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FINNISH BANKING 2022

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Overview of the Finnish banking sector and the key changes in its operating environment in 2022

INTRODUCTION

The Finnish banking 2022 report is an overview of the Finnish banking sector and the key changes in its operating environment in 2022. Finance Finland publishes the banking report annually, with a focus on current topics affecting the sector that year.

The report covers two main themes:

1) developments in the operating environment and
2) developments in the banking sector.

The purpose of the report is to increase knowledge of the factors that affect the banking sector and to present a summary of the state of the banking sector. The report also includes an overview of topical monetary policy measures, the regulatory and supervisory environments, and developments in the banking sector.

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GENERAL OPERATING ENVIRONMENT

In 2022, the Covid pandemic no longer claimed centre stage. Decision-makers seemed to be less inclined to introduce new restrictions, and people seemed to better tolerate the risk of infection without feeling the need to barricade at home, perhaps because risk groups had full vaccination coverage, which helped open up society. New virus variants caused concern over the year, but people had already learned to live with the pandemic.

In early 2022, general uncertainty shot up radically when Russia invaded Ukraine. The effects of the war rippled across Europe and increased tension in superpower relations. The increased uncertainty pushed the price of energy up. The repercussions of the war dampened the mood, slowing down the housing market in Finland and making the long-lasting positive trend in the stock market take a downward turn. The rise in the price of energy, raw materials and foods caused consumer inflation to pick up speed globally.

The war also weakened the outlook of the Finnish economy. Finnish companies largely pulled out of the Russian market, causing Finland's exports in service and goods to Russia to shrink dramatically. The rise in general uncertainty reduced investment demand, component shortages created bottlenecks in production, and China's lockdowns and other reasons caused disruptions in supply chains. In Europe, an energy crisis loomed large. At the same time, rising inflation and interest rate hikes eroded households' purchasing power. Against this backdrop, the growth forecast of the Finnish economy was revised significantly downward.

The surge in inflation reflected on interest rates and interest rate expectations globally. In the euro area, consumer price inflation reached a record high of 10.7% in October, a level unprecedented in the European single currency era. The rapid inflation increased expectations for tighter monetary policy measures, causing market interest rates to rise and stock market indices to fall. Central banks indeed hiked their key interest rates several times during the year.

In addition to Russia's war of aggression, the coronavirus pandemic and the resulting measures, other topics that featured heavily during the year included climate change and its effects and mitigation. From a climate perspective, 2022 was indeed one of the hottest years on record. The EU's aim to make Europe the world's first climate-neutral continent by 2050 and Finland's goal to become a carbon-neutral country by 2035 set certain expectations both for new regulation and the financial market's role in achieving this. The banking sector will play a significant role in climate transition as finance will be increasingly redirected towards green investments. Financing needs and the role of the financial sector in the green transition are discussed in more detail in the final report of the national working group on financing the green transition.[1]

1 https://julkaisut.valtioneuvosto.fi/handle/10024/164654

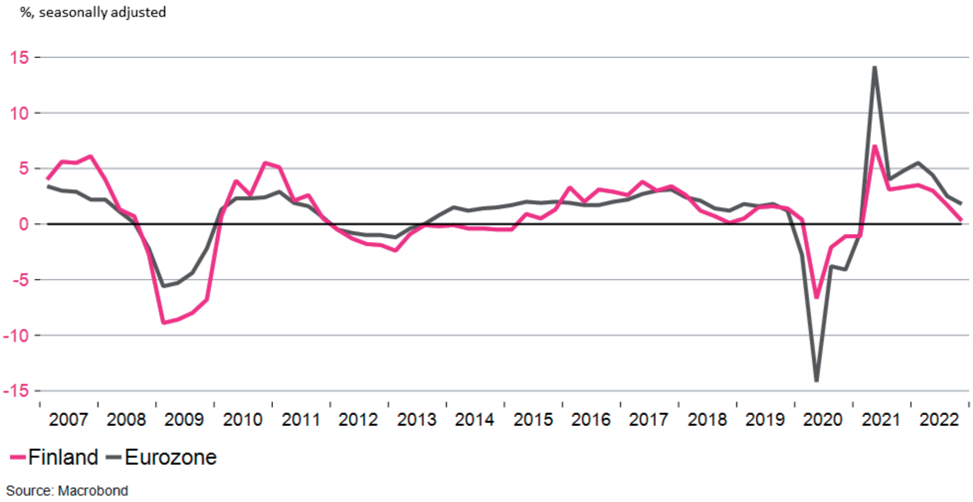


Figure 1: Annual change of GDP in Finland and the euro area (%)

1.1 Finnish economy

In the Finnish economy, 2022 was a year of very contradictory developments. Finland's GDP surpassed its pre-pandemic level already during the first half of 2021, and the economy continued to grow strongly in the latter part of the year. Indicator data for the early months of 2022 and the Bank of Finland's short-term forecasting models suggested that the Finnish economy would continue to grow in the first months of 2022.[2]

Finland's GDP did continue to grow in the early months of 2022 thanks to the high demand of many services and the backlog orders delivered to manufacturing customers. Private consumption increased even though the rising inflation eroded consumer purchasing power. Overall, Finland's exports were expected to return to their pre-pandemic level in early 2022 despite the global supply chain bottlenecks and component shortages that slowed down recovery.

After the early months, however, the outlook took a significant turn for the worse. Russia's invasion of Ukraine heightened uncertainty to a new level. Economic sanctions imposed on Russia and Belarus reflected negatively on Finnish companies as well. The price of energy and raw materials soared, which drove up both producer and consumer price inflation. Finland's country risk also heightened temporarily because of Russia's military aggression.

As demand dwindled in the global economy, new orders in manufacturing also slowed down. At the same time, accelerating inflation and rising interest rates eroded households' purchasing power and undermined consumer confidence. As a result, the growth forecast of the Finnish economy was revised downward.

One of the few positive sides to this upended geopolitical situation was that it helped accelerate the green transition. The transition away from Russian energy and the commitment to further reduce greenhouse gas emissions boosted investments in renewable energy, in which Finland is among the leading EU countries.[3] In 2022, Finland's wind power capacity increased by 75% and brought more than €2.9 billion in investments to Finland.[4]

Despite the challenging year, the volume of Finland's GDP rose by 2.1% in 2022 according to Statistics Finland's revised preliminary data.[5] (Figure 1)

The rise in energy and raw material prices pushed up imports of goods in monetary terms and weakened the goods account, while transport and tourism weighed down the balance of services. The balance of goods and services therefore showed a marked deficit. The current account deficit grew to a new record of €10 billion. In relation to GDP, the current account has not been in such a deep deficit since 1992.[5]

Finland's employment rate of those aged 15 to 64 was 73.8% in 2022, which was 1.6 percentage

2 https://www.bofbulletin.fi/en/2022/articles/war-in-ukraine-will-slow-finland-s-gdp-growth-and-increase-inflation/

3 https://www.motiva.fi/en/solutions/renewable_energy/renewable_energy_in_finland

4 https://tuulivoimayhdistys.fi/en/ajankohtaista/press-releases/finnish-wind-power-year-2022-wind-power-capacity-increased-by-75-and-brought-more-than-2-9-billion-investments-to-finland

5 https://stat.fi/en/publication/cl8ikcze65pgm0bvxyr2453xm

points higher than in 2021. According to Statistics Finland's Labour Force Survey, the average number of employed persons aged 15 to 74 was 2,619,000 and that of unemployed persons was 190,000. There were 65,000 more employed and 22,000 fewer unemployed persons than in 2021.[6]

Finland's employment rate has been showing a positive trend since 2016. Although real earnings decreased in 2022 due to the rise in inflation, the positive employment development was important for households' financial situation.

Household indebtedness and related legislative measures have been an active topic of conversation in Finland for years now. It has been estimated that in terms of financial stability, the stability concerns related to household indebtedness are more often caused indirectly through risks taking place in economic development rather than directly through the credit risks of residential mortgage loans. Rising interest rates may allow households less financial latitude and thus curb consumer demand if the level of debt is high.

In counterbalance to the growing household indebtedness, households have also increased their assets. By the end of 2022, more than 300,000 people had opened an equity savings account, which were only recently introduced in Finland.[7] Saving in investment funds has also attracted increasing interest among Finns in recent years. At the end of 2022, about 1.47 million Finns had made fund investments. The combined assets of Finnish investment funds totalled €134 billion at the end of 2022.[8]

The growth in households' deposits slowed down from the pandemic years in 2022, but the growth nevertheless amounted to €2.8 billion. At the end of 2022, the stock of Finnish households' deposits totalled €111.8 billion and the average interest rate on the deposits was 0.21%. The rising interest rates slightly increased the popularity of deposits with an agreed maturity. While their share (4%) of the stock of deposits remains small, their growth rate towards the end of the year was fast. The average interest rate of new deposits with an agreed maturity was 1.85% in December.[9]

The pandemic years have also been characterised by the growth of the student loan stock. According to the Bank of Finland statistics, the student loan stock broke records, exceeding €5 billion for the first time in August 2021.[10] The student loan stock continued to grow in 2022, reaching €5.7 billion at year-end.[11] There are a few key factors that explain this growth. Firstly, the pandemic has cut the number of jobs in many sectors that typically employ students, thus increasing the need for financial aid for students. Secondly, the volume of student loans has been increased by the larger loan tranches that flowed from the student financial aid reform of 2017 and by an increased number of borrowers.[12]

1.2 Housing market

The banking sector has continued to grant residential mortgages to households as usual during both the pandemic and the war, which has been extremely important in terms of labour mobility and the increasing popularity of remote work, for example. The Finnish housing market boomed during the early stages of the pandemic, but housing prices have nevertheless developed moderately in Finland by international comparison.[13] Regional differences in housing prices remain large, and in parts, the market has continued to diverge even further. In many municipalities, housing prices have either remained level or continued to fall.

