

DECISION MEMORANDUM



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Amendment to regulations regarding the countercyclical buffer rate

Summary

Given the present economic and financial conditions, Finansinspektionen decides to increase the countercyclical capital buffer for Sweden and sets the buffer rate at 2 per cent. The countercyclical buffer guide, which is a starting point in setting the buffer rate, shall be set at 0.5 per cent. The countercyclical buffer rate shall be applied as of 19 March 2017.

Finansinspektionen shall, in accordance with Chapter 7, section 1 of the Capital Buffers Act (2014:966), set a countercyclical buffer guide and a countercyclical buffer rate each quarter. The buffer rate shall be applied by credit institutions, securities companies, Svenska skeppshypotekskassan, fund management companies with discretionary portfolio management and alternative investment fund managers authorised to conduct discretionary portfolio management when calculating the firm-specific countercyclical capital buffer.

Finansinspektionen finds that the systemic risks linked to financial imbalances have increased somewhat, compared to both June 2015 when the buffer was raised to 1.5 per cent and December 2015 when Finansinspektionen decided to leave the buffer unchanged. Credit growth is high and lending to households has recently been increasing at an even faster rate. High housing prices, low interest rates and strong economic growth in Sweden could result in even more credit expansion. This could, in turn, contribute to the continued build-up of systemic risks.

In summary, Finansinspektionen finds reason to increase the countercyclical capital buffer in order to strengthen the resilience of the financial system, thus improving its ability to manage any credit losses that may arise in the future. Finansinspektionen therefore decides that the countercyclical buffer rate shall be raised to 2 per cent.

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1 Points of departure

The Capital Requirements Directive¹ contains provisions regarding setting the countercyclical buffer rate (see, inter alia, Article 136). These provisions are implemented in Swedish law mainly through Chapter 7, sections 1–3 of the Capital Buffers Act (2014:966) (the Buffer Act). According to Chapter 7, section 1 of the Buffer Act, Finansinspektionen shall set a countercyclical buffer guide and a countercyclical buffer rate each quarter.² The countercyclical buffer guide shall be used as a reference in setting the countercyclical buffer rate, which in turn shall provide the basis for calculating the size of the firm-specific countercyclical capital buffer according to Chapter 6 of the same act.

The countercyclical buffer rate set by Finansinspektionen pursuant to Chapter 7, section 1 of the aforementioned act shall be applied by all firms concerned. Finansinspektionen's decision to set these rates is a matter of setting standards and is therefore implemented in the form of regulations.

The firms covered by the Buffer Act are credit institutions, securities companies, Svenska skeppshypotekskassan, fund management companies with discretionary portfolio management and alternative investment fund (AIF) managers licensed to conduct discretionary portfolio management. In this memorandum, "bank" is used as a collective term for these firms.

1.1 Objective of the regulation

The purpose of the countercyclical capital buffer is to strengthen the resilience of banks and ensure that the banking system as a whole has sufficient capital to sustain the flow of credit to households and corporations in situations when shocks to the financial system could cause a credit crunch. The countercyclical capital buffer is a time-varying capital requirement. This means that the buffer is activated when there is a risk that financial imbalances, and hence systemic risks, will increase. In an ensuing recession or in the event of major losses for the banks, the buffer requirement may be reduced to counteract tighter lending and thereby alleviate the economic downturn.

1.2 Current and forthcoming regulations

The Buffer Act came into effect on 2 August 2014. Finansinspektionen decided on 8 September 2014 to issue new regulations concerning a countercyclical

¹ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

² For a description of the quarterly procedure for setting the countercyclical buffer rate, see FI (2014), *Regulations regarding the countercyclical buffer rate* Published on www.fi.se on 10 September 2014, FI Ref. 14-7010.

buffer rate, see Finansinspektionen's Regulations (FFFS 2014:33) regarding the countercyclical buffer rate (the buffer rate regulations). The countercyclical capital buffer for Sweden has been activated through these regulations. These regulations established that the countercyclical buffer rate should be 1 per cent and applied by Swedish banks as of 13 September 2015.

On 22 June 2015, Finansinspektionen made a quarterly decision to raise the countercyclical buffer rate in the buffer rate regulations to 1.5 per cent. This buffer rate shall be applied as of 27 June 2016.

On 14 December 2015 Finansinspektionen made its most recent decision³ in accordance with the quarterly procedure. Through this decision, it was determined that the buffer rate of 1.5 per cent shall continue to apply.

1.3 Alternative to regulation

When preparing the regulations regarding the countercyclical buffer rate, Finansinspektionen has observed EU law and the rules of the Capital Requirements Directive. Sweden is obliged to implement the rules of the Capital Requirements Directive regarding e.g. countercyclical capital buffers. These rules are implemented in Swedish law primarily through Chapter 7, sections 1–3 of the Buffer Act. According to Chapter 7, section 1 of the Buffer Act, Finansinspektionen shall set a countercyclical buffer guide and a countercyclical buffer rate each quarter. With due consideration for the Swedish judicial system, this entails an obligation for Finansinspektionen to issue regulations regarding countercyclical buffer rates. There is thus no alternative to regulation.

1.4 Legal basis

Finansinspektionen, according to Chapter 7, section 1 of the Buffer Act, shall set a countercyclical buffer rate each quarter and, according to section 19, point 4 of the Special Supervision and Capital Buffers Ordinance (2014:993), Finansinspektionen is authorised to issue implementing regulations by reason of this provision.

1.5 Preparation of the matter

According to the quarterly procedure for determining the countercyclical buffer rate, new regulations will be issued when Finansinspektionen assesses that the rate decided needs to be changed. Ahead of such a change, the proposed regulations shall be submitted for consultation, and after the consultation period Finansinspektionen's Board of Directors decides on the change. This decision is then published by Finansinspektionen on its website. If Finansinspektionen's Board of Directors considers there to be no need to

³ FI (2015), *Decision regarding the countercyclical buffer rate*. Published on www.fi.se on 15 December 2015, FI Ref. 15-16477.

change the rate, this decision will also be published on Finansinspektionen's website. The Board of Directors will also determine, well in advance of each new decision, the focus of the preparatory work ahead of the next decision. The decision regarding this focus is also announced on Finansinspektionen's website.

Finansinspektionen's Board of Directors made a focus-related decision on 18 January 2016 to explore whether the countercyclical capital buffer should be raised in March. Given this decision, Finansinspektionen analysed whether there were grounds to raise the buffer rate or if it should remain the same. On 5 February 2016, Finansinspektionen submitted for consultation a proposal to amend regulations regarding the countercyclical buffer rate and a consultation memorandum. The analysis presented in this decision memorandum is based on information obtained and received up through and including 7 March 2016.

Written feedback to the proposal has been received from the Swedish Bankers' Association, the Association of Swedish Finance Houses, the Swedish Savings Banks Association, the Board of Swedish Industry and Commerce for Better Regulation, the Riksbank, the Swedish National Debt Office, the Swedish National Board of Housing, Building and Planning and the Swedish Better Regulation Council. The Swedish Competition Authority, the Swedish Investment Fund Association, FAR and the Swedish Accounting Standards Board reported that they do not have any feedback regarding the proposal. Finansinspektionen will discuss the feedback from the consultation in the following sections.

2 Reasoning and considerations

In this section, Finansinspektionen describes its position regarding the size of the countercyclical capital buffer rate in Sweden. This section includes a description of the considerations made about the size of the buffer rate given the current economic and financial conditions. This section also contains an account of the feedback from the consultation and Finansinspektionen's view regarding this feedback.

2.1 Background

The purpose of the countercyclical capital buffer is to strengthen the resilience of banks and ensure that the banking system as a whole has sufficient capital to sustain the flow of credit to households and corporations in situations when stress in the financial system could cause a credit crunch. The countercyclical capital buffer is a time-varying capital requirement. This means that the buffer is activated when there is a risk that financial imbalances, and hence systemic risks, will increase. In an ensuing recession or in the event of major losses for the banks, the buffer requirement may be reduced to counteract tighter lending and thereby alleviate the economic downturn.

Finansinspektionen sets the countercyclical buffer rate for Sweden by means of a qualitative assessment that takes quantitative factors into consideration. The single most important factor is the development of debt among households and firms. Finansinspektionen therefore monitors debt carefully and in particular how it develops in relation to the gross domestic product (GDP) and the disposable income of households. *The buffer guide* is a factor used to determine the level of the buffer rate. Finansinspektionen also considers other quantitative variables that are relevant for assessing the cyclical systemic risks. This analysis is supplemented with judgements.

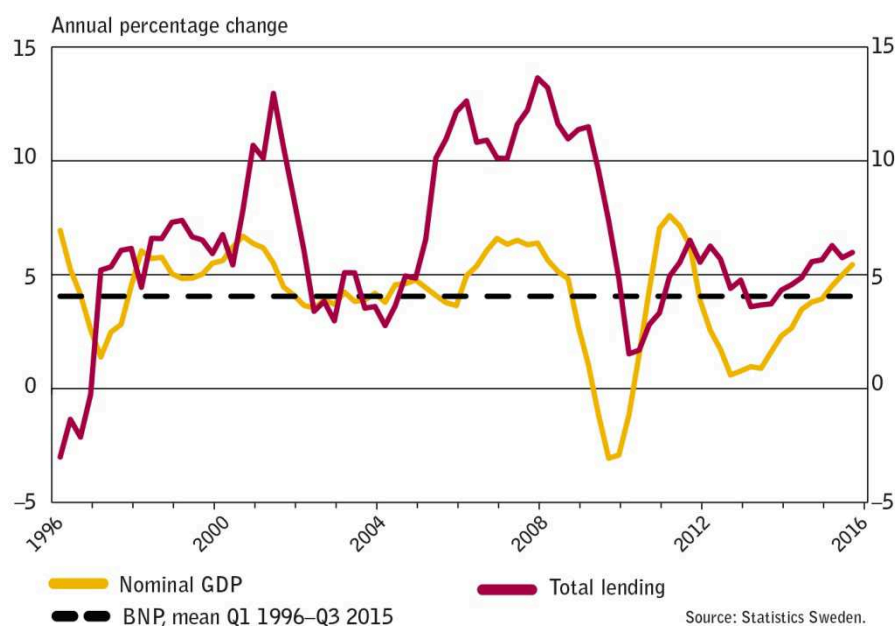
2.2 Development in total lending

Finansinspektionen's assessment of the cyclical systemic risks is based on the developments in lending to the non-financial sector over time, both as a whole⁴ and in part (for example lending to households and corporates, respectively). Lending is then related to other quantities, such as GDP or developments in household disposable income. These relationships are studied to assess whether imbalances are building up in the financial system.

