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Response to the EBA consultation on Draft Guidelines on ADC exposures to residential property under Article 126a of Regulation (EU) 575/2013

General comments and views

Ministry of Finance welcomes the EBA's work on further defining the criteria on the risk weight treatment of ADC exposures as set out in the Article 126a of the Capital Requirements Regulation. While the new concept of ADC exposures brings clarity to the existing risk weight treatment of 'speculative immovable property financing', Ministry of Finance highlights that EBA guidelines must recognize well-functioning national legislative frameworks and national practices that have a proven track record on mitigating the risks related to financing of residential property in a construction phase.

Finnish legal framework on marketing and selling unfinished residential property to consumers protect many market participants: consumers as buyers, mortgage lenders providing finance for purchasing of individual residential units, as well as the lenders of the constructors. These provisions, included in the Housing Transactions Act, provide mandatory guarantees in the construction phase, provide mandatory separate bank account for sale prices and regulate the conditions of the payment of the sale price, as well as lay down rules on contractual penalties in cases of breach of a sale contract. Additionally, Finnish Credit Institution Act limits credit granting to housing companies under construction: such lending is limited up to 60% of the total amount of sale prices of residential units in the same housing company.

A specific feature of the Finnish homeownership is vast majority of multi-unit residential buildings being owned by housing companies (*asunto-osakeyhtiö*), as regulated in the Housing Company Act, separate from a conventional limited liability company. The ownership of these companies and the right of possession of individual residential units are linked together. The purpose of a housing company is, according to the Housing Company Act, is solely to manage the buildings and premises owned by the company.

According to our experience nationally, these structural features significantly mitigate the risks of financing property under construction as bankruptcies of such housing companies are extremely rare¹, therefore justifying the lower 100% risk weight treatment. During the negotiations, it was important to ensure that our national system can be interpreted within the scope of Article 126a's 100% risk weight. However, the draft guidelines does not seem to recognize our national framework for housing companies and the sale of residential units at the construction phase.

General overview of the Finnish legal framework applicable to the sale of residential units at the construction phase

Finnish Housing Transactions Act provides a specific framework for residential construction projects when residential units are sold to consumers at the construction phase (RS framework). Such framework aims at finishing residential construction projects according to the construction plan as well as to provide buyers financial safeguards and access to relevant information to assess the risks of the construction project.

Such framework contains following relevant elements that are mandatory in nature:

- Disclosure and documentation requirements: relevant documents (including, inter alia, incorporation documents of the established housing company, the construction agreement, budget, land use planning documents, pledges to immovable property, etc.) must be made deposited to a credit institution and made available to the buyers of the residential unit. Such documents shall be binding throughout the construction phase.
- Financial planning requirement, including a binding construction budget that cannot be exceeded at the expense of the buyers, unless unanimously approved by the buyers.
- Obligation to obtain a guarantee (from a bank, insurance company or a public sector entity) for the construction phase (min. 5% of the construction budget, or 10% of the total amount of sale prices of the residential units in that same construction project, if higher). Such guarantee is required to stay in force until the construction is finished and

¹ Based on the data of the Finnish Trade Register, the total number of housing companies were 91 831 as per January 3, 2024 (updated information available at <https://www.prh.fi/en/kaupparekisteri/tilastot/lkm.html>). The typical number of bankruptcy application filed by housing companies is about 10 per year. In the course of ten years, approximately 40 housing companies have been declared bankrupt. According to the studies, such bankruptcies were typically not related to the construction phase.

the housing company (owners of which are the buyers of the individual residential units) has confirmed its completion.

- Separate bank account to which the purchase prices must be deposited. The funds of that account are allowed to be used solely for the purposes of that particular construction project.
- The Housing Transactions Act provide the possibility that the buyer of a residential unit and the constructor may agree that the purchase price of the residential unit shall be paid by instalments as the construction works progress. In addition, the Act provides that purchase price installments shall not be significantly disproportionate to the degree of completion of the building. This is also a market practice.
- In cases of withdrawal from the sale agreement before the completion of the residential building, the constructor (seller) has the right to a compensation from the consumer. Such compensation shall be proportionate taken into consideration the additional costs and losses to be incurred from the withdrawal. Also standard penalty fee (such as lump sum or percentage from the sale price) is also possible, provided that such fee is proportionate as described above.
- A consumer buying a residential housing unit in an unfinished property has the right to refund of the purchase price in cases of the constructor's bankruptcy only to the extent that exceeds the value of the housing unit, provided that there are funds in a separate bank account left for the construction project that have not already been used for the construction, and that the housing company does not decide to finalize the construction on its own account.
- In cases of the constructor's bankruptcy the housing company, owned by the buyers of the residential units, has the right to continue the construction project and finalize the building on its own account. While bankruptcies of housing companies are extremely rare, Ministry of Finance's observation is that this is typically the option that is used in cases of constructor's bankruptcy.

In addition, Finnish Credit Institution Act limits credit granting to housing companies established at the planning or construction phase. Such lending is limited up to 60% of the total amount of the total sale prices of residential units in the same housing company.

Experts from the Ministry of Finance are happy to provide further background information with details.

Ministry of Finance views that the framework as described above has proven to significantly lower the risks of sale of unfinished residential property and to provide benefits to both consumers and banks. Additionally, such framework improves the functionality of the residential market in Finland.

Ministry of Finance suggests the EBA to further develop guidelines in order to better reflect the features of the Finnish framework and similar other arrangements in the Member States.