The year 2022 was contradictory in the housing market. In the first quarter, the sales of older homes were lively, but there was a shortage of

6 https://www.stat.fi/en/publication/cl8cwwnhk9mur0avur7dt-t33y
7 https://www.euroclear.com/finland/fi/news-and-insights/news/Osakesaastotileja-yli-300000.html (in Finnish)
8 https://www.finanssiala.fi/en/topics/funds/#/
9 https://www.suomenpankki.fi/fi/Tilastot/rahalaitosten-tase-lainat-ja-talletukset-ja-korot/#:~:text=Suurien%2C%20yli%201%20milj.,keskikorko%20oli%204%2C76%20%25.
10 https://www.suomenpankki.fi/en/Statistics/mfi-balance-sheet/older-news/2021/average-interest-on-new-student-loans-close-to-zero--stock-of-student-loans-exceeds-eur-5-billion/
11 https://www.suomenpankki.fi/en/Tilastot/rahalaitosten-tase-lainat-ja-talletukset-ja-korot/taulukot/rati-taulukot-fi/pt_kotitalouksien_lainat_ja_talletukset_en
12 https://www.eurojatalous.fi/fi/blogit/2017/opintolainat-kasvavat-ennatysvauhtia-suurin-syy-opintotuen-uudistukset/ (in Finnish)
13 https://www.eurojatalous.fi/fi/2022/artikkelit/asuntojen-hinnat-laskussa-pohjois-maissa-pankit-kestavat-riskeja-hyvin/ (in Finnish)

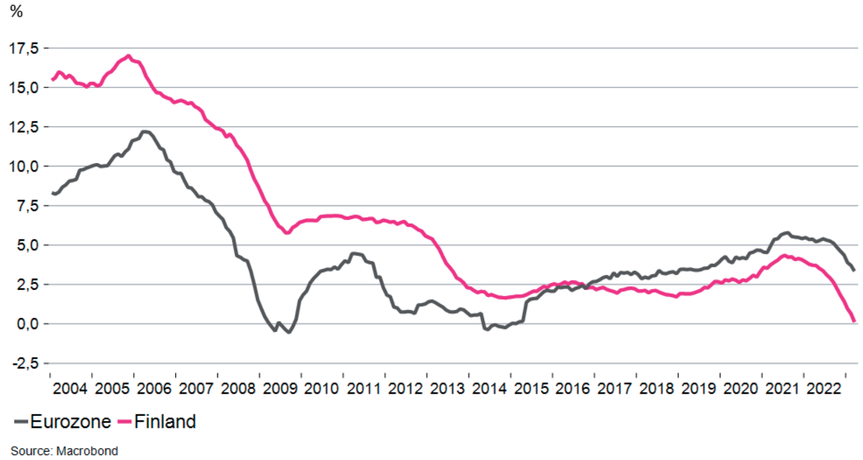


Figure 2: Annual growth rate of the housing loan stock in Finland and the euro area

new homes.[14] The average lending margins on new housing loans stood at about 0.8% in January 2022.[15] The average repayment period of a new residential mortgage loan stayed at a good 21 years.

The changes in the economic outlook brought on by Russia's invasion of Ukraine also reflected on the Finnish housing market. Buyers became more cautious and selling times grew longer. The boost given by the pandemic faded, and the soaring heating energy prices, rising loan rates and increasing general uncertainty slowed the housing market down. The steep rise in reference rates eventually pushed housing prices down after a good start to the year.

According to Finance Finland's banking barometer conducted in early 2022, the demand for household loans fell significantly in the first quarter compared to the previous year. Bank managers also reported a desolate outlook for households' willingness to take out loans in the summer of 2022: for the first time in the history of the quarterly conducted survey, not a single respondent expected the demand to pick up. Instead, respondents expected households to have an increasing need for grace periods and other flexible loan arrangements.[16] In the latter half of 2022, home sales indeed decreased from the previous year.

At the end of December 2022, the stock of housing loans stood at €108.5 billion, and the annual growth rate of the stock was 0.5%. Investment property loans (e.g. buy-to-let) accounted for €8.8 billion of the housing loan stock. Non-performing loans constituted 1% of housing loans (12/2021: 1.1%).[17] When granting housing loans, banks value the mortgage lending value clearly under the market value of the time of the credit granting. This protects them against credit losses in an environment of decreasing property prices. Out of all loans of Finnish households at the end of December, consumer credit totalled €17.1 billion and other loans €18.0 billion.[18] (Figure 2)

The interest expenses of housing loans rose clearly from the previous year. At the end of 2022, the average interest rate was 1.97% in housing loans (0.78% in 2021) and 2.1% in investment property loans (0.91% in 2021).[19] (Figure 3)

At the end of December 2022, the stock of loans to housing corporations stood at €42.3 billion. 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. In international statistics, Finland's housing corporation loans are included in the corporate loan portfolio, but in national statistics, corporate loans and housing company loans are separate categories, which means that increased construction does not have the same effect on the corporate loan portfolio.

14 https://kiinteistonvalitysala.fi/vuoden-2022-ensimmaisella-neljanneksella-vanhojen-asuntojen-kauppa-yha-vilkasta-uudiskohteista-pulaa/ (in Finnish)
15 https://www.finanssivalvonta.fi/contentassets/644fcdc2b0b7416c97de0496344a7c2f/mv_30032022/macroprudential_decision_30032022.pdf
16 https://www.finanssiala.fi/wp-content/uploads/2022/06/FA-Pankkibarometri-II-2022.pdf (in Finnish)

17 https://publications.bof.fi/bitstream/handle/10024/52686/Pankkisektori-Q4-2022.pdf (in Finnish)
18 https://www.suomenpankki.fi/en/Statistics/mfi-balance-sheet/
19 https://www.suomenpankki.fi/en/Statistics/mfi-balance-sheet/

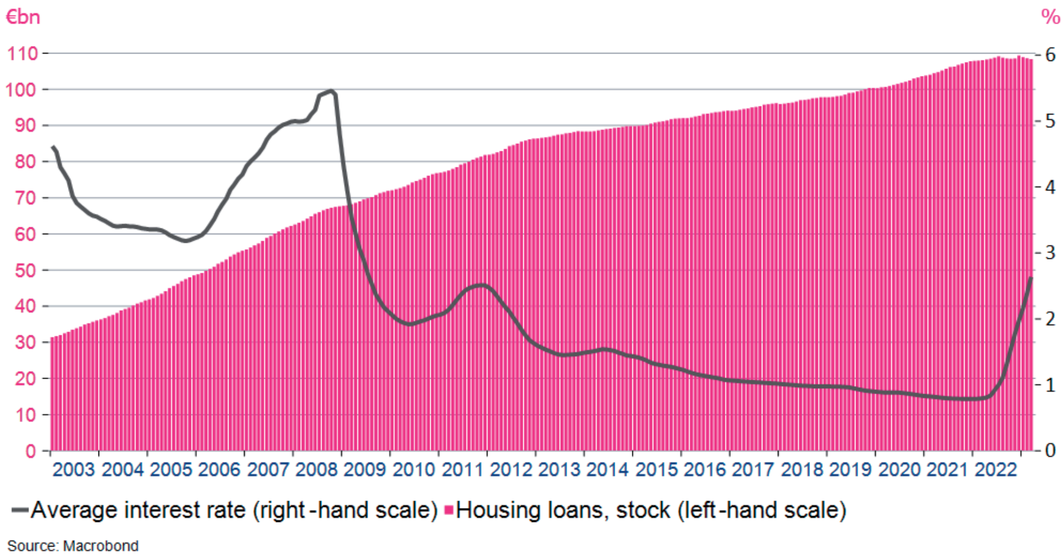


Figure 3: Households' housing loan stock and average interest rate

In general, loans taken out to construct a residential building 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. These housing company loans continue to include few non-performing loans (0.19% of the loan stock, €40 million in total).

The term 'housing corporation' encompasses all corporation forms of housing units, not just limited liability housing companies. Some of the housing corporation loan volume is held by households, some by housing investment funds and other housing investors, and some by companies.

Towards the end of 2022, the long-term trend of active construction took a downward turn. Of the roughly 39,000 building starts, privately funded totalled about 33,000, which is 15% less than in 2021.