Lending to households and corporates is increasing in Sweden, and has increased at a faster pace than nominal GDP since 2011 (see Diagram 1). Lending to the private sector amounts at present to 147 per cent of GDP. During the third quarter of 2015, total lending grew by 6.0 per cent at an annual rate compared to the third quarter of 2014. In the same period, nominal GDP grew by 5.4 per cent. Lending is thus continuing to increase faster than GDP.

⁴ For Sweden, the measure of total credit to the private sector covers all corporate and household lending issued through monetary financial institutions (MFI) and the total market financing of firms. The market funding of firms has been defined as the value of all outstanding corporate bonds and certificates traded on the fixed-income market.

1 Total lending and nominal GDP

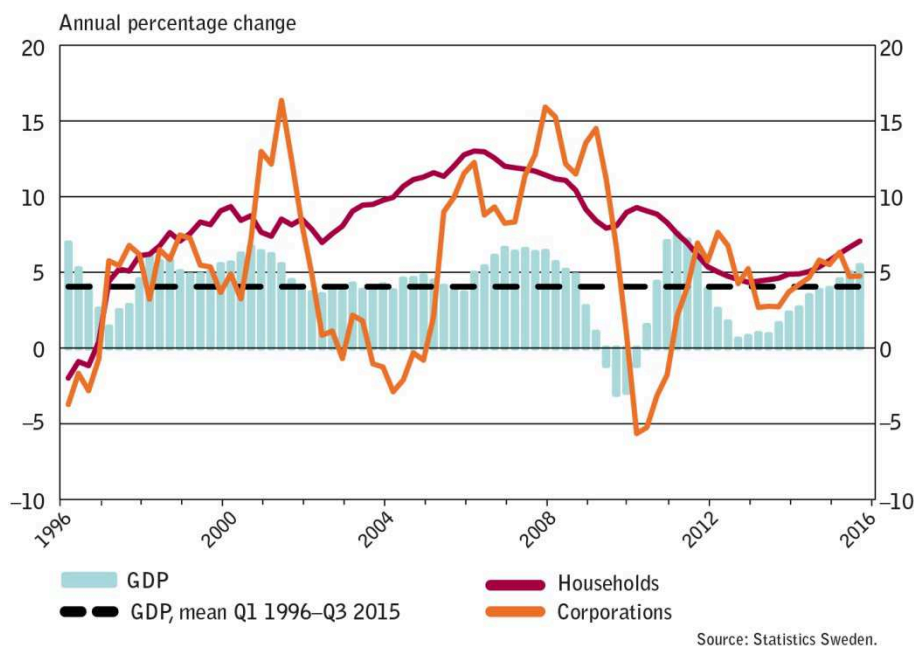


In order to see what is driving this growth in total lending, it is relevant to look closer at how lending to households and corporates has developed.

2.2.1 Developments in lending to households

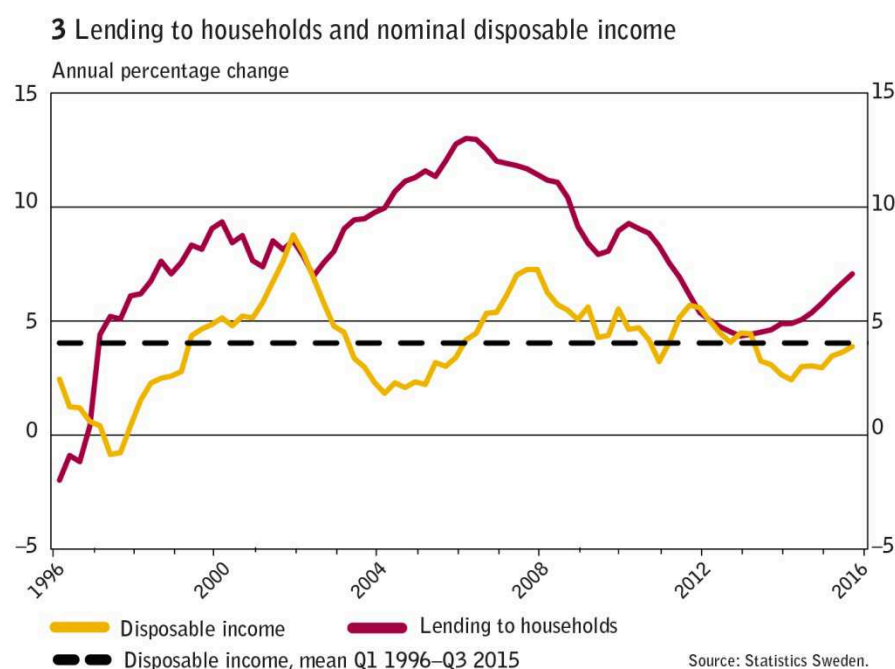
Lending to households has been increasing since the end of the 1990s and growth has been much higher than the growth of the nominal GDP (see Diagram 2).

2 Lending to households and corporations, and nominal GDP

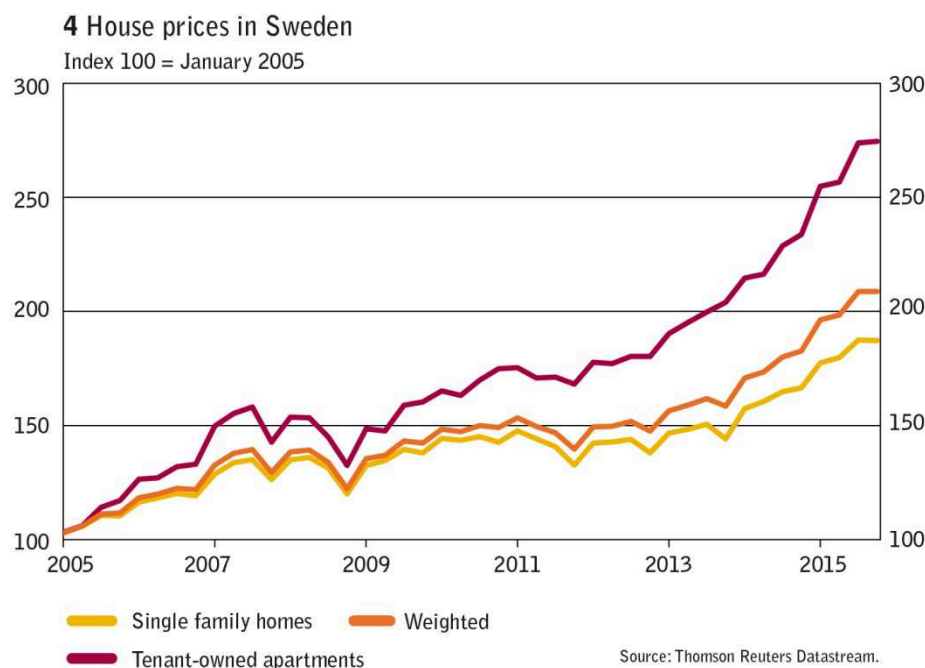


Household debt has grown even more rapidly since the beginning of 2014. This upward trend continued during the third quarter of 2015 and the annual growth rate amounted to 7.1 per cent. This is an increase of 0.4 percentage points compared to the previous quarter and 1.7 percentage points compared with the same quarter the previous year. Moreover, monthly statistics from Statistics Sweden show that the rate of growth is still rising. In January 2016, debts increased by 7.5 per cent. This is the highest rate of increase since 2011.

Household debt is thus continuing to accelerate and at a rate that is much faster than nominal GDP. Lending to households is also increasing faster than disposable incomes, which grew 3.9 per cent in the third quarter of 2015 (see Diagram 3).



The most significant explanation behind the rising level of lending to households is the rise in housing prices. Households finance a large portion of their housing purchases through loans, and mortgages represent more than 80 per cent of household debt. Swedish housing prices have increased sharply in recent years, even if this increase has slowed over the past few months (Diagram 4). Housing prices are also high in relation to household income (see Diagram B 1.1).



Statistics from Statistics Sweden show that prices for single-family dwellings during the last quarter of 2015 were more than 11 per cent higher than in the same quarter in 2014.⁵ This development is reflected in the annual growth rate for mortgages. In January 2016, mortgages grew by 8.4 per cent, compared to 6.5 per cent in January 2015. Rising housing prices, low interest rates and a strong economic development could drive the growth of household debt up even higher. Such a development could in turn increase the vulnerabilities in the economy.

Finansinspektionen finds at the same time that Swedish households have good resilience and the risks of major credit losses linked to household indebtedness remain low. This assessment is based on stress tests that Finansinspektionen regularly conducts on individual households with new mortgages.⁶ The stress tests show that new mortgage borrowers are resilient in the presence of higher interest rates, loss of income and declining house prices. However, even if households manage to make their payments, higher interest rates or the loss of income could result in a decrease in the demand for housing. Higher interest rates and thus high debt payments in the long run could also lead to real economic consequences, primarily in the form of a decline in consumption.

⁵ According to Statistics Sweden's Real Estate Price Index, prices for single-family dwellings in Sweden rose by 2 per cent during the fourth quarter of 2015, compared with the third quarter. According to Valueguard's HOX Housing Index, housing prices increased in January 2016 by 14.5 per cent on an annual basis. Compared to December 2015, prices increased by 3.2 per cent. However, prices tend to increase more in January than in December. Adjusted for the seasonal effect, the increase is 0.5 per cent. See http://www.valueguard.se/201601_Indexpublicering.

