland, FIN-FSA

2.2 Credit institutions' market shares

The largest Finnish banking group in terms of market share is OP Financial Group. It commanded a market share of 34–38% in deposits, housing loans and corporate loans alike. The second largest banking group at year-end 2020 was Nordea Group with market shares of 25–27%.

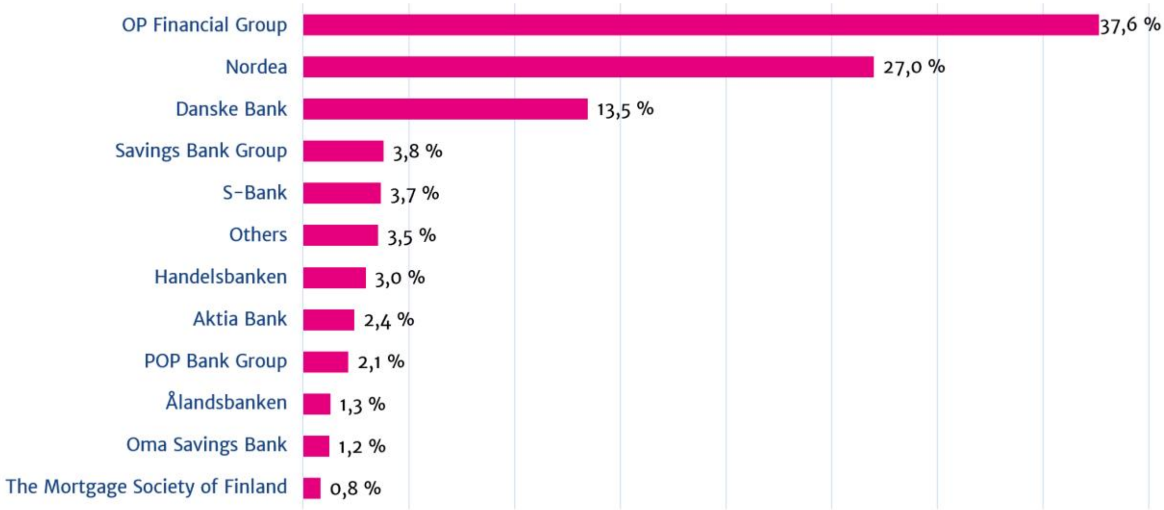
Credit institutions' market shares have not changed much in recent years. In granted loans, changes were very small, about one percentage point at most in 2020. In deposits, OP Financial Group lost 1.6 percentage points in market share while Danske Bank gained 2.0 percentage points.

Figure 7. Credit institutions' non-MFI loans in Finland, market shares on 31 Dec 2020



Source: Bank of Finland

Figure 8. Credit institutions' non-MFI deposits in Finland, market shares on 31 Dec 2020



2.3 Capital adequacy and profitability

The financial crisis caused by the coronavirus pandemic was also reflected in Finnish banks' operating environment, although less than predicted. Despite economic uncertainty, the banking sector's capital ratios changed little, and the Common Equity Tier 1 (CET1) ratio and leverage ratio even improved in 2020. The overall capital adequacy ratio of the sector stood at 21.2% at the end of year, down 0.1 percentage points from 2019. The sector's Common Equity Tier 1 (CET1) ratio strengthened 0.5 percentage points to 18.1%. The leverage ratio increased 0.3 percentage points to 6.2%. The capital adequacy of the Finnish banking sector remains well above the EU average.

The aggregate operating profits of the Finnish banking sector grew by €0.9bn, totalling €4.3bn in 2020. Because the comparison year 2019 involved many non-recurring costs that weakened banks' operating profits, the growth of the operating profits in 2020 was mainly related to smaller costs.

Net interest income increased 4% to €6.7bn. Commission income stayed at €3.9bn, the same as in 2019. Despite the coronavirus crisis, the banking sector's income remained level. Growth in net interest income was primarily due to smaller interest expenses. Banks' operating environment was characterised by historically low interest rate level and interest margins lowered by competition. At the same time, new participants entering the market bring more competition in payments, for example.

Net interest income is still the banking sector's most substantial source of income. Net interest income is the difference between interest income and interest expenses. The structure of total profits varies greatly between banks, however. In some banks, net interest income is the constant, main source of income, and in others, the main source of income are commissions. Net interest income currently contributes more than half of all income in the sector. Commissions include, for example, the fees collected from customers' use of payments and asset management services.