State-subsidised housing production formed 15% of all new construction, which is the lowest level since 2007. The increasing construction costs and rising interest rates clearly decreased building starts in state-subsidised housing production in 2022.[20] Part of the reason for the lower number of starts is that banks show little interest in financing state-subsidised housing production due to reasons related to the calculation of capital requirements, collateral practices and other conditions.[21]

SUPERVISORY MEASURES

2.1 The ECB's monetary policy

In monetary policy, the year 2022 was divided. The European Central Bank's (ECB) decisions were followed with keen interest throughout the year, and debate was sparked especially by the ECB's stance and reaction to the accelerating inflation. The normalisation of monetary policy was also a frequent topic during the year.[22]

The pandemic emergency purchase programme (PEPP) was discontinued at the end of March 2022.[23] Asset purchases under the asset purchase programme (APP) were reduced step by step. The Governing Council decided on a monthly net purchase pace of €40 billion in the second quarter and €30 billion in the third quarter under the APP.[24] Net purchases were discontinued in the third quarter. From October 2022 onwards, the Governing Council will maintain net asset purchases under the APP at a monthly pace of €20 billion for as long as necessary to reinforce the accommodative impact of its policy rates.[25]

20 https://www.ara.fi/fi-FI/Ajankohtaista/Uutiset_ja_tiedotteet/Uutiset_ja_tiedotteet_2023/Asunto_ja_ARAraken taminen_kaantyi_laskuu(65080)#:~:text=Pitk%C3%A4%C3%A4n%20korkealla%20tasolla%20jatkunut%20asuntorakentaminen,pienin%20osuus%20vuoden%202007%20j%C3%A4lkeen (in Finnish)

21 https://www.finanssiala.fi/wp-content/uploads/2023/01/fa_lausunto_18012023_ymv_hallituksen_esitys_pitkan_korkotukimallin_kehittaminen.pdf (in Finnish)

22 https://www.suomenpankki.fi/en/media-and-publications/releases/2022/ecb-monetary-policy-normalisation-is-proceeding-consistently/

23 https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.mp220203~90fbe94662.en.html

24 https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.mp211216~1b6d3a1fd8.en.htm

25 https://www.suomenpankki.fi/en/monetary-policy/implementation-of-monetary-policy/monetary-policy-purchase-programmes/

The Governing Council expects net purchases to end shortly before it starts raising the key ECB interest rates.

Interest rate hike expectations changed over the course of the year. In the early part of the year, there was talk about raising interest rates gradually and moderately, while in the latter part of the year, the ECB was expected to react strongly to the sharply rising inflation. Monetary policy remained accommodative in the first half of the year, but changed course in the summer only to tighten significantly in late 2022.

Interest rates rose sharply in the financial market as central banks began to tighten their stance. The ECB started to tighten its monetary policy in the summer. The ECB's Governing Council raised interest rates for the first time in 11 years in July (by 0.5 percentage points), and again in September (by 0.75 percentage points). The September rate hike was the biggest in the ECB's history.[26] In December, the ECB raised its deposit facility rate to 2%. The 12-month Euribor rate, the most commonly used housing loan reference rate in Finland, rose by 3.8 percentage points in 2022 to 3.3%.[27]

Late in 2022, the ECB announced that it is likely to make further hikes to its key interest rates. According to the ECB, inflation was still much too high at the time, and it was also expected to remain higher than the target level for a longer time.

2.1.1 Targeted longer-term refinancing operations (TLTROs)

The third series of targeted longer-term refinancing operations (TLTRO III) undertaken during the pandemic saw the most affordable financing conditions in the history of the Eurosystem – never before has the Eurosystem granted credit to banks at a rate that is lower than the ECB's deposit facility rate.[28] At the end of 2022, the Finnish banking sector had acquired some €30 billion through the programme.[29]
The ECB's Governing Council decided to recalibrate the conditions of TLTRO III in its October 2022 meeting. In view of the unexpectedly high inflation, the ECB considered it necessary to recalibrate TLTRO III to ensure consistency with the broader monetary policy normalisation process and to reinforce the transmission of its policy rates to bank lending conditions. The Governing Council decided to index the interest rate on all remaining TLTRO III operations to average applicable key ECB interest rates from 23 November 2022 onward and introduce three additional voluntary early repayment dates for banks wishing to terminate or reduce borrowings before maturity. The early repayments of Finnish banks were much smaller in relation to those of other European banks.

The Governing Council's decision attracted considerable attention in the banking sector. Commenters generally pointed out that changing financing conditions ex post facto was problematic and chipped the ECB's credibility. Tensions between the ECB and banks under its supervision had already been running higher since the ECB decided to limit banks' distribution of dividends during the pandemic so as not to risk their capital adequacy.

2.1.2 Monetary policy and the climate

The ECB published its new monetary policy strategy in 2021. Although the main focus of the changes adopted in the new strategy was on the formulation of the price stability objective and the measures the Eurosystem can take to achieve it, climate change also featured as one of the central topics in the strategy review. In its new strategy, the ECB committed to an ambitious climate-related action plan to further include climate change considerations in its monetary policy framework.

According to the action plan, the ECB will expand its analytical capacity in macroeconomic modelling, statistics and monetary policy with regard to climate change. The ECB will also develop new experimental indicators, covering relevant green financial instruments and the carbon footprint of financial institutions, as well as their exposures to climate-related physical risks.

26 https://www.ecb.europa.eu/ecb/educational/explainers/tell-me-more/html/interest_rates.en.html
27 https://www.suomenpankki.fi/en/Tilastot/korot/kuviot/korot_kuviot/euriborkorot_pv_chrt_en/
28 https://www.eurojatalous.fi/fi/blogit/2021/pankit-nostaneet-ennatyksellisen-maaran-edullisia-kohdennettuja-luottoja/ (in Finnish)
29 https://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=123.ILM.M.FI.N.A050200.U2.EUR

The ECB will introduce environmental sustainability disclosure requirements as a new eligibility criterion for collateral and asset purchases. The treatment of debt securities used as collateral for monetary policy credit or acquired under purchase programmes can be differentiated based on their environmental impact. The new requirements are designed to promote the harmonisation of disclosures.[30]

In July, the ECB's Governing Council decided to take further steps to include climate change considerations in the Eurosystem's monetary policy framework.[31] It decided to adjust corporate bond holdings in the Eurosystem's monetary policy portfolios and its collateral framework, to introduce climate-related disclosure requirements and to enhance its risk management practices.

2.2 Regulatory environment

The regulatory environment was busy in 2022. The widely discussed Basel III reform on banks' capital requirement regulations was active throughout the year. Basel III is a regulatory framework published by the Basel Committee on Banking Supervision in 2017 to finalise the post-crisis regulation framework on banks' capital adequacy and liquidity. The purpose of the reform is to improve risk calculation and increase comparability between banks.

The European Commission published its proposal for the implementation of the final Basel III standards on 27 October 2021. The proposal entailed broad amendments to the EU Capital Requirements Regulation (CRR) and the Credit Requirements Directive (CRD). The proposed reforms (CRR III and CRD VI) are supposed to take effect at the beginning of 2025.

The CRR is directly applicable legislation, so it does not require national implementation. The CRR includes provisions relating to the calculation of own funds and prudential minimum requirements, liquidity, leverage ratio and large exposures.[32] The CRD covers requirements relating to the taking up of business and the provision of services as well as requirements relating to official supervision, sanctions and reliable corporate governance. It also includes additional capital requirements in the form of various buffers.

The Finnish financial sector has been concerned about how much the Basel standards will increase Finnish banks' capital requirements and about how little attention the standards give to promoting sustainable economic growth. The Finnish Financial Supervisory Authority FIN-FSA's impact assessments have fluctuated over time. According to the most recent calculations, the reform would increase Finnish banks' capital requirements by about 3-4% after the transition period has ended. Finance Finland considers this estimate too modest. Finance Finland has also criticised the finalised reform for failing to take national specificities – such as Finland's low-risk mortgages – sufficiently into account in the regulatory proposals. The Finnish Parliament's Commerce Committee emphasised in its statement that to ensure proportionate and material regulation, it is necessary to take into account the national specificities of the member states and their credit institutions in the negotiations. The Commerce Committee also repeated its often-raised concern about the proportionality of regulation in relation to its benefits.[33] Throughout the negotiations, Finance Finland has considered it important to make the safeguarding of Finland's specificities as important an objective as the improvement of the financial system's resilience.[34]

The Basel III reform entails temporary reliefs extending to 2032 on residential mortgages and unrated corporate loans. One purpose of the long transitional periods is to allow enough time to assess whether there is a need for more permanent legislation.[35]

30 https://www.suomenpankki.fi/fi/media-ja-julkaisut/puheet-ja-haastattelut/2022/johtokunnan-jasen-tuomas-valimaki-ilmastonmuutos-rahapolitiikan-pitkan-aikavalin-haasteena-puhe-taloustutkijoiden-kesaseminaarissa-15.6.2022/ (in Finnish)
31 https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220704~4f48a72462.en.html
32 https://www.finanssivalvonta.fi/en/regulation/regulatory-framework/crrcrd/
33 DEMC91C.tmp.xml (eduskunta.fi) (in Finnish)
34 Valtioneuvoston kirjelmä eduskunnalle komission ehdotuksesta Euroopan parlamentin ja neuvoston asetukseksi asetuksen (EU) N:o 575/2013 muuttamisesta, direktiiviksi direktiivien 2013/36/EU ja 2014/59/EU muuttamisesta ja asetukseksi asetuksen (EU) N:o 575/2013 ja direktiivin 2014/59/EU muuttamisesta (Basel III -standardien täytäntöönpano) - Finanssiala (in Finnish)
35 https://www.finanssiala.fi/wp-content/uploads/2022/06/Raportti-pankkisaantelysta-22062022.pdf (in Finnish)

The effectiveness of macroprudential regulation was also assessed in 2022. In late 2021, the European Commission published a targeted consultation on improving the EU's macroprudential framework for the banking sector. This had to do with the review of legislation required under Article 513 of the CRR.[36]

In its response to the consultation, Finance Finland argued that macroprudential requirements must be kept predictable, symmetric and transparent. The guiding principle should be that of only one capital requirement or restriction for one risk. The amendments should not increase the overall level of capital requirements from their current level.