⁶ FI (2015), *The Swedish mortgage market 2015*. Published on www.fi.se on 14 April 2015, FI ref. 14-8731.

2.2.2 *Developments in lending to corporates*

Lending from monetary financial institutions (MFI) to non-financial firms increased by 2.5 per cent in the third quarter of 2015, which is slightly slower than in the previous quarter. The latest monthly figures from Statistics Sweden show that the MFI's lending to corporates has begun to accelerate. The annual growth rate in January 2016 was 4.7 per cent.

In recent years, the market for borrowing through bonds and certificates has become an increasingly important source of funding for non-financial firms. This market funding makes firms less dependent on banks and thereby less sensitive to disruptions in the banking sector. At the same time, firms may become more sensitive to disruptions in the securities markets. Becoming established on the bond market incurs considerable expenses. It is therefore primarily the larger firms that have a considerable need for external funding that raise these funds through bonds and certificates. With a growth rate of 10.6 per cent, firms' market funding continued to increase sharply during the third quarter of 2015.

In total, lending to corporates increased by 4.8 per cent during the third quarter of 2015, which is slightly slower than nominal GDP (see Diagram 2). At present, Finansinspektionen sees no clear signs that extensive imbalances are building up in the corporate sector.

2.2.3 *Upward revised models for the debts of households and firms*

As a complement to its analysis of outcomes, Finansinspektionen also uses forecasting models for households' and firms' debts.⁷ The forecasts show how the debts could develop over time and help Finansinspektionen plan its work with the countercyclical capital buffer.

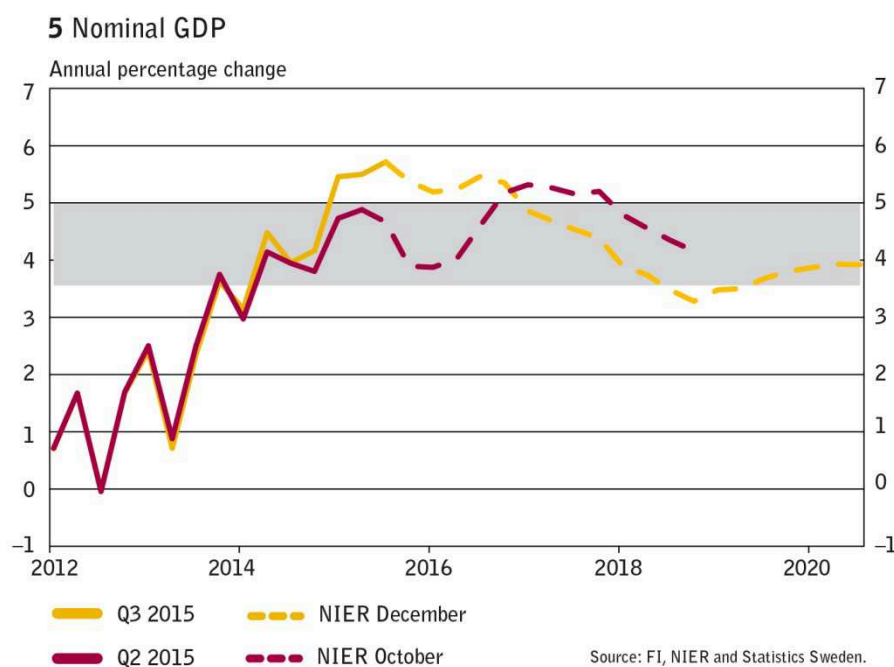
The household model contains debt, property prices, consumer confidence (economic activity) and a mortgage rate. The corporate model contains debt, a business tendency indicator (economic activity) and a corporate borrowing rate. The models' forecasts for individual variables depend partly on how the other variables develop and partly on a long-term normal level.⁸ The normal level comes from a combination of assessments and information from data sets. The normal level for debts in this case is that they shall grow in line with nominal GDP.⁹ The models are assessed on the basis of their forecasting performance and how well the estimated correlations between the variables coincide with economic theory.

⁷ For a description of the approach and the household model, see FI (2015), *A model for household debt*, FI Analysis no. 4. Published on www.fi.se on 1 December 2015.

⁸ The normal level is the growth that the model's variables will demonstrate in the long run.

⁹ The model estimates a 95-per cent probability interval for the normal level for the annual GDP growth to be between 3.6 per cent and 5.0 per cent. Thereby, debts grow with the same rate in the normal level.

In the analysis that is presented here, the models are based on outcomes up to and including the third quarter of 2015. The forecasts for debts are conditional on the National Institute of Economic Research's (NIER) macroeconomic assessment in December 2015.¹⁰ Compared with the forecasts that were presented in Finansinspektionen's stability report in December 2015, both GDP outcome and NIER's forecast for GDP growth in 2016 have been revised upwards (see Diagram 5). For 2017 and 2018, GDP growth has been revised slightly downward.

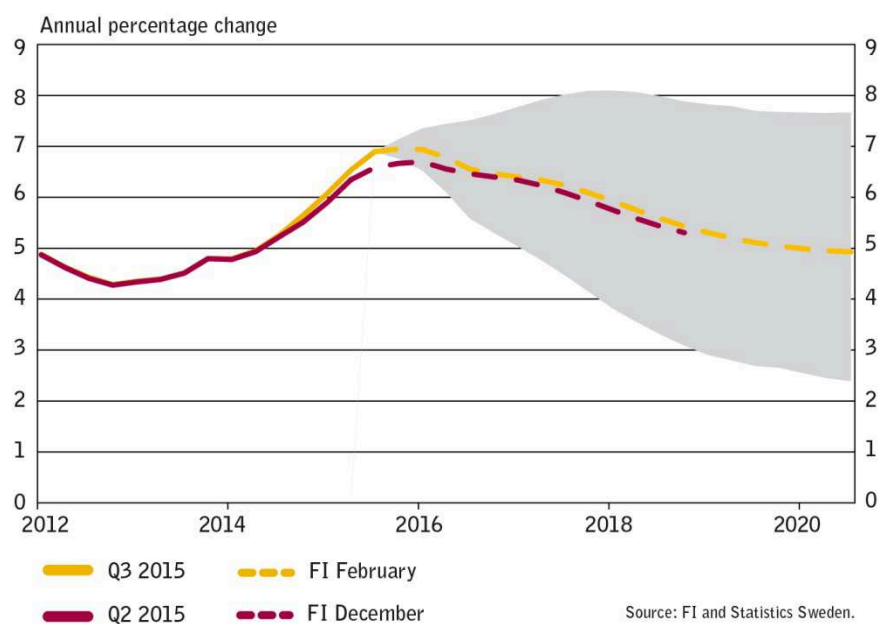


Note: The grey shading shows a 95-per cent probability interval for the growth of nominal GDP in a normal state.

Household debts are growing faster than the normal level during the entire forecast period (see Diagram 6). Moreover, the prognosis for the rate of increase in household debt has been revised upward since the previous forecast occasion. This can be explained by both the upward revision in the outcome for household debts and that the outcome for the third quarter was higher than expected. The stronger GDP growth, in both the outcome and NIER's forecasts, also contributes to the upward revision of the forecast for household debts.

¹⁰ National Institute of Economic Research, *Konjunkturläget*, December 2015.

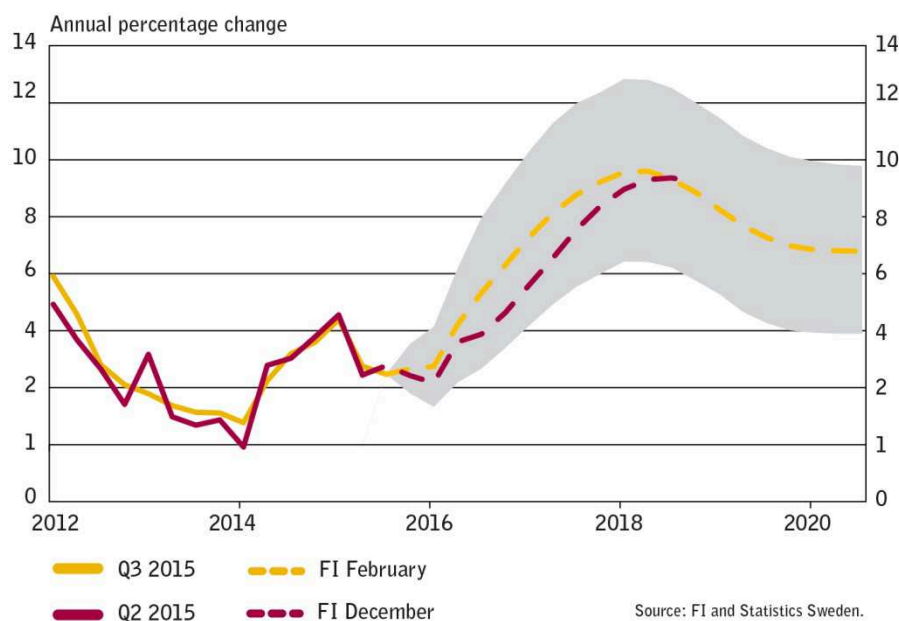
6 Households' nominal debt



Note: The grey shading shows a 68-per cent probability interval for the growth of nominal GDP in a normal state.