Q1: Materiality of pre-sale and pre-lease contracts

The proposed definitions of pre-sale/pre-lease contracts should be further clarified as in all legal systems there is no clear difference between an agreement made in the precontractual phase and the final agreement.

Finnish Housing Transactions Act does not recognize separate pre-sale contracts when housing units are sold in the construction phase. Instead, the law requires a final sale contract, containing the terms and conditions applicable to the construction phase. Such provisions lay down rules on the payment schedule of the purchase price during the construction phase and the penalty payments that the consumer is obligated to pay when withdrawing from the agreement before the completion of the building.

Finnish Housing Transactions Act provides also other safeguards for residential construction projects when individual residential units are sold to consumers on the construction or planning phase.

Ministry of Finance therefore suggests to the EBA to develop draft guidelines in a way that would better reflect these specificities or to allow wider discretion in the national level.

Q2: Substantial cash deposits

With reference to our response to question 1, according to the draft guidelines it is not exactly clear when an agreement could be interpreted as a precontractual agreement and when as a final agreement as in some legal systems an agreement may contain characteristics from both. Comments presented at question 1 are relevant also for the purposes of question 2.

Market practices of housing finance differs in the EU Member States, for which reason it is important to consider national specificities, including national markets and national legal frameworks.

Q3: The appropriateness of the proposed 10% threshold, considering applicable consumer protection laws

With reference to our response to question 1, according to the draft guidelines it is not exactly clear when an agreement could be interpreted as a precontractual agreement and when as a final agreement as in some legal systems an agreement may contain characteristics from both. Comments presented at question 1 are relevant also for the purposes of question 2. Therefore, it is unclear whether the proposed 10% cash deposit requirement would be applicable to the Finnish system and market practices.

According to the explanatory part of the Draft GL, EBA has already explored how consumer protection provisions would affect on the eligibility of the lower 100% risk weight treatment. EBA has concluded that as consumer protection legislation and prudential regulation of banks serve different purposes, the requirements of 100 % risk weight treatments should be set independently from the consumer protection rules.

Ministry of Finance appreciates that the EBA has recognized consumer protection legislation as one factor to be considered in this context. However, Ministry of Finance finds that consumer protection legislation does not severely conflict with the prudential regulation when considering the overall functionality of the housing market.

While consumer protection legislation is tailored primarily to enhance the consumers' position, it also improves the overall functioning of the market, including the viability of residential construction projects. Such legislation also provides indirect safeguards for the mortgage lenders that finance individual consumers purchasing residential units. In the EBA guidelines it is utmost important to achieve a well-balanced approach between these legitimate interests that serve the needs of both financial stability and the functionality of the housing market. According to our experiences in the national level, consumer protection rules do not necessarily hamper the risk mitigation of the finance of unfinished property.

Ministry of Finance suggests that consumer protection rules that provide proportionate and reasonable protection for consumers as buyers of the residential units shall not affect on the applicability of the 100 % risk weight treatment. Alternatively, national competent authorities could have the mandate to further specify the impact of consumer protection legislation.

Finally, Ministry of Finance highlights that the Finnish system and market practice provide additional safeguards even beyond the sale contract, such as guarantees, mandatory financial planning requirement, separate bank account for the sale prices (etc.) that should be taken into account in this context.

Q4: Single ratio to all ADCs vs. more granular treatment

Against the background explained above, Ministry of Finance suggests to develop the guidelines in a way that would allow more granular treatment of the ADC financing projects. For example, Finnish system and market practice provide many different safeguards, benefiting many market participants, including banks. We refer to our responses to the previous questions as well as the general remarks above.

Based on the observations from our national market practices, Ministry of Finance and Finnish Financial Supervisory Authority have recognized that concentration risks related to housing companies need closer attention. If one buyer (regardless of whether an individual investor or investment company) purchases several residential units from the same housing company, such setting may constitute an increased risk both for the completion of the building as well as for the operation of the housing company after the finalization of the building. In this case there is an increased risk of cash flows. Our understanding is that some banks in our market have also paid attention to such setting.

Ministry of Finance proposes that in cases of increased concentration risk as described above, the use of 100% risk weight requires additional safeguards, such as positive creditworthiness assessment of a buyer that purchases a significant proportion of the housing units. Regarding the proportion of the total contracts that potentially constitutes increased uncertainty of the cash flows should be closely assessed. Ministry of Finance's preliminary view is that such proportion might be set to 30–50%.

Q17: Eligible equity

Finnish Credit Institution Act limits credit granting to housing companies under the construction phase: such lending is limited up to 60% of the total amount of sale prices of residential units in the same housing company. Such limit means, in practice, that buyers of residential units are obligated to pay the rest of the total final price (40%) directly to the constructor/developer, contributing to the equity of the construction project.

Ministry of Finance suggests to clarify in the Guidelines how similar financing limits and structures described above would be recognized as eligible equity from the perspective of the requirements of lower 100 % risk weight treatment.

Other aspects

Ministry of Finance suggests the EBA to further clarify the applicability of the ADC treatment when the construction or development phase is finished. Ministry of Finance suggests to clarify in the EBA Guidelines that the treatment of an ADC exposure ends when the construction phase is ended and when the property is handed to the buyers. In such cases the exposure would be treated as corporate, IPRE or residential exposure, as applicable, after the construction phase.

Moreover, Ministry of Finance also wishes a clarification that when the obligor has no intention to sell or lease the property under construction, an ADC treatment shall not apply. Such cases include, for instance, when setting up production plants or building premises for own use where the cash flows do not depend on the sale or lease of that property.

We remain at your disposal for any further questions and clarifications. Our contact persons are:

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Sincerely,



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