The EU's Banking Union project was also discussed in 2022. On 16 June, the Eurogroup agreed to divide the further development of the Banking Union into smaller steps. The meeting started with four elements on the table: the crisis management of small and medium banks and the use of deposit guarantee funds to this end, a European deposit insurance scheme, the treatment of banks' sovereign bond holdings, and the single market. In the end, it was decided that only the first of the four – crisis resolution – would proceed at this point, and plans for a European deposit insurance scheme were postponed. Finance Finland was satisfied that the work will first focus on laying down the foundation and only then on building further from a solid standing point.

In Finland, household indebtedness has been a permanent topic of discussion in recent years. The Finnish government submitted a legislative proposal on new measures to curb household indebtedness in June 2022. The proposal was based on the recommendations of the Ministry of Finance working group published in October 2019. The Parliament passed the bills in early 2023, and the acts will enter into force in July 2023. Under the new acts, the maximum maturity period of new housing loans will be 30 years. In addition, housing companies will be permitted to borrow at most 60 per cent of the unencumbered price of the flats to be sold, the maximum maturity period of loans to housing companies will be 30 years, and no interest-only periods will be permitted for five years from the completion of the dwelling, except during the first year. The registration and supervision of non-bank consumer creditors will also be transferred entirely to the FIN-FSA.

Finance Finland supported some of the changes – such as introducing the loan-to-value limit to housing company loans and extending regulation to cover different creditors on a broad basis – but considered some of them problematic, especially the one about the FIN-FSA being authorised to give credit institutions orders pertaining to the limits and distributions on the assessment of insolvency risk.

Interest rate risk regulation was updated in late 2022. The European Banking Authority (EBA) published on 20 October a final set of guidelines and two final draft regulatory technical standards (RTS) specifying technical aspects of the revised framework capturing interest rate risks for banking book (IRRBB) positions. These regulatory products complete the onboarding into EU law of the Basel standards on IRRBB. [37]

The EU Taxonomy, a classification system for sustainable economic activities, was another topic that featured heavily during the year. The European Parliament did not object to the Commission's Taxonomy Delegated Act. According to the act, specific nuclear and gas energy activities can be included, under certain conditions, in the list of environmentally sustainable economic activities covered by the EU Taxonomy.[38]

The purpose of the Taxonomy is to help banks and other financiers reliably identify investments that are sustainable. It is important to note that even if a company's operations fall outside the classification, it does not mean that they are prohibited or cannot be financed. Finance Finland supports the establishment of common, science-based criteria for sustainable investments in the EU, but does not take a stand on what criteria should be set for non-financial sectors.

36 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2021-banking-macroprudential-framework-consultation-document_en.pdf

37 https://www.eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-process-srep-and-pillar-2/guidelines-irrbb-and-csrbb

38 https://www.europarl.europa.eu/news/en/press-room/20220701IPR34365/taxonomy-meps-do-not-object-to-inclusion-of-gas-and-nuclear-activities

In relation to various regulatory projects, Finance Finland has emphasised the importance of extensive and carefully conducted impact assessments. Ideally, regulation increases clarity, transparency, trust and confidence in the financial market and prevents unnecessary administrative burdens and costs.

2.3 Supervisory environment

Of Finnish credit institutions, Nordea, OP Financial Group and Municipality Finance are under the direct supervision of the European Central Bank (ECB). The ECB also supervises the Finnish branch of Danske Bank. Other banks are supervised by the Finnish Financial Supervisory Authority (FIN-FSA) as part of the Banking Union's joint banking supervision.

The FIN-FSA Board assesses on a quarterly basis the short- and long-term risks to the stability of Finland's financial system. If necessary, the Board may tighten or relax its macroprudential instruments to promote stability. In its first macroprudential decision of 2022, the FIN-FSA Board decided to maintain credit institutions' lowered structural capital requirements, i.e. to keep them at the level at which they were set in spring 2020 due to the COVID-19 pandemic. At the same time, it decided to extend the validity of the decision on a lower housing loan cap, keeping the loan cap on residential mortgage loans other than first-home loans at 85%. It also decided to keep banks' countercyclical capital buffer requirement unchanged at its standard level of 0.0%. The Board also stated that it will assess the effects of the war on the stability of the Finnish financial system and on the need to deploy macroprudential tools.[39]

The FIN-FSA Board tightened its macroprudential policy stance in June. It raised the additional capital requirements (O-SII buffers) for credit institutions significant for the Finnish financial system (other systemically important institutions, O-SIIs). O-SIIs refer to credit institutions that pose a systemic risk so great that their failure could have severe negative impact on the financial system and the real economy. Nordea's O-SII buffer rate rose to 2.5% (from 2.0%) and OP Financial Group's to 1.5% (from 1.0%). The buffer requirement for Municipality Finance Plc remained unchanged at 0.5%. The decision entered into force on 1 January 2023.[40]

Finance Finland holds that in setting O-SII buffers, it would be important to consider the cyclical position and the effect higher buffer rates will have on the credit institutions' lending capacity. In Finance Finland's view, the buffers should have been kept unchanged due to the uncertain economic outlook.

In June, the FIN-FSA Board also issued a recommendation on mortgage borrowers' maximum debt servicing burden, which entered into force on 1 January 2023. According to the recommendation, the 'stressed' debt-service-to-income (DSTI) ratio of a borrower should, as a rule, be no more than 60% of their net income. The stressed DSTI ratio should be calculated by taking extensively into account the applicant's housing loans, other loans and housing company-related charges for financial costs, and their stressed servicing costs. The stressed servicing costs should be calculated with a maturity of no more than 25 years and an interest rate of at least 6% (except for fixed-rate loans and loans with long-term interest rate hedges).

Finance Finland considered the timing of this recommendation problematic and estimated that it may further strengthen the negative effects the economic situation has on the housing market and, as a result, on labour mobility.
The third macroprudential decision of 2022 was published at the end of September. The FIN-FSA Board decided to keep both the loan cap, i.e. the maximum loan-to-collateral (LTC) ratio, and the countercyclical capital buffer (CCyB) requirement for banks unchanged. The Board also clarified its recommendation on a maximum debt-servicing burden for housing loan applicants' loans and housing company-related charges for financial costs.

In its fourth and final macroprudential decision of the year, the FIN-FSA Board announced that it was preparing to make a decision on the activation of

39 https://www.finanssivalvonta.fi/en/financial-market-stability/macroprudential/macroprudential-decisions-and-appendices/macroprudential-decisions-2022/macroprudential-decision-30-march-2022/

40 https://www.finanssivalvonta.fi/en/financial-market-stability/macroprudential/macroprudential-decisions-and-appendices/macroprudential-decisions-2022/macroprudential-decision-27-june-2022/

a systemic risk buffer (SyRB) in the first quarter of 2023. According to the decision, the structural risks and vulnerabilities surrounding the Finnish banking sector provide a justification for the imposition of a SyRB requirement. The FIN-FSA Board deactivated the SyRBs that had been set for Finnish banks in spring 2020 to mitigate the effects of the COVID-19 pandemic.[41]

Finance Finland was surprised that the FIN-FSA considered reactivating the requirement in a situation where the risk of recession was real. Finance Finland was also surprised to see the FIN-FSA use the European Systemic Risk Board's (ESRB) warning from September as a justification, as it was largely based on cyclical factors. According to the Act on Credit Institutions, the imposition of a systemic risk buffer must be based on an assessment of long-term factors independent of cyclical fluctuations, also considering its effects on banks' lending capacity.

In supervision, the FIN-FSA's releases included two thematic reviews of banks under its direct supervision, one concerning the work of their boards of directors[42] and the other concerning liquidity stress testing, funding plans and funding contingency plans.[43]

2.4 The Financial Intelligence Unit and suspicious transaction reports

The Finnish Financial Intelligence Unit receives reports regarding suspicious transactions and suspected terrorist financing from parties subject to the reporting obligation under the Act on Preventing Money Laundering and Terrorist Financing. Some of the reports are transaction-based mass deliveries that are based on the automatic reporting practices of certain obliged entities. Mass reports are typically based on a certain maximum threshold, meaning that all transactions that exceed the maximum threshold are reported to the Financial Intelligence Unit.