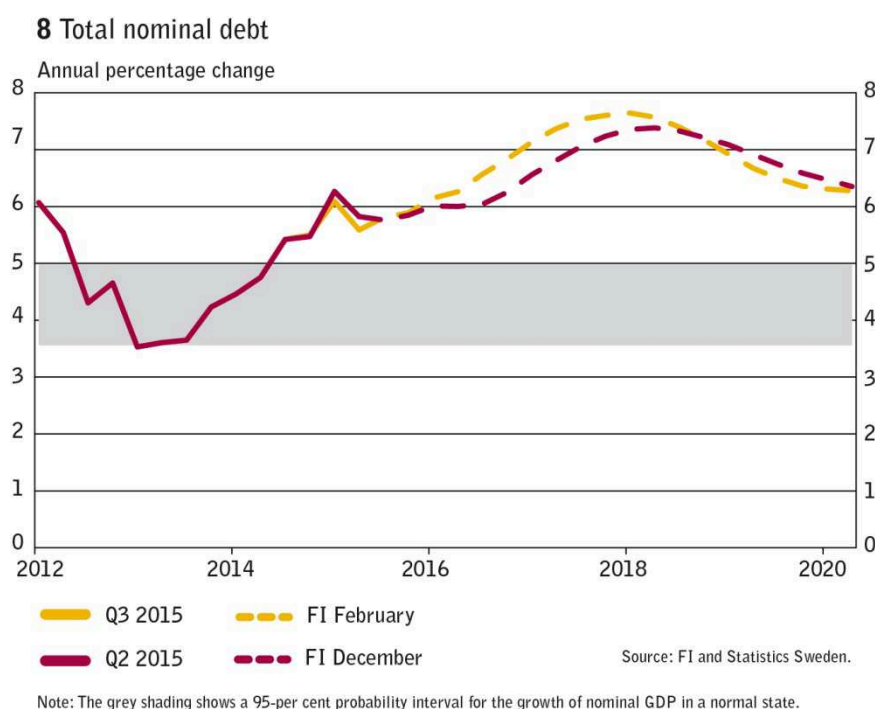
Corporate debts, according to the model estimation, are more sensitive to interest rates than household debts, and the low interest rate explains why debt growth is accelerating during 2016 and 2017 (see Diagram 7). Due to NIER's higher GDP forecast, firms' debts are revised upward compared to the previous forecast occasion. Corporate debts are growing faster than normal during the entire forecast period.

7 Corporates' nominal debt (MFI)



Note: The grey shading shows a 68-per cent probability interval for the growth of nominal GDP in a normal state.

As a whole, the total debts are increasing slightly faster in the current forecast compared to the previous forecast (see Diagram 8).¹¹ The total debt growth is above the long-term sustainable growth during the entire forecast period. Since debt growth up to 2018 is judged to be higher than the previous assessment, the risks have increased slightly.



2.3 The countercyclical buffer guide

The buffer guide is part of Finansinspektionen's analysis and assessment of the size of the countercyclical buffer in Sweden. It is based on the credit-to-GDP gap, which specifies how much the total lending to households and corporates in relation to GDP deviates from its long-term trend. The credit-to-GDP gap is considered to be a useful indicator for when to activate and raise the countercyclical buffer guide. However, the credit-to-GDP gap is considered to be less useful for determining when the buffer should be released. With regard to reducing the buffer rate, therefore, other indicators are recommended, such as financial stress indicators.¹² There is thus no mechanical link between the guide and the level of the countercyclical buffer.

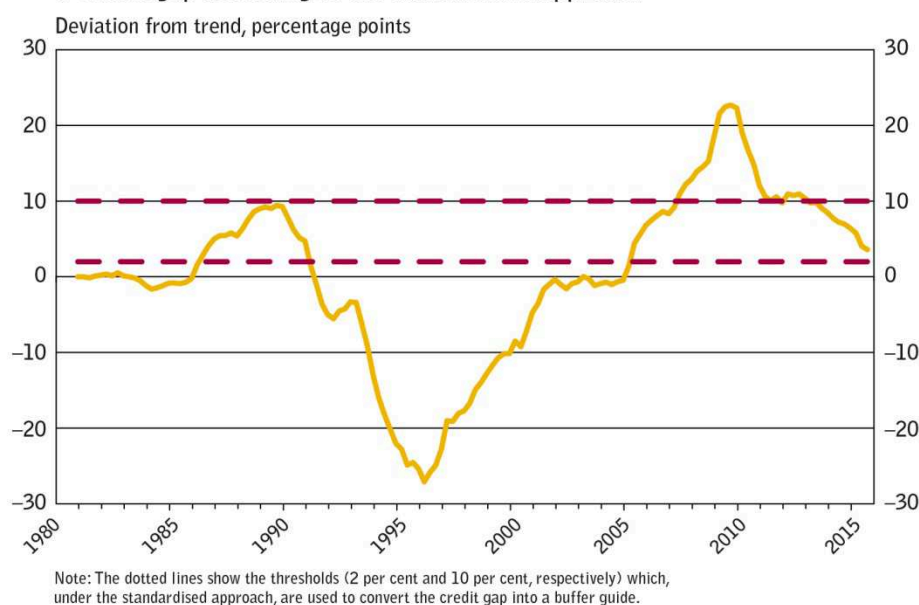
Finansinspektionen calculates the buffer guide in accordance with the Basel Committee's (BCBS) standardised method, which uses the credit-to-GDP gap

¹¹ The downward revision of the total debts in the second quarter of 2015 is related to a relatively large downward revision in the market funding volume.

¹² ESRB (2014), *Operationalising the countercyclical capital buffer: indicator selection, threshold identification and calibration options*, Occasional Paper No. 5.

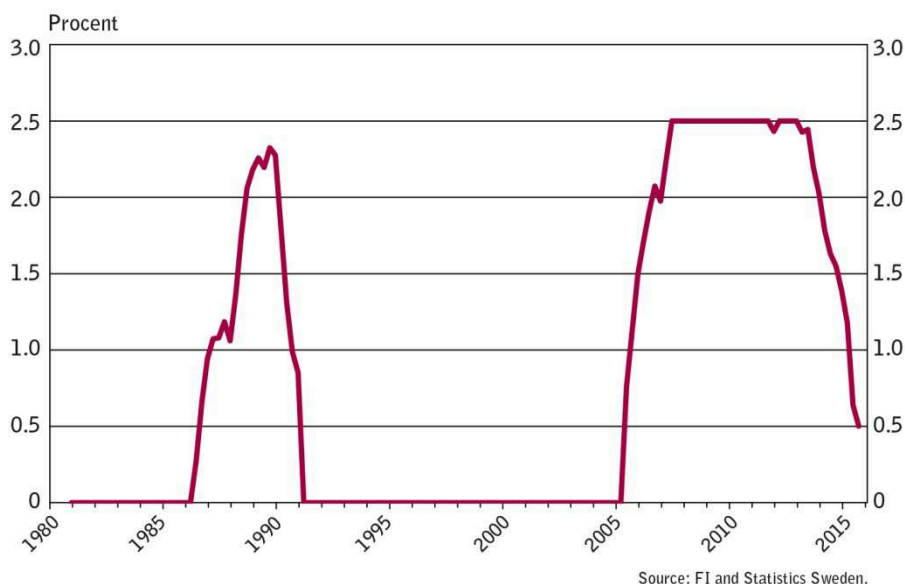
as its basis.¹³ According to the standardised method, the credit-to-GDP gap is estimated at 3.6 per cent in the third quarter of 2015 (see Diagram 9).

9 Credit gap according to the standardised approach



The size of the credit-to-GDP gap is converted into a buffer guide in accordance with a formula for the relationship between the credit-to-GDP gap and the buffer guide. The estimated credit-to-GDP gap of 3.6 per cent gives a buffer guide of 0.5 per cent (see Diagram 10).

10 Buffer level according to standardised approach



¹³ For more information about the standardised method, see FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on www.fi.se on 10 September 2014, FI Ref. 14-7010.

2.4 Other quantitative indicators

In its guidelines¹⁴ for setting countercyclical buffer rates, the European Systemic Risk Board (ESRB) recommends that the authority responsible for assessing the systemic risks linked to strong credit growth shall also take into account other quantitative indicators. Finansinspektionen has, by reason of these guidelines, decided to monitor a number of indicators which are considered relevant for Sweden.¹⁵ These indicators include various measures of the progression of household and corporate lending, housing prices in relation to disposable income, current account and financial savings in the public sector as a share of GDP, bank capital levels, the interest-to-income ratio of households, and developments in real equity prices.¹⁶

Finansinspektionen makes the assessment that the banks' overall capitalisation is good (see Diagram B 1.3).¹⁷ The indicators for current account and financial saving in the public sector, as a share of GDP, show no significant imbalances in the Swedish economy as a whole. Sweden has had large surpluses in its current account since the middle of the 1990s, which, combined with stable public finances, indicates relatively small risks for the Swedish economy (see Diagram B 1.2).

Financial market indicators reflect the market actors' expectations regarding the future state of the economy and therefore supplement other indicators. In Sweden, the real share prices have posted strong growth since the financial crisis, particularly since the middle of 2012. There are no indications that the sharp rise in share prices in Sweden is linked to excessive credit growth. In recent months share prices have fallen (see Diagram B 1.5). Uncertainty for the development in the global economy in general and the economic development in China in particular increase the risks for a small, open economy like Sweden's economy, which is dependent on trade with other countries.

2.5 The countercyclical buffer rate for Sweden

Finansinspektionen's position: The countercyclical capital buffer for Sweden shall be raised and the buffer rate set at 2 per cent. The countercyclical buffer guide for Sweden is set at 0.5 per cent.

Consultation memorandum: The content of the proposal was the same.

¹⁴ ESRB (2014), *ESRB Recommendation on guidance for setting countercyclical buffer rates*, ESRB/2014/1.

¹⁵ See also ESRB (2014), *Operationalising the countercyclical capital buffer: indicator selection, threshold identification and calibration options*, Occasional Paper No. 5.

¹⁶ Appendix 1 provides diagrams showing the development for these indicators. For more information about the choice of indicators, see FI (2014), *Regulations regarding the countercyclical buffer rate*. Published on www.fi.se on 10 September 2014, FI Ref. 14-7010.

¹⁷ See also FI (2016), *The Swedish banks' capital requirements, fourth quarter 2015*. Published on www.fi.se on 25 February 2016, FI Ref. 15-7395.

Consulted bodies: *The Riksbank* welcomes an increase in the countercyclical buffer rate, but finds that the buffer rate should be set at 2.5 per cent instead of the proposed 2 per cent. It is the view of the Riksbank that it is important to strengthen the banks' resilience in light of the expansive monetary policy and the systemic risks that have built up in Sweden over a longer period of time. In order to counteract the high systemic risks, it is also important to implement more measures than only a higher buffer rate.