Net income from trade and investments improved 30% to nearly €1bn in 2020. The favourable development of net interest from trading and investment activities was largely the result of changes in market values. The first wave of the coronavirus pandemic caused heavy fluctuation in financial markets, but the markets recovered to pre-crisis levels during the second half of the year. Investment activities include banks' dealing on own account.

A substantial portion of Finnish banks' funding comes from non-MFI deposits, whose average interest was close to zero in 2020. However, the numbers vary greatly between credit institutions: some fund their operations almost entirely with deposits, while others (finance houses, mortgage credit banks and Municipality Finance plc.) do not take deposits at all.

Most deposits come from households. The average interest rate for household deposits fell minutely to 0.07% in 2020. This means that deposit funding has been very inexpensive. Corporate and housing company deposits have partly been charged negative interests. The average interest rate of the housing company deposit portfolio fell below zero at the end of 2020. This has partially compensated for the strain negative interests in central bank deposits have put on banks.

The average maturity of banks' funding has been lengthening for years as banks prepare for upcoming regulation. The stock of bonds with a short maturity period of less than a year (i.e. certificates of deposit) has been shrinking since 2008. The binding Net Stable Funding Ratio (NSFR) requirement steers European banks to focus their funding in long-term debt securities.

The Finnish banking sector's return on equity (ROE) was 6.4% at the end of 2020, noticeably above the average ROE of 2.5% for all EU banking sectors (1–9/2020). The coronavirus crisis has had widespread negative effects on European banks' ROE. While Southern European countries' banking sectors have recorded systematic losses even before the coronavirus crisis, banks in countries such as Germany are now also struggling to make a profit.

Once the coronavirus-induced financial crisis broke out, Finnish banks reacted quickly to the changed operating environment by granting grace periods (payment moratoria) and other flexible arrangements for their household and corporate customers. The number of repayment holidays, in particular, swiftly increased in early 2020. In the course of the year, households and businesses applied for a total of more than 300,000 loan grace periods. Corporate customers were also offered e.g. lower service fees and financial consultancy.

The number of temporary lay-offs and the fast growth of unemployment were reflected in the number of applications. Unlike in some other EU countries, Finland has not had moratoria required by legislation or mutually agreed by the entire sector, and the granting of loan payment extensions has been left at each bank's own discretion. The average length of a repayment holiday was six months. Nearly all applications were accepted.

During the second wave of the pandemic in the second half of 2020, the demand for new repayment holidays was significantly lower and returned to nearly normal levels. Extension applications to existing moratoria were also relatively few. The proportion of forborne corporate loans grew 0.3 percentage points and comprised 2.0% of total loans at the end of 2020. The proportion of forborne loans to households grew 0.8 percentage points and comprised 2.1% of total loans at the end of 2020. Compared to the European average, Finnish banks have proportionately less outstanding corporate loans to the sectors and industries most impacted by the coronavirus crisis, such as travel and hospitality industry.

The quality of Finnish banks' credit portfolio has remained clearly higher than the European average throughout the crisis. Its ratio of non-performing loans (NPL) is still among the lowest in Europe. Finnish banks' NPL ratio in the households sector was 1.6% in 2020, which is 0.3 percentage points more than the previous year. In the corporate sector, the NPL ratio dropped 0.1 percentage points to 2.5%. Housing company loans' NPL ratio has stayed significantly smaller at about 1%. As noted, non-performing assets and problem loans have burdened the European banking sector after the financial crisis, some areas like Southern Europe more than the others. The coronavirus crisis has made things even more difficult for a number of European banks.

The Finnish banking sector's short-term liquidity remained strong in spite of the coronavirus crisis. The sector's Liquidity Coverage Ratio (LCR) rose 4 percentage points to 171%. The LCR is calculated by comparing a bank's liquidity buffer with its net cash outflows over a 30-day stress period. The minimum LCR requirement is 100%.

The liquidity buffer of Finnish banks totalled €132bn and consisted mainly of central bank deposits and high-quality covered bonds. Banks paid negative interest for their central bank deposits. The ECB's deposit facility rate has been negative since mid-2014, and at the end of 2020, the rate was negative at −0.50%.

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