According to the Financial Intelligence Unit's half-year report, banks submitted about 6,100 suspicious transaction reports in the first half of 2022.[44] The number of suspicious transaction reports has some annual variation. By way of comparison, banks submitted about 13,900 reports in 2021. Financial sector companies spend over €100 million every year to prevent money laundering. Only a fraction of the reports lead to preliminary investigation or charges.

The full statistics for 2022 were not yet available when this report was written.

Money laundering is the attempt to mask the origins of illegal income by passing it through banks. In Finance Finland's view, the prevention of money laundering and terrorist financing would benefit from Europe-wide harmonised regulation. At the moment, the national laws of each member state attempt to prevent crime that is highly international by nature. The regulation should ensure sufficient flexibility to allow banks to make use of their own risk assessments.[45]

2.5 The Finnish Financial Stability Authority

The Finnish Financial Stability Authority serves as Finland's national resolution authority to ensure the stability of the financial market and restructure credit institutions and investment firms experiencing financial difficulties. The Financial Stability Authority also acts as Finland's national authority responsible for the deposit guarantee scheme.[46]

In 2022, the Financial Stability Authority collected a total of €140 million as deposit guarantee contributions and entry contributions for a new bank. After the contributions for 2022 have been collected, the fund will amount to approximately €919 million.[47] The deposit guarantee contributions accumulate the Deposit Guarantee Fund, the purpose of which is to secure the claims

41 https://www.finanssivalvonta.fi/en/financial-market-stability/macroprudential/macroprudential-decisions-and-appendices/macroprudential-decisions-2022/macroprudential-decision-16-december-2022/

42 https://www.finanssivalvonta.fi/tiedotteet-ja-julkaisut/valvottavatiedotteet/2022/teema-arvio-finanssivalvonnan-suorassa-valvonnassa-olevien-pankkien-hallitusten-tyoskentelyssa-on-kehitettavaa/ (in Finnish)

43 https://www.finanssivalvonta.fi/en/publications-and-press-releases/supervision-releases/2022/thematic-review-room-for-development-in-the-ilaap-methodologies-of-banks-directly-supervised-by-the-financial-supervisory-authority/

44 https://poliisi.fi/documents/25235045/67733116/Rahanpesun-selvittelykeskus-puolivuosikatsaus-2022.pdf/e6b6d0d7-8ae4-d6e8-53e5-c87f3899ebcc/Rahanpesun-selvittelykeskus-puolivuosikatsaus-2022.pdf?t=1659075148282 (in Finnish)

45 https://www.finanssiala.fi/en/news/anti-money-laundering-needs-european-harmonisation-international-crime-cannot-be-curbed-with-national-legislation/

46 https://rvv.fi/en/mission-and-objectives

47 https://rvv.fi/en/-/financial-stability-authority-to-collect-eur-140-million-to-the-deposit-guarantee-fund-in-2022

of deposit banks' depositors. The target level of the Deposit Guarantee Fund is 0.8% of the total amount of the covered deposits held by deposit banks operating in Finland, and it must be reached by 3 July 2024.

In addition, the Financial Stability Authority collected a total of €320 million from Finnish institutions to the Single Resolution Fund (SRF) in 2022. The contributions payable by Finnish institutions represent an average growth of 19% from the previous year.[48] In accordance with the Single Resolution Mechanism regulation, the target level of the SRF at the end of 2023 is at least 1% of the amount of covered deposits of credit institutions authorised in all participating member states.

BANKS OPERATING IN FINLAND

3.1 Overview of the Finnish banking sector and key figures in 2022

In 2022, the operating environment of banks was characterised by exceptional uncertainty. Rapidly rising inflation and sharp interest rate hikes together with a worsening economic outlook affected the demand for both housing and corporate loans, especially towards the end of the year. Stock prices also fell during the year in all key markets, with the Nasdaq Helsinki general index going down by about 15%. This decreased banks' net income from trade and investments.

The growth rate of both deposits and credits was clearly slower than in previous years, settling at around two per cent. At the end of 2022, loans to households stood at €143.6 billion (€141.7 billion in 2021) and loans to housing corporations at €42.3 billion (€39.5 billion in 2021). The stock of loans to non-financial corporations (excluding housing corporations) granted by banks operating in Finland totalled €62.6 billion (€59.8 billion in 2021).

Despite the worsening general economic situation, the debt service capacity of both households and corporations remained good throughout the year, and the ratio of non-performing loans (NPL) remained level. The challenging operating environment did not affect banks' credit granting capacity, which remained strong.

The role of net interest income in banks' results increased. The rising interest level can be expected to boost the financial performance of banks also in the near future, as the interest rates of the loan stock are updated to reflect the higher interest level. The growth of net interest income was also boosted by the low cost of funding.

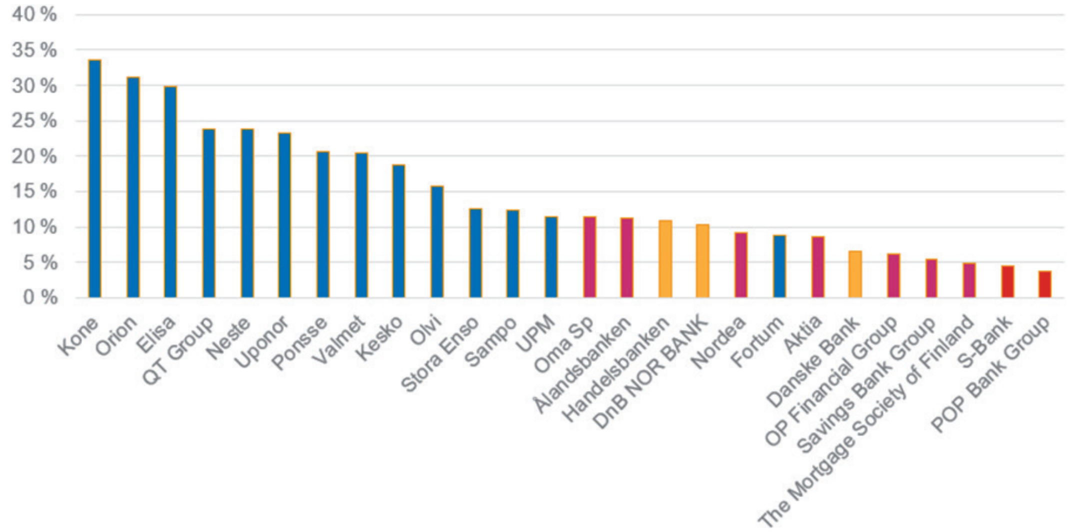
The banking sector had a good year in terms of business results, even if the results fell a little short of the previous year's results. The results were boosted by the growing net interest income, which increased by about 14% from the previous year. The banking sector's profit in January–December amounted to about €6.6 billion (€6.8 billion in 2021). Net interest income made up 55.7% of the profit. At the same time, the ratio of net interest income to interest-bearing balance sheet items, i.e. the interest rate margin, rose to about 1.15% (1.06% in 2021). Most of the net interest income comes from household and corporate loans.[49]

The slight dip in the profit is explained by the decrease in commission income and income from trade and investments as well as by the increase in costs. The rising interest level increased net interest income especially in the latter half of 2022. In the final quarter, net interest income amounted to about €2.4 billion, which is the highest quarterly figure since 2018. The growth of net interest income was also boosted by the growth in loans granted by banks and by the low cost of funding.

Commission income is another major source of income in the banking sector: it makes up almost one third of the profits. The majority of commission income comes from asset management. This item is sensitive to market changes and reflects the amount of assets in asset management. Commission income from payment transactions compensated for the lower profits from asset management.

48 https://rvv.fi/en/-/financial-stability-authority-to-collect-eur-320-million-in-ex-ante-contributions-from-credit-institutions

49 https://publications.bof.fi/bitstream/handle/10024/52686/Pankkisektori-Q4-2022.pdf?sequence=1&isAllowed=y



Source: Financial Statements, Investing.com

Figure 4: Return on equity – 5-year average (2018–2022)

The Finnish banking sector's profitability remained above the European average, but fell slightly from the previous year. The banking sector's return on equity (ROE) stood at 9.6% at the end of December (9.9% in 2021).

A comparison of the profitability of Finnish banks and other sectors reveals that the banking sector's profitability does not stand out as particularly great, even though it is fairly commonly said to be. (Figure 4)

The banking sector's cost/income ratio (CIR) weakened slightly from the previous year-end, totalling 52.7% (51.1% in 2021). The Finnish banking sector's CIR nevertheless remained better than the European average. In general, large banks perform better in the CIR comparison.

The Finnish banking sector's capital adequacy has also remained strong and above the European average. In 2022, the sector's common equity tier 1 (CET1) capital ratio fell by 0.6 percentage points to 17.2% and total capital ratio by 0.8 percentage points to 20.6%. In the EU, banks' average CET1 capital ratio was 15.3% and total capital ratio 18.6% at the end of September 2022.