The Riksbank also believes that the higher buffer rate should be applied as early as in six months, instead of the proposed twelve months. Its reasoning for this is that the purpose of the countercyclical capital buffer is to increase the banks' resilience when systemic risks are building up, i.e. already before they materialise. A more rapid implementation of the buffer requirement would support this objective. The greater uncertainty in global markets, which demonstrates that risks can materialise quickly, emphasises the need for earlier application of the buffer requirement.

The Swedish National Debt Office supports Finansinspektionen's proposed increase to the countercyclical capital buffer from 1.5 per cent to 2 per cent. Systemic risks in the financial sector have been following a rising trend for a while, and there are currently few signs that this trend will change any time soon.

The Swedish National Debt Office shares Finansinspektionen's view that the Swedish economy has shown strong growth. In the near future, debt levels will probably increase as a result of the major housing investments that are being made today; investments that are desirable from an economic perspective to help resolve problems on the housing market. Given the exceptionally low interest rate level and in particular the financial actors' expectations that the interest rate will remain low for a long time, this could contribute to further increasing household indebtedness.

The Swedish National Debt Office shares Finansinspektionen's view that rapidly increasing indebtedness could result in increased systemic risks in the financial sector. In general there is a negative relationship between household debt and consumption during and after a financial crisis. If the total demand falls sharply, there is a risk that this will result in larger credit losses in the banks, which in turn could result in a reduction of credit in the economy and thus further accentuate the economic downturn.

Finally, the Swedish National Debt Office states in its consultation response that the continued increase in the financial systemic risks, combined with the banks' high rates of lending, in particular to households, justifies a relatively high countercyclical capital buffer. The Swedish National Debt Office therefore supports the proposal to raise the buffer rate to 2 per cent.

The Swedish National Board of Housing, Building and Planning supports Finansinspektionen's proposed change in the countercyclical buffer rate.

The Swedish Bankers' Association opposes Finansinspektionen's proposal to set the countercyclical buffer rate at 2 per cent. The Association believes that the measure is not appropriate since the requirement decreases the banks' incentives to issue credit to customers whose loans have higher risk weights, since this type of lending is relatively more expensive. This development counteracts actions that are needed to create balance in the Swedish economy since the result would be higher funding costs for small firms and new production of housing. It is therefore unavoidable that the buffer requirement will affect the real economy, mainly by potentially hampering business and industry growth, investments and demand.

The Association also states that the increase in housing prices has slowed and the forecasts are indicating more stable prices than rising prices, which should be taken into consideration. In addition, the rise in housing prices and thus credit growth is primarily due to the slow rate of construction in expanding cities. To increase the cost of funding new production of housing by raising capital requirements is counterproductive, in the opinion of the Association.

Furthermore, the Association states that Swedish banks are currently very well capitalised, both in relation to the risks that they are taking and in comparison with banks from other countries, and the banking sector has high resilience. Thus, the risk that the banks would not have enough capital to withstand a systemic crisis, which should be the basis on which the level of the countercyclical buffer is set, is low.

Finally, the Association states that the buffer guide, which according to the standardised method is set at 0.5 per cent, shows that the countercyclical buffer should be lowered rather than raised. This is primarily because the trend for the guide is negative. Even if there are reasons not to take the guide into consideration in its entirety, the Association believes that the reasons for the restrictive approach to the guide should be better highlighted. The Association also states that the guide should be subject to restrictive considerations even when it is demonstrating a positive trend.

The Swedish Savings Banks Association opposes the proposal to raise the countercyclical buffer rate with the justification that an increase would lead to a reduction in lending, which affects all sectors. According to the Association, an increase in the buffer rate would primarily have an impact on lending to corporates, while lending to households would not be affected to the same extent. The reason for this is that the banks' risk weights for lending to non-financial firms is generally higher than lending to households.

The Board of Swedish Industry and Commerce for Better Regulation opposes the proposal to raise the countercyclical buffer rate. The Board is very respectful of the efforts made by the State to try to prevent problems that could

arise in the financial system and in the long run lead to significant macroeconomic problems. However, the Board believes that Finansinspektionen should take into account and report on other measures that are being discussed and implemented with basically the same goal as the regulation change that was submitted for consultation. For example, the amortisation requirement will most likely enter into force in some form by the summer. Prices on the housing market have slowed somewhat since the last decision regarding the buffer rate, which suggests that the buffer rate does not need to be changed.

The Board also finds that the countercyclical buffer is a blunt instrument in relation to the fundamental problems that Finansinspektionen would like to use to justify the increased costs. The proposal to raise the buffer will increase the costs of all credit institutions, regardless of their exposure to household mortgages. Trying to fix the fundamental problems on the housing market, which are related to extreme supply deficiencies, by using different types of regulations that affect the supply of credits will not work. The solution requires a more unified strategy. The Board also believes that Finansinspektionen now mainly gets to take care of the symptoms, while the more structural measures linked to how the housing market functions require other measures in other policy areas.

The proposal would probably also result in other incentives for lenders given the system with risk weights for commercial interests and new production of housing, which could generate as a whole unfavourable effects for the real economy. It is therefore the view of the Board that the proposal should not be implemented.

The Association of Swedish Finance Houses opposes an increase in the countercyclical capital buffer. The Association finds the buffer to be a blunt instrument, since it does not take into account that credit growth differs greatly between different areas. The buffer generates incorrect signals and negative effects on lending to corporates that are unnecessarily affected by the increase.

In the opinion of the Association, the risks have not increased to any major extent since June 2015 when the most recent increase was decided. Housing prices, which are strongly linked to the increased indebtedness of households, are showing signs of slowing. This, combined with the pending amortisation requirement, suggests that Finansinspektionen at this point in time should wait to see the outcome of the amortisation requirement before implementing an increase in the capital buffer. The Association therefore believes that an increase from 1.5 to 2 per cent is not justified.

Finansinspektionen's grounds: The purpose of the countercyclical capital buffer is to strengthen the banks' resilience during periods when systemic risks are building up. As described above, credit growth continues to be strong today and debts are currently growing at a rate of 6 per cent a year. The rate at which debt has been growing has accelerated for a long time and debts are now

increasing faster than what Finansinspektionen judges to be sustainable in the long run. Debts are also growing faster now than in June 2015 when Finansinspektionen raised the buffer to 1.5 per cent.¹⁸ The forecasts also show that the debt is rising more than what was predicted in December 2015. These elevated risks over a long period of time suggest that the buffer should be raised.

It is Finansinspektionen's view that corporate lending is currently developing normally. There are no indications that imbalances are building up in the corporate sector. What is instead driving the strong growth in total lending is the accelerating lending to households. The increase in household debts is in turn heavily linked to the increase in prices on the housing market, since household debt consists primarily of mortgages. Housing prices have demonstrated exceptional growth in recent years, in part due to low interest rates and rising income. During 2015 prices increased by more than 17 per cent for tenant-owned apartments and by more than 12 per cent for single-family homes.¹⁹ Even if there are some signs that this trend is slowing, it is still too early to draw any far-reaching conclusions.

Given this context, it is worth noting that the amortisation requirement is expected to be in place this summer. The purpose of this measure is to reduce the sensitivity of Swedish households to economic shocks, such as a drop in housing prices, and thus make the Swedish economy more stable. The amortisation requirement is expected to slow the development in housing prices and lending to households. Finansinspektionen previously made the assessment that the absence of an amortisation requirement meant that annual credit growth for the household sector would be at most 0.2-0.3 percentage points higher for a number of years than what it would have been had an amortisation requirement been introduced. At the same time, both households and firms have begun to adapt themselves to the pending requirement, which reasonably means that the slow-down effect could be less noticeable.

Even if household debt is currently not considered to pose a threat to financial stability, its development is worrying. The low interest rates combined with continued strong economic growth could enable a continued upward trend in household lending. The Swedish households certainly have good resilience, but the risks facing household finances rise as indebtedness rises and disposable income is not rising at the same rate. There is less space for households to manoeuvre if the economy were to take a turn for the worse, household prices were to fall or interest rates were to rise. Even if the risk of credit losses in the household sector is judged to be low, disruptions such as higher unemployment or rising interest rates could weaken household finances and trigger more

¹⁸ Debt growth amounted then to 5.6 per cent, see FI (2015), *Amendment to regulations regarding the countercyclical buffer rate*. Published on www.fi.se on 23 June 2015, FI Ref. 15-7062.

¹⁹ See Valueguard's HOX Housing Index, http://www.valueguard.se/201512_Indexpublicering

conservative behaviour. Experience has shown that highly indebted households have a stronger tendency to decrease their consumption and thus decrease demand for the goods and services offered by firms. A decrease in revenue in turn reduces firms' ability to pay their debts. In the end, this raises the risk that banks will suffer higher credit losses in their exposures to corporates, and lending from the banks will contract. This development could primarily affect small and medium-sized firms, which are more dependent on the banks for their funding.

Ensuring that firms and households have access to loans even during economic downturns is ultimately important. A higher countercyclical buffer could counteract a development in which the banks, in a recession, would feel forced to decrease their lending to households and corporates. In such a situation, the banks could draw on the accumulated buffer to cover losses and continue to supply the economy with loans.

Finansinspektionen believes that lending, which is continuing to rise, is contributing to an increase in systemic risks. According to NIER, the Swedish economy is entering into a boom cycle. When the Swedish economy enters a period of strong growth, there is also increased risk that credit growth will be boosted to a level that is above what can be considered sustainable. Despite the banks' strong capital position, Finansinspektionen believes that the cyclical systemic risks have increased somewhat due to the strong growth in lending. As a result, there is a greater need to further enhance the resilience in the banking system, which is the main reason for raising the countercyclical buffer.

In addition to debt levels, Finansinspektionen also monitors a number of other indicators that offer a comprehensive overview of the systemic risks. One of these indicators is the buffer guide. The guide serves as the point of departure for Finansinspektionen's assessment of the size of the countercyclical buffer. However, the buffer guide is not used mechanically to set the level of the buffer. This is because the standardised method that is used to calculate the guide has a number of weaknesses, which means that the indicator could provide misleading signals. Therefore, the buffer guide must be interpreted with caution. One problem with the standardised method is that the risks are underestimated for countries that have experienced rapid credit growth for a long period of time. This has been the case for Sweden since the growth in total lending was high for the first decade after the turn of the century. For this reason, Finansinspektionen believes that the decline in the buffer guide currently provides an inaccurate reflection of the risks and that the buffer guide should be given minimal consideration when determining an appropriate size for the countercyclical buffer.

In summary, Finansinspektionen finds that the systemic risks linked to financial imbalances have continued to increase, compared to both June 2015 when the buffer was raised to 1.5 per cent and December 2015 when Finansinspektionen decided to leave the buffer unchanged. Thus, there is justifiable reason to increase the countercyclical capital buffer in order to

increase resilience in the banking system, and hence improve its ability to manage any credit losses in the future.

In terms of the assessment of the size of the buffer, Finansinspektionen believes that lending to the non-financial sector in Sweden continues to be high, but that, in the end, it is not increasing dramatically or excessively. The fact that cyclical systemic risks are continuing to increase gradually suggests that the buffer should be raised in the same way. Finansinspektionen therefore believes that it is reasonable to raise the countercyclical buffer gradually while systemic risks are increasing, but before they reach alarming levels. This is a more effective approach than reacting late and raising the buffer first when it is clear that the risks are very high. Raising the buffer gradually at an early phase can also decrease the banks' costs for building additional resilience. Banks can thus fulfil the requirements by being conservative in their dividends. Given this background, Finansinspektionen makes the assessment that the countercyclical buffer rate shall be increased to 2 per cent.

2.5.1 Finansinspektionen's view on the feedback received

Finansinspektionen notes that the opinions of the consulted bodies regarding the proposed increased countercyclical buffer are divided. Some support the proposal while others oppose it entirely. Arguments have been put forth for an even higher countercyclical buffer rate than that proposed by Finansinspektionen as well as for leaving the buffer unchanged.

The Riksbank, for example, finds that the buffer not only needs to be raised to a higher level than Finansinspektionen's proposal, but also that it should be introduced within a shorter period than twelve months. It argues that systemic risks have been building up over a long period of time and that the resilience of the banks should be strengthened in light of the expansive monetary policy and already before the systemic risks materialise. Finansinspektionen's analysis above shows that the systemic risks linked to financial imbalances have increased recently, and that credit growth is continuing to accelerate. It is in light of this development that Finansinspektionen is now increasing the countercyclical buffer in order to strengthen resilience in the banking system. Finansinspektionen believes that the buffer should be raised gradually while systemic risks are increasing but before they reach alarming levels. Even if the upward trend in credit growth has continued, it is Finansinspektionen's assessment that the increase is not so excessive that it justifies a buffer rate higher than 2 per cent. Finansinspektionen also makes the assessment that the risk build-up is not considered to be so exceptionally high that it requires a faster implementation than what would normally be the case by law (see section 2.6).

A recurring argument against the increase to the buffer from the consulted bodies that oppose the proposal is that the countercyclical buffer is a blunt tool that does not take into account that credit growth is very different in different areas. The measure raises the risk of reducing the incentives for the banks to

lend to corporates, despite the fact that it is the rising debt of households and not lending to corporates that is problematic. Finansinspektionen agrees that the countercyclical buffer is a blunt instrument for dampening credit growth and that it does not take into account the development in individual sectors. The buffer also has a greater impact on the corporate sector since exposures to corporates on average have a higher risk weight than exposures to households.

At the same time, however, it is important to remember that the buffer's primary objective has never been to reduce credit growth since its effect on banks' expenses, and thus lending, are small (see sections 3.2 and 3.3 below). The aim of the buffer instead is to primarily ensure that the banks have more capital and thus more resilience in situations where systemic risks are increasing. This increases the banks' possibilities to continue lending during crises. If there is a need to reduce the amount of lending to households, measures that have a more direct impact on indebtedness should be taken instead. The pending amortisation requirement is one example of this.

The somewhat higher systemic risks that Finansinspektionen sees building up as a result of household indebtedness could also potentially create risks for credit losses in lending to corporates. In an economic downturn, the probability is large that households will reduce their consumption but continue to pay their loans. The risk for credit losses in the banks' household portfolios is thus small. However, reduced consumption could lead to falling demand in the economy, which has a negative impact on firms. The risk is therefore judged to be greater for potential credit losses in the corporate portfolios of banks. It is in this type of situation that the accrued countercyclical buffer could be useful. Following a decision by Finansinspektionen to reduce the buffer requirement, the buffer can be used to absorb incurred losses. This in turn gives the banks the possibility to continue to supply credits to the real economy when needed most. If each of the banks accrues a sufficiently large countercyclical buffer during good times, this will ensure that the banking system will be able to contribute to and support sustainable economic growth.

Another argument presented by the consulted bodies that oppose the proposal is that the risks, in their opinion, have not really increased much since June 2015 when the most recent increase was decided. As support for this argument, they mention that housing prices, which are strongly linked to the increased indebtedness of households, are showing signs of a slow-down. This development, combined with the pending amortisation requirements, would rather suggest that Finansinspektionen should defer raising the buffer. Finansinspektionen does not share the view that risks have not increased in recent months. Quite the opposite, total lending, which is the focus of the countercyclical buffer, has continued to rise. During the third quarter of 2015, credit growth was 6 per cent, which is a high and unsustainable level in the long run. It is Finansinspektionen's opinion that this suggests that the financial imbalances and the cyclical systemic risks linked to a continued high level of credit growth are still building.

In terms of housing prices, it is too early to tell if they have stabilised. Uncertainty on the housing market has increased slightly in the past few months. Some of the factors that indicate that prices will continue to rise sharply are the housing shortage, the low interest rates and population growth rates in excess of the rate at which new housing is being built. At the same time, however, more housing has been built, and the banks have increased their demands on mortgage applicants and their repayment capacity. Taken together, these factors indicate that prices will rather increase in the future at a slower rate.²⁰ Finally, Finansinspektionen believes that the amortisation requirement will only have a minor effect on slowing the growth of housing prices and household indebtedness since both households and banks have already begun to adapt to the pending requirements. The banks are already requiring amortisation of mortgages partly in line with Finansinspektionen's proposal.

In terms of the banks' capitalisation, the Swedish Bankers' Association states that the Swedish banks are well capitalised and therefore continue to have high resilience. The Association takes the position that the risk that the banks would not have enough capital to withstand a systemic crisis is low. Finansinspektionen has noted in its analysis that the banks' capital strength is certainly still good, but that resilience needs to increase in light of the heightening systemic risks and accelerating credit growth. The fact that the Swedish banks are well capitalised in relation to the risks they are taking is one thing, but Finansinspektionen takes a broader perspective. One interesting aspect to take into consideration in this context is whether the banks also account for the risks to which they are exposing the financial system and the economy. As previously mentioned, mortgages grew by 8.4 per cent on an annual basis in January 2016. Swedish mortgages can in general be viewed as an asset with very low risk for the banks. In relation to the inherent risk in this product, the banks can be considered to be well capitalised. On the other hand, however, household debt, which primarily consists of mortgages, could have negative effects mainly on the economy, in the form of decreased consumption, but also on the banks in the long run.

Raising the countercyclical buffer is not about the banks not having enough capital to withstand a crisis. There are different ways to handle a crisis that results in credit losses for the banks. Experience has shown that in such a situation the banks tend to reduce lending to households and corporates. This measure may very well safeguard the banks' and the system's stability, but it is hardly desirable for the economy. If the banks were to have a countercyclical buffer that was sufficiently large, they could continue to supply credits to the real economy even if the economy were to take a turn for the worse and credit

²⁰ Even SEB's housing price indicator, which demonstrates the difference between the households that believe prices will rise and those that believe prices will fall, indicates that households expect housing prices to rise. The indicator rose to 60 in March 2016, compared to 50 the month before. Of the polled households, 71 per cent answered that they believe prices will rise in the next year, while 11 per cent answered that they believe prices will fall. See <http://www.demoskop.se/publicerat/boprisindikatorn-for-mars-2016>.

losses would materialise in the banking system. This benefits the economy at large.

In terms of the countercyclical buffer guide, the Swedish Bankers' Association has stated that its decreasing rate indicates that the buffer should be lowered rather than raised. The Association grants that there may be reasons not to consider the guide in its entirety and that this restrictive approach should also apply in the presence of an upward trend for the indicator, but it still believes that the reasons for the restrictive approach to the guide should be better illustrated. Finansinspektionen would like to emphasise once again in this context that the guide is only a starting point in setting the buffer rate and it is not a determining factor in the assessment of the size of the buffer.

Analyses conducted by the BCBS and the ESRB show that the credit-to-GDP gap, which serves as the basis for the calculation of the guide, is a valuable starting point in guiding the decision on countercyclical buffer rates, but its performance can differ across countries and over time. These analyses show, thereby, that the credit-to-GDP gap sometimes can provide misleading information, which the designated authorities should be aware of when assessing the sustainable level of credit in the economy and the appropriate countercyclical buffer rate. The ESRB recommends, therefore, that the designated authorities should periodically reassess the performance of the indicators on which they place most weight. That the credit-to-GDP gap and other indicators sometimes convey misleading information is a well-known fact.²¹ It is also given this background that both the BCBS and the ESRB recommend that designated authorities take into account different types of quantitative and qualitative information, including other indicators in addition to the buffer guide, when determining the degree of systemic risk and setting the buffer rate in accordance with this risk.