The dip in the capital ratios is explained by the buybacks of own shares in the first three quarters and by changes in the bank-specific internal capital adequacy calculation models. Total capital ratio was also brought down by the repurchase of capital instruments included under own funds. The fact that the banking sector remained profitable cushioned the dip in the capital ratios during the year and improved them towards the end of the year.[50] The strong capital position puts Finnish banks in a good position to withstand losses potentially brought on by the negative economic effects of Russia's war in Ukraine or by major changes in financial market pricing, for example.

Banks have also prepared for credit losses by setting additional discretionary allowances for credit losses. Additional allowances made during the pandemic have been reallocated to cover increased credit risks.

The Finnish banking sector's own funds exceeded the capital requirements by a wide margin. The sector's surplus of own funds exceeded the total capital requirement by €14.3 billion at year-end 2021 (€17.6 billion at year-end 2020), which is about 6% of risk-weighted assets.

Thanks to their strong capital adequacy, Finnish banks have been able to offer their customers flexibility in loan servicing. Forbearance refers to loan repayment reliefs that the lender can grant to customers experiencing financial difficulties to help them tide over temporary payment difficulties. The relative share of forbearance loans have been decreasing since the end of 2021. At the end of 2022, the share of corporate forbearance loans was 1.3% (2.1% in 2021) and household forbearance loans 1.9% (2.1% in 2021).

50 Korkotason nousu kasvatti tuottoja epävarmassa toimintaympäristössä (bof.fi) (in Finnish)

The ratio of non-performing loans (NPL) remained moderate and among the lowest in Europe. In household loans, the ratio of non-performing loans is still slightly higher than before the pandemic, but in corporate loans, the NPL ratio is already clearly lower than the pre-pandemic level. At the end of 2022, the NPL ratio of Finnish banks was 1.4% in household loans (1.4% in 2021) and 1.3% in corporate loans (2.1% in 2021).

Russia's war of aggression has had only minor direct effects on banks' operations. The Finnish banking sector has not had significant direct exposures to Russia, and these were further decreased when the war broke out. According to the FIN-FSA, direct exposures to Russia amounted to roughly €40 million at the end of 2022. The effects of the war on banks' corporate credit risk position mainly arose from certain sectors, particularly as a result of the price hikes in energy and raw materials. Russia's warfare has thus not had much effect on Finnish banks. Of course, the slowing world economy has affected stock prices and therefore also banks' returns.

The war has highlighted the risk of cyber threats. Although cyber threats and information influencing were a hot topic in early 2022, the situation has remained stable. Individual denial-of-service attacks have taken place, but they have had little or no effect on the running of banks' payment systems.[51]

The financial sector is generally well-prepared especially for short-term disruptions, and the sector's preparedness for cyber threats and attacks is at a high level.[52] Generally speaking, the banking sector has proven its crisis resilience and handled its tasks extremely well and reliably during both the pandemic and the war.

The banking sector's leverage ratio fell to 5.7% (6.0% in 2021) as CET1 capital decreased. The leverage ratio of Finnish banks is slightly above the European average (5.1% in 9/2022).

The liquidity and financial position of banks in Finland, and elsewhere in Europe, have remained good, supported particularly by central bank deposits and funding. Current accounts and other accounts with low rates of interest continue to hold a large amount of deposits, which reflects on banks' funding costs. At the end of December 2022, Finnish households' deposit stock totalled €111.8 billion, with the average interest rate of household deposits being 0.21%. Overnight deposits made up for €101.9 billion and deposits with an agreed maturity for €3.7 billion of households' deposit stock.[53] (Figure 5)

According to the FIN-FSA, Finnish banks are dependent on market funding, which exposes them to market disruptions and rising funding costs. It is worth noting that market funding is not a bad thing as such, because it creates predictability. As the first months of 2023 have proven, deposits can often be withdrawn quickly, which makes them less predictable.(FIGURE 6)

The Finnish banking sector's liquidity remained strong in 2022. The average liquidity coverage ratio (LCR) stood at 176% at the end of 2022 (178% in 2021). The LCR ratio was well above the 100% limit set in regulation and slightly higher than the EU average (EBA 09/2021: 162%). The average LCR of Finnish less significant institutions, small and medium-sized banks directly supervised by the FIN-FSA, improved markedly in 2022, reaching 167% at the end of the year (152% in 2021). The quality of Finnish banks' LCR reserves was good overall: 97% of the reserves consisted of the most liquid assets, i.e. level 1 assets.[54]

51 https://www.finanssivalvonta.fi/globalassets/fi/tiedotteet-ja-julkaisut/lehdistotiedotteet/2022/finanssivalvonnan_lehdistotiedote-laisuus_13092022.pdf (in Finnish)

52 https://www.finanssiala.fi/uutiset/fiva-finanssisektori-kohtaa-kriisin-vakaana-ja-hyvista-lahtokohdista-ala-varautunut-kasvavaan-kyberhyokkaysten-riskiin/ (in Finnish)

53 https://www.suomenpankki.fi/en/statistics2/News/mfi-balance-sheet/2023/interest-rates-on-corporate-loans-rose-sharply-in-2022/#:~:text=The%20stock%20of%20Finnish%20households%E2%80%99deposits%20at%20end%2DDecember%202022%20totalled%20EUR%20111.8%20billion%2C%20and%20the%20average%20interest%20rate%20on%20the%20deposits%20was%200.21%25.

54 https://publications.bof.fi/bitstream/handle/10024/52686/Pankkisektori-Q4-2022.pdf?sequence=1&isAllowed=y (in Finnish)

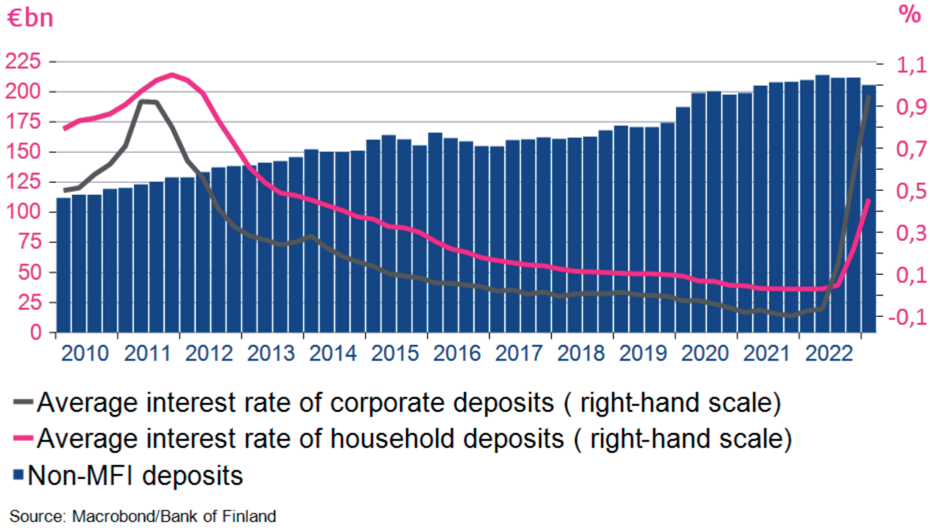


Figure 5: Credit institutions' funding and the average interest rates of corporate and household deposits

The binding net stable funding ratio (NSFR) requirement became applicable at the end of June 2021. Its purpose is to reduce banks' overreliance on short-term wholesale funding and to limit the degree of maturity mismatch between banks' assets and liabilities. The NSRF requires that banks' available stable funding over a one-year horizon is at least as large as the required stable funding over the same horizon in both normal and stressed conditions.

The Finnish banking sector's average NSFR stood at 119% at the end of December 2022, which is well above the 100% minimum requirement but slightly below the EU average (EBA 09/2022: 127%). All Finnish banks exceeded the minimum requirement: the lowest NSFR was 107%.
The substantial increase in central bank funding has raised the asset encumbrance (AE) ratio of European banks. In Finland, the AE ratio has been at a fairly high level for a long time due to banks' reliance on covered bonds, but it has remained stable. At the end of 2022, the AE ratio stood at 29% (29.3% in 2021), which is roughly the same as the EU average (EBA 06/2022: 28.6%).

In planning for their funding activities, Finnish banks have prepared for the release of the pandemic build-up of household and corporate deposits when household consumption returns to normal and the investment demand of companies is revived. Strong liquidity buffers, relatively diverse and decentralised funding channels as well as low market funding costs made possible by a solid capital position protect Finnish banks from risks related to a potential decline in deposit funding. A relatively small share of Finnish banks' funding consists of central bank funding, which also reduces the refinancing risk related to the maturity of central bank funding.

3.2 Particular features of the Finnish banking sector

One of the particular features of the Finnish banking sector is its concentration. The share of loans granted in Finland to non-financial institutions by the three largest banks (OP Financial Group, Nordea and Danske Bank) totalled 68.5% (68.9% in 2021) and their share of all deposits totalled 77.2% (76.9% in 2021).

In addition to its concentrated nature, the Finnish banking sector is closely interconnected with the other Nordic countries through ownership and investments. It also relies significantly on market-based funding. Other typical features include the significant share that housing loans have of all lending, the small amount of non-performing assets and the good level of profitability by European comparison.

Overall, international credit rating agencies consider banks' operating environment to be stable, partially thanks to their good capital levels and profitability. Finnish banks' assets consist mainly of low-risk mortgage-backed claims and corporate loans. The sector has a strong loss-absorbing capacity, as is also proved by the supervisory stress tests.[55]

55 https://www.finanssivalvonta.fi/en/publications-and-press-

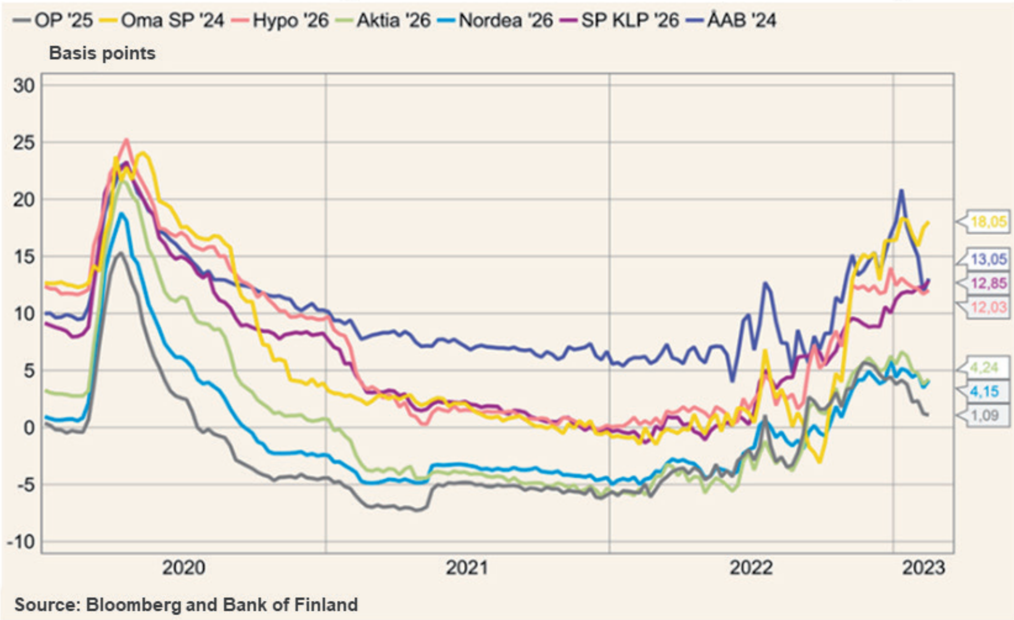


Figure 6: Risk premiums of Finnish banks' covered bonds (asset swap spread)

Being part of the euro area and the ECB's banking supervision increases the predictability of the Finnish banking sector's operating environment and promotes fair competitive conditions with our European counterparties. This ensures that banks have good preconditions to grow and develop their services, which in turn increases stability in the financial market.

In Finland, national debt is not as common a topic as it is in southern Europe, for example. The Finnish government diversifies the investor base of its funding geographically. A broad investor base strengthens the government's funding capacity, supports credit pricing in the secondary market and forms a part of long-term refinancing risk management. Despite the ECB's monetary policy purchase programmes, Finland's public debt is still largely owned by international investors.

The share of mortgage-backed loans of all loans granted by banks fell from 54% in 2021 to 51% in 2022. Despite the dip, the real-estate market's development continues to play a major role in banks' financial position.[56]

By international comparison, the Finnish banking sector has below-average exposures to the sectors most badly damaged by the pandemic (tourism, hospitality). In fact, the Finnish banking sector has survived the shock brought on by the pandemic well, and the changes in non-performing assets or IFRS 9 assets do not speak of significantly increased risks. In the Nordic countries, banks' credit losses from the pandemic crisis seem to be proving smaller than feared.

3.3 Green finance

The financial markets in Finland function well in general, and eligible projects receive funding on acceptable terms. For example, wind power projects carried out on project funding do not, as a rule, have problems accessing private funding. [57] In fact, the problem is partly reversed – finding green transition projects to fund is challenging for finance providers.

Banks can steer society in a more sustainable direction. The Finnish financial sector's role in this is discussed in more detail in the final report of the national working group on financing the green transition, published in December 2022. The final report highlights the role the financial markets play in promoting the green transition.[58]

The report brings forward that private investments in the green transition will be

releases/Press-release/2021/results-of-the-eu-wide-stress-tests-finnish-banking-sectors-solvency-would-withstand-a-strong-weakening-in-the-operating-environment/
56 https://publications.bof.fi/bitstream/handle/10024/52686/Pankkisektori-Q4-2022.pdf (in Finnish)

57 https://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/164654/VN_2023_5.pdf?sequence=1&isAllowed=y
58 https://www.finanssiala.fi/en/news/banks-can-steer-society-in-a-more-sustainable-direction-final-report-on-financing-the-green-transition/

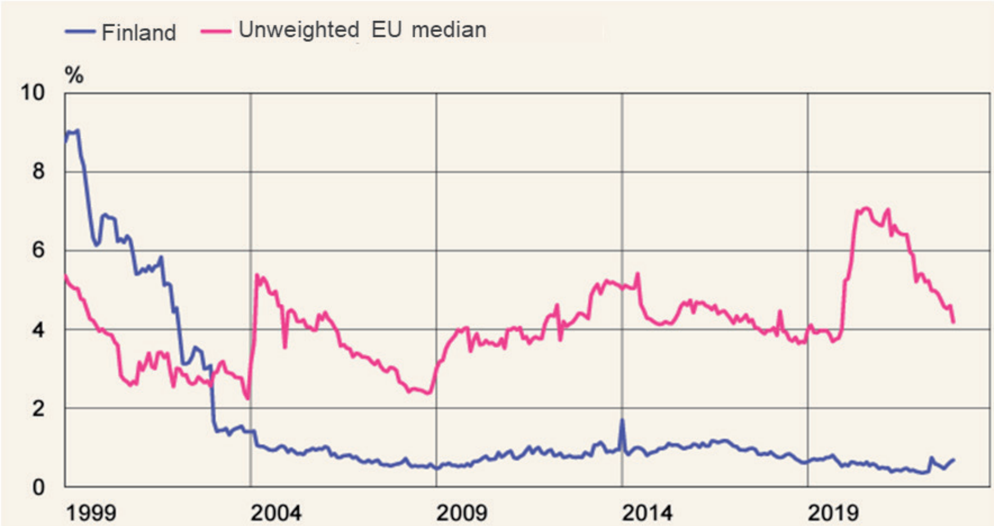


Figure 7: Credit institutions' domestic government bond assets relative to credit institutions' total assets
Source: Finnish Financial Supervisory Authority, European Central Bank

primarily financed from private sources. Public financial instruments will complement and leverage market financing, in particular to share the risks associated with developing and marketing new solutions.

The European Investment Fund's (EIF) loan guarantee scheme is an example of a guarantee scheme that seeks to boost clean technology and energy efficiency investments in small and medium-sized enterprises (SMEs), households and housing companies. The Finnish government has approved Finland's participation in this €700 million InvestEU guarantee scheme. Finland will invest €100 million in the EIF's Sustainability Guarantee product, which is a guarantee programme delivered through financial institutions. It is estimated that the leverage effect of Finland's contribution is seven times higher. Finnish banks have been eager to take up on the EIF's offer.[59]

In addition, the demand for energy efficiency subsidies that promote the green transition have secured a stable footing. The government decree on energy subsidies for residential buildings in 2023 encourages investments in improving a building's energy efficiency. Finance Finland considers this proposal to be mostly very supportable and supportive of the green transition. However, it begs the question as to why, if the general objective is to decrease overall energy consumption, 'communities engaged in economic activity' are left outside the scope of the decree. The justification offered looks at the situation from a reverse perspective, stating that private sector projects would be carried out anyway – which can hardly be said for certain. Finance Finland considers it important that energy efficiency subsidies are targeted towards as many different groups as possible.[60]

Sustainability risks are an essential part of banks' overall risk management. It is important to keep prudential regulation risk-based so as not to price risks incorrectly due to political objectives or to unnecessarily weaken lenders' opportunities to serve companies.[61]

3.4 Banking group employees and offices

At the end of 2022, there were 196 credit institutions operating in Finland if group structures are ignored.[62] This is 10 fewer than at the end of 2021, mainly due to mergers within banking groups. 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.

59 https://www.finanssiala.fi/en/news/finnish-banks-took-up-the-eifs-offer-investeu-loan-guarantee-scheme-makes-it-easier-to-finance-green-transition-investments/

60 https://www.finanssiala.fi/lausunnot/valtioneuvoston-asetus-asuinrakennusten-energia-avustuksista-vuodelle-2023/ (in Finnish)

61 https://www.finanssiala.fi/wp-content/uploads/2022/01/FA_04012022_Pankkien_vakavaraisuussaantelyn_rooli_vihreassa_siirtymassa.pdf (in Finnish)

62 https://www.suomenpankki.fi/en/Statistics/mfi-balance-sheet/list-of-mfis/

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 2022.