As Finansinspektionen has already highlighted, the standardised method that is used to calculate the credit-to-GDP gap has a number of known weaknesses and as a result can generate misleading signals. One problem with the method is that the risks are underestimated in countries that have had fast credit growth for a long period of time, which has been the case for Sweden during the first decade following the turn of the century. The fact that the buffer guide is decreasing at the same time as credit growth in Sweden is increasing to levels that are not sustainable in the long run demonstrates that the indicator is currently inaccurately reflecting the risks. This is why Finansinspektionen is currently placing less weight on the buffer guide and drawing on all of the

²¹ Principle 3 (Risk of misleading information) of Recommendation of the European Systemic Risk Board of 18 June 2014 on guidance for setting countercyclical buffer rates (ESRB/2014/1) lays down that "Designated authorities should assess the information contained in the credit-to-GDP gap and any other relevant variables or models that combine variables, being mindful that the information they provide may be misleading. Designated authorities should take this assessment into account when exercising their judgement regarding the sustainability of credit growth in order to set the appropriate countercyclical buffer rate. The usefulness of these variables and models should be periodically reassessed."

other indicators that are available and making its own qualitative assessments.²²

A more general argument has been presented by the Board of Swedish Industry and Commerce for Better Regulation, which takes the position that Finansinspektionen should take into account and report on other measures that are being discussed and implemented with basically the same goal as the increase to the countercyclical buffer. During the years since the financial crisis, Finansinspektionen has taken a number of measures to strengthen the resilience of both the banks and households. The most relevant measures given this context include the implementation of a mortgage cap, the implementation of a risk weight floor for Swedish mortgages, raised capital requirements for the four major systemically important banks and the proposal to implement an amortisation requirement. Finansinspektionen has also recently published a proposal to raise the capital requirements, primarily for exposures to corporates²³, for banks that use the IRB approach. Each of these measures contributes to making the banking system and Swedish households more resilient to various disruptions in the economy. Finansinspektionen also regularly monitors the consequences of its regulatory measures on, for example, capital levels via the financial stability reports that are published twice a year.²⁴

The measures mentioned above target and manage systemic risks that are more structural in nature. The countercyclical buffer, however, aims to manage systemic risks that are cyclical. These types of risk have a tendency to build up during strong economic periods that are often characterised by considerable optimism and expansive lending. When the business cycle turns, this optimism turns into pessimism, which is reflected in the banks' propensity to tighten lending more than is warranted or desirable from an economic perspective. The countercyclical buffer gives the banks the opportunity to cover losses that arise and continue to supply the economy with necessary credits even during economic downturns.

Finansinspektionen is thus working on several different fronts to manage the risks, both structural and cyclical, that are linked with the high credit growth in general and household indebtedness in particular. In this work

²² The BCBS's guidance for the setting of the countercyclical buffer sets forth that authorities should use their judgement when setting the buffer, after having taken into consideration the best available information to evaluate the build-up of systemic risk, rather than relying mechanically on the credit-to-GDP gap. For more information, please see BCBS (2010), *Guidance for national authorities operating the countercyclical capital buffer*.

²³ For more information, please see Finansinspektionen's Consultation Memorandums, *FI's supervision of banks' calculations of risk weights for exposures to corporates* (FI Ref 15-13020) and *Pillar 2 capital requirements for maturity assumptions* (FI Ref 16-2703), both of which were published on www.fi.se on 1 March 2016.

²⁴ See, for example, FI (2015), *Stability in the Financial System 2015:2*. Published on www.fi.se on 1 December 2015, FI Ref. 15-15827.

Finansinspektionen is using more targeted measures that are intended to manage risks in individual sectors as well as broader tools that aim to strengthen the banking system's resilience. A risk management strategy that allows the use of more than one tool at the same time is not contradictory. Quite the opposite, the combination of several measures can be more powerful and more effective for preventing and reducing systemic risks in the financial system.

Another argument that was presented by the Board of Swedish Industry and Commerce for Better Regulation is that the fundamental problems in the dysfunctional housing market, which suffers from extreme supply problems, should be handled through a unified strategy rather than with different regulations that affect the access to credit. According to the Board, structural measures within policy areas other than macroprudential supervision are required to manage how the housing market functions. Finansinspektionen agrees that many of the driving factors behind the rising housing prices and high indebtedness of households are structural in nature, which Finansinspektionen has also highlighted previously and most recently in a joint report to the Financial Stability Council.²⁵ Several measures in a number of different policy areas are needed to remedy the problems on the housing market. But this aside, Finansinspektionen has a responsibility and obligation under its mandate to ensure that the financial system is robust and resilient if and when various disruptions arise.

In this section Finansinspektionen has addressed the feedback and arguments put forth by the consulted bodies on the proposal to increase the countercyclical buffer rate. In summary, Finansinspektionen finds strong grounds not to change its assessment of the level of the countercyclical capital buffer.

2.6 Entry into force

According to Chapter 7, section 6 of the Buffer Act, a decision to activate or increase a countercyclical buffer rate shall contain information about when the buffer rate shall enter into force. A decision involving an increase to the buffer rate must, as a general rule, enter into force twelve months after the decision has been announced. However, the decision may enter into force earlier if there are special grounds.

²⁵ Finansinspektionen, Sveriges Riksbank and the Swedish National Debt Office (2015), *The driving forces behind household indebtedness*, Report to the Financial Stability Council. Published on http://www.fi.se/upload/90_English/95_Supervision/2015/Drivkrafter_150702_eng.pdf on 3 July 2015. See also Hansen (2013), *Explanations for the development in household debt since the mid-1990s*, Analysis materials for the Council for Cooperation on Macroprudential Policy, Memorandum 1, Finansinspektionen.

Finansinspektionen's analysis, as presented above, shows that the systemic risks linked to financial imbalances are continuing to build. It is given this background that Finansinspektionen views there to be a need to raise the countercyclical buffer. However, even if credit growth is at a high level today, the build-up of risk is not so exceptionally high as to require that the measure be implemented faster than that which shall normally apply by law. The stated countercyclical buffer rate shall therefore enter into force as of 19 March 2017, which is in accordance with the general rule above.

In the opinion of Finansinspektionen, there is no need for specific information initiatives in connection with the entry into force, because the firms affected can be considered to be well aware and well informed of the measures and the background thereof.

3 Impact assessment

Below, Finansinspektionen describes the impact of the increase to the buffer rate. This section starts with an account of the consulted bodies' feedback regarding the impact of the proposal. It then describes which firms are subject to the requirement to maintain a countercyclical capital buffer and the impact on these firms due to the buffer being raised from 1.5 to 2 per cent. Furthermore, the impact on consumers, investors and the national economy is described, and, in conclusion, the impact on Finansinspektionen.

3.1 Feedback from the consulted bodies

The Swedish Better Regulation Council finds that the quality of the impact assessment is sufficient on all points except one. The impact assessment states that the increase to the countercyclical buffer rate will not have any effects on the banks' working conditions, competitiveness or other terms. It also states that the small firms that are exempted from needing to hold capital to meet the requirements of the countercyclical capital buffer are not affected by the change in the regulations but will benefit in relation to affected banks. The Council finds this reasoning to be somewhat contradictory. If the smaller firms' exemption from the requirement is beneficial in relation to the banks that are affected, there could be some impact in the competitive relationship between the firms that are subject to the requirement and those that are not. According to the Council, there is no clear justification for Finansinspektionen's assessment with regard to the impact on the competition conditions for affected firms. However, given that all of the other points have been accounted for with sufficient clarity, this deficiency is not crucial. The Council thereby finds that the impact assessment meets the requirements of sections 6 and 7 of the Regulatory Impact Assessment Ordinance (2007:1244).

The Swedish Bankers' Association believes that the increase to the buffer requirement decreases the banks' incentives to grant credit to small firms and for the new production of housing, and will result in raised funding costs. The

buffer requirement will therefore affect the real economy, mainly by potentially hampering business and industry growth, investments and demand.

The Swedish Savings Banks Association also says that an increase to the buffer rate will result in a reduction in lending, which will affect all sectors. The measure would primarily have an impact on lending to corporates, while lending to households would not be affected to the same extent. The same argument is also presented by the *Association of Swedish Finance Houses*, which believes that the buffer sends the wrong signals and has a negative effect on lending to corporates, which are unnecessarily affected by the increase.

The Board of Swedish Industry and Commerce for Better Regulation believes that the proposal would probably also lead to other incentives for lenders given the system with risk weights for commercial interests and new production of housing, which as a whole could generate unfavourable effects for the real economy. The proposal to raise the buffer will also increase the costs of all credit institutions, regardless of their exposure to household mortgages. According to the Board, it is very probable that the increased costs will in the end be carried by the consumer, i.e. corporates and private individuals. The Board states that it is therefore reasonable for Finansinspektionen to report the total economic effects of the rules that are implemented with the goal of improving financial stability. Without a comprehensive overview of these measures, each of which has slightly differing purposes, it is difficult to identify the necessity for new requirements implying increased costs.

Finansinspektionen discusses this feedback in the following review of the impact on banks, consumers and the economy.

3.2 Impact on firms

3.2.1 Affected firms

The countercyclical buffer rate shall be used to calculate the firm-specific countercyclical capital buffer. The firms covered are credit institutions, securities companies, Svenska skeppshypotekskassan, fund management companies with discretionary portfolio management and alternative investment fund (AIF) managers licensed to conduct discretionary portfolio management. In total, 87 banks, 35 credit market companies, 109 securities companies, 24 fund management companies with discretionary portfolio management, 22 AIF managers with discretionary portfolio management and Svenska skeppshypotekskassan, i.e. 278 firms, are affected.

According to Chapter 9, section 1 of Finansinspektionen's regulations (FFFS 2014:12) regarding prudential requirements and capital buffers, small and medium sized securities companies, fund management companies with discretionary portfolio management and AIF managers with discretionary portfolio management are exempted from the requirement to maintain a firm-specific countercyclical capital buffer. Groups are also exempted if they

only consist of firms which, at an individual level, are exempted from the requirement. Pursuant to the exemption provision and based on the information from the third quarter of 2015, 143 firms will be exempted from the requirement to maintain a firm-specific countercyclical capital buffer.

In summary, 87 banks, 35 credit market companies, 7 securities companies, 4 fund management companies with discretionary portfolio management, 1 AIF manager with discretionary portfolio management and Svenska skeppshypotekskassan will be subject to the requirement to maintain a firm-specific countercyclical capital buffer.

3.2.2 Costs for the firms

An increase to the countercyclical buffer rate in Sweden to 2 per cent carries certain consequences for the banks. Below, the estimated effects are described for the ten largest Swedish banks. Finansinspektionen has estimated the effects based on data for the third quarter of 2015. The calculations pertain to the consolidated level.

Finansinspektionen has calculated the firm-specific buffer rate on the basis of the relevant credit exposures reported by each firm to Finansinspektionen for the third quarter of 2015. The share of affected credit exposure in Sweden of each firm is stated below:

- Nordea: 20 per cent
- SEB: 41 per cent
- Handelsbanken: 52 per cent
- Swedbank: 62 per cent
- SBAB: 98 per cent
- SEK: 65 per cent
- Länsförsäkringar: 100 per cent
- Skandia: 46 per cent
- Landshypotek: 100 per cent
- Kommuninvest: 81 per cent

In order to calculate the firm-specific buffer rate, the share of the affected credit exposure in Sweden, as above, is multiplied by the buffer rate of 2 per cent. Buffer rates for other countries have not been taken into account. An increase to the countercyclical capital buffer also affects the specific capital requirement under Pillar 2. This is because the calculation of the Pillar 2 basic requirement, which is the result of the current risk weight floor for mortgages of 25 per cent, also includes the countercyclical capital buffer rate. Table 1 below shows the capital need in Swedish kronor resulting from setting the countercyclical capital buffer at 2 per cent.

1 Capital requirements (CET 1) for the ten largest banks in SEK million, effect of increase of countercyclical capital buffer from 1.5 to 2 per cent

	Increase of the countercyclical capital buffer (2 %)	Risk weight floor Swedish mortgages (25 %)	Total capital
Nordea	1,365	449	1,814
SEB	1,230	438	1,669
Handelsbanken	1,221	680	1,900
Swedbank	1,256	848	2,104
SBAB	198	265	463
SEK	247	0	247
Länsförsäkringar	246	130	376
Skandia	100	0	100
Landshypotek	102	15	116
Kommuninvest	28	0	28
Total	5,993	2,825	8,818

In total the increased capital need resulting from the increase in the countercyclical buffer rate from 1.5 to 2 per cent is estimated to amount to SEK 8.8 billion. The capital need calculated above is the largest expense item for the affected banks.

Finansinspektionen finds that the increase to the countercyclical buffer rate will not have any effect on the banks' working conditions, competitiveness or other terms. Neither does the increase entail considerable administrative expenses for the banks concerned. Finansinspektionen activated the countercyclical buffer in September 2014 and the affected firms have been applying the buffer requirement since September 2015. This means that the banks already have processes in place for gathering, processing and reporting information. The change in the buffer does not result in any more or any less time for the various tasks since the working procedure has not been affected. The banks update the information relevant for calculating the firm-specific countercyclical capital buffer on an ongoing basis. This forms part of the reporting to Finansinspektionen already done by the banks. The increase to the buffer level changes nothing in this respect.

The increase to the countercyclical buffer does not entail any need for further investment or staff changes for the banks concerned. Neither is the focus of the operations or other conditions affected by the amendment to the regulations. In general, an increase to the countercyclical buffer rate to 2 per cent is not expected to have any other consequences, such as financial costs, because the change does not bring about any new or amended fees for the banks.

Neither is the increase in the countercyclical buffer expected to affect the specialised financial institutions. Finansinspektionen's calculations indicate that the effect of the increase in the buffer on corporate interest rates will be around 0.05 percentage points, i.e. 5 basis points. Such an increase in the interest rate is expected to only have marginal effect on the demand for credit

from small and medium-sized firms and thus have a very little effect on the financing firms' opportunities and incentives to offer loans to these companies.

As described above, certain small firms are exempted from having to maintain capital to meet requirements for a countercyclical capital buffer. This means that these firms are not affected by the regulations, which would favour them in relation to affected banks. However, this theoretical competitive advantage is judged to be too small to be able to affect the firms' actual competitiveness and their behaviour or their relative strength on the market. It is also less probable that the exempted firms, which primarily consist of small securities companies, operate or compete on the same market as the greater portion of the firms that are subject to the requirement to hold a countercyclical buffer, namely banks and credit market companies. The measure is therefore considered not to have a negative impact on the affected firms' competitiveness or result in any material impact on the competition between the firms that are subject to the buffer requirement and those that are not.

In summary, Finansinspektionen makes the assessment that the capital need that arises as a result of the higher countercyclical buffer is relatively small, in particular when compared to the banks' CET 1 capital or total assets. A buffer rate of 2 per cent should not have a curbing impact on the banks' incentives and ability to supply the real economy with credit.

3.3 Impact on society and consumers

The primary purpose of the countercyclical capital buffer is to strengthen the banks' resilience. A positive side-effect is that the buffer might potentially help curb lending in periods of excessive credit growth.

Finansinspektionen's decision in September 2014 to activate the countercyclical buffer and set the rate at 1 per cent has resulted in the accumulation of an extra buffer of capital by the Swedish banks over the past six months that they may use to manage any credit losses arising during an economic downturn. An increase to the buffer is judged to further increase resilience in the banking system and contribute to a more stable financial system in Sweden. Ultimately, this also means that future crises might be less costly for society.

A recurring argument against the increase among the consulted bodies that oppose the proposal is that the countercyclical buffer risks having an unnecessary impact on sectors that are not contributing to the rising credit growth. The measures could have negative effects on lending to corporates and raise their funding costs. The result, in the long run, could be that the real economy is affected through restrictions to the growth, investments and demand of the commercial sector.

Higher capital requirements on banks, all else equal, raises their costs. Finansinspektionen makes the assessment that the effect on the lending rates

and credit growth will be small. Finansinspektionen's calculations, which are based on very prudent assumptions, show that an increase in the countercyclical buffer rate from 1.5 to 2 per cent would give have an effect on the mortgage rate of a maximum of 0.01-0.02 percentage points (1-2 basis points). Such an increase would only very negligibly curb household demand for credit and demand in the economy at large. A similar calculation for the corporate rate was described above. This effect is also small, around 0.05 percentage points, and is thus expected not to materially influence corporates' demand for credit. In summary, Finansinspektionen does not expect consumers to be affected by significantly higher costs due to the increase in the countercyclical buffer.

Well capitalised banks should, moreover, be considered as less risky and thus lead to lower return expectations from both investors and shareholders. A resilient banking sector that is well-equipped for difficult times leads to increased market confidence, better funding possibilities and most likely also to lower funding costs.

The Swedish banking sector also currently has good, stable earnings. In 2015, the four major Swedish banks in total reported a profit of SEK 80 billion. This can be compared to the increase in the capital requirement for these banks of SEK 7.5 billion as a result of an increase of 0.5 percentage points to the countercyclical buffer. Swedish banks would therefore need to use only a relatively small part of their profits to fulfil the raised capital requirements resulting from a countercyclical buffer of 2 per cent. There is also a one-year delay in the application of the capital buffer, which gives the banks plenty of time to build up their buffers.

In summary, Finansinspektionen is of the opinion that the interest rate increases, to which an increase to the countercyclical capital buffer could give rise, are small and that the effect on economic activity in the near future will thus be slight. The Swedish banking sector currently has sound earnings capacity, which further limits the potential negative effects which the countercyclical capital buffer could have on economic activity in the short term.

Finally, the Board of Swedish Industry and Commerce for Better Regulation has stated that Finansinspektionen should report the total economic effects of the rules that are implemented with the goal of improving financial stability. Finansinspektionen shares the Board's view on the importance of analysing and reporting the total economic effects of implemented measures. Such an analysis, however, lies outside the scope of the work on these regulations.

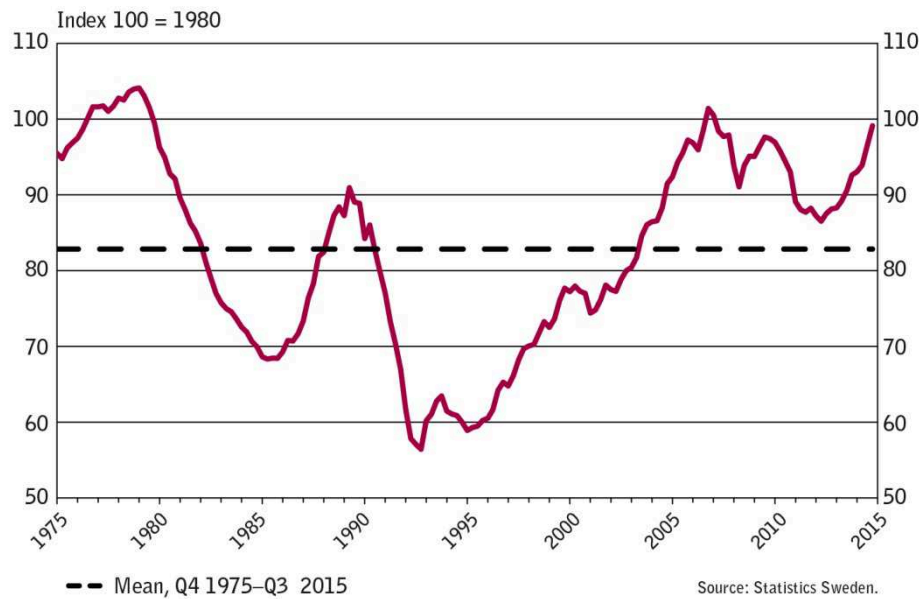
3.4 Impact on Finansinspektionen

Finansinspektionen assesses and sets the countercyclical buffer rate for Sweden on a quarterly basis. This work includes monitoring and analysing a number of different relevant indicators and otherwise making an overall assessment based