The Finnish banking sector continues to have an important role as an employer. Finnish banking groups and foreign deposit-taking banks' Finnish branches employed a total of 19,922 people at the end of 2022. This is 227 employees fewer than in the previous year.

The number of bank offices fell. At the end of 2022, Finnish banking groups had 772 offices in Finland, which is 38 fewer than the year before. (Figure 8)

In 2022, the largest Finnish banking group in terms of market share was OP Financial Group, which commanded a market share of 35–39% (34–39% in 2021) in deposits, housing loans and corporate loans alike. The second largest banking group was Nordea Group with market shares of 25–31% (25–32% in 2021).

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 2022. In deposits, changes were marginal: OP Financial Group gained 0.4 percentage points in market shares while others lost 0.4 percentage points.
(Figure 9 and Figure 10))

IN CONCLUSION

Banks have played a central role in economic development and stability during the coronavirus pandemic and Russia's war of aggression. In terms of their capital position, Finnish banks have performed well. Retained earnings, additional capital buffers and a good liquidity position improve the risk position and risk tolerance of Finnish banks.

Thanks to its sound basis, the sector can offer customers flexibility in loan payments and provide other forms of support in the face of crises, thus directly benefiting the real economy. An efficient and flexible allocation of financing and a stable financial system promote economic growth and welfare. The importance of this cannot be overstated.

Banks' ability to grant credits and offer companies and households flexibility in their loan servicing in the face of temporary difficulties must be ensured also in the future. This is especially important in Finland and elsewhere in Europe, where the financial system is very bank-centric.

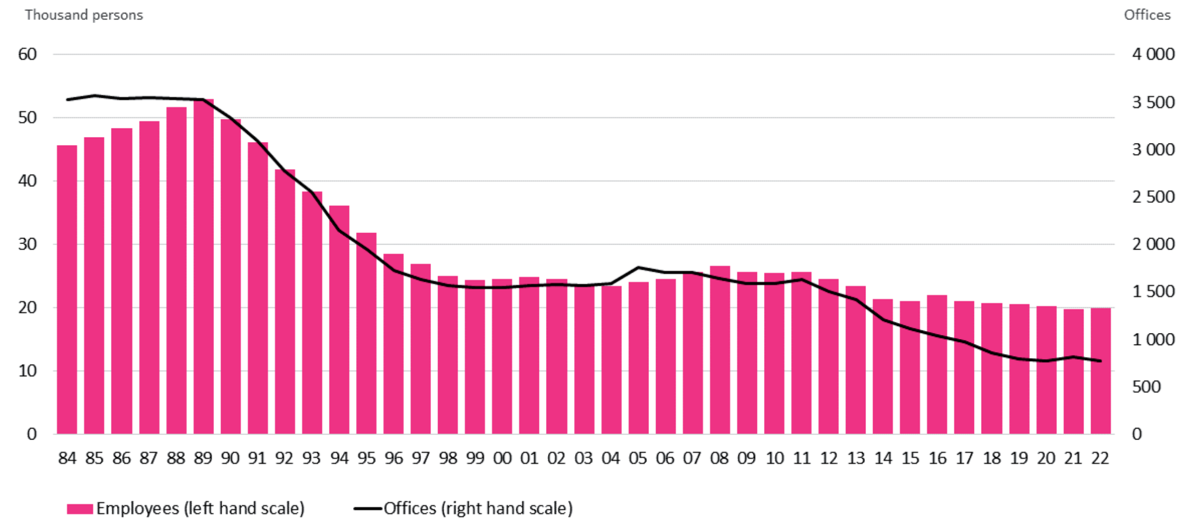
The time of low interest rates is over for now. Although banks' financial development and performance have remained strong during the pandemic, banks are not short of challenges. Their operating environments and business requirements are in constant change. Over a longer term, banks' profitability has decreased because of increased financial regulation, low interest rate levels, higher own funds requirements, digitalisation, more intense competition, new supervisory measures and the costs resulting from these measures.

The Finnish banking sector's profitability and return on equity is on a good level by European comparison. The cost/income ratio that measures cost-effectiveness is better than the European average. It is worth noting that banks have a relatively low return on equity compared to many other sectors.

In the future, it is particularly important that new fees, new regulation and other measures that put a strain on banks' profitability are justified. It is vital to guarantee such conditions for banks that allow them to conduct profitable business and encourage them to develop new services and functions.

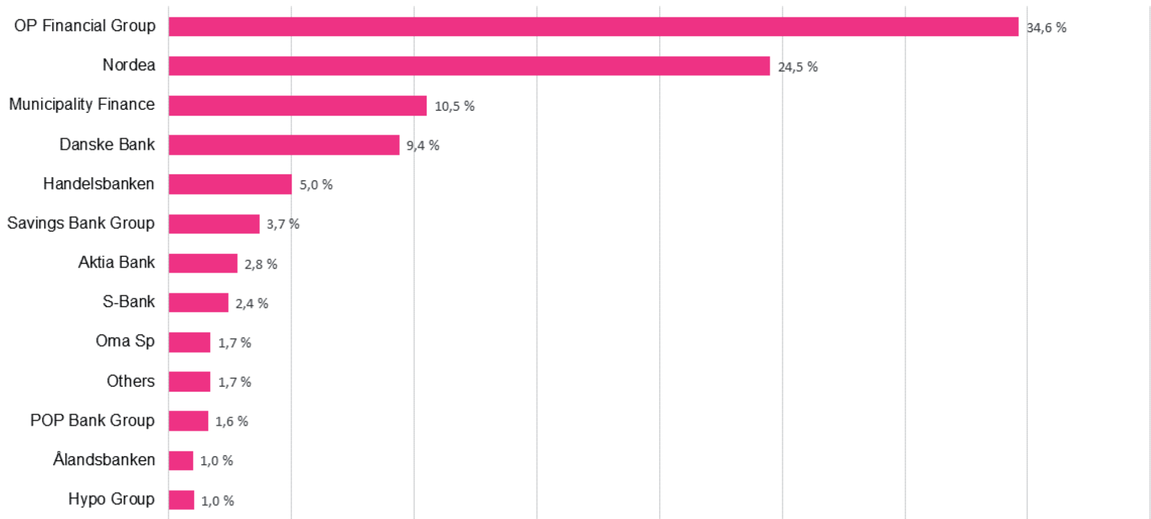
Banks and the rest of the financial sector are starting to see the effects of climate change and its mitigation. Transitioning to a low-carbon economy requires sizeable investments, which in turn require funding. Banks have a significant role in financing the transition. Banks are also integrating sustainability even more tightly into their investment and credit granting processes.

Well-functioning banks and financial markets that price risks correctly are a prerequisite for the cost-effective implementation of the green transition. Banks have a key role in offering companies sufficient funding for making energy efficient investments in low-carbon sectors and promoting green innovations in carbon-intensive industries.



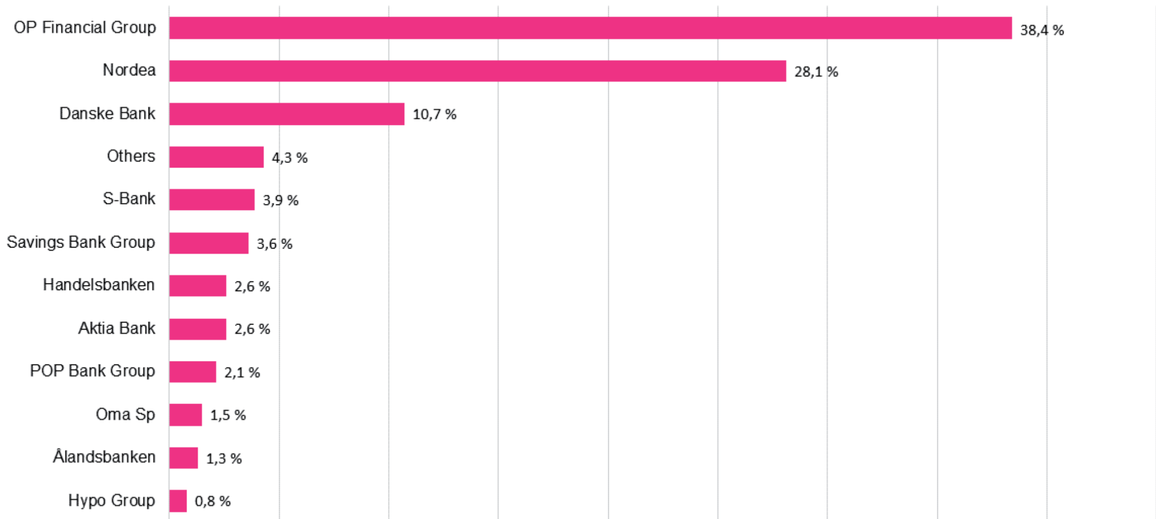
Source: Statistics Finland, FFI, Bank of Finland, FIN-FSA

Figure 8. Bank employees and offices



Source: Bank of Finland

Figure 9: Credit institutions' non-MFI loans in Finland, market shares on 31 Dec 2022



Source: Bank of Finland

Figure 10: Credit institutions' non-MFI deposits in Finland, market shares on 31 Dec 2022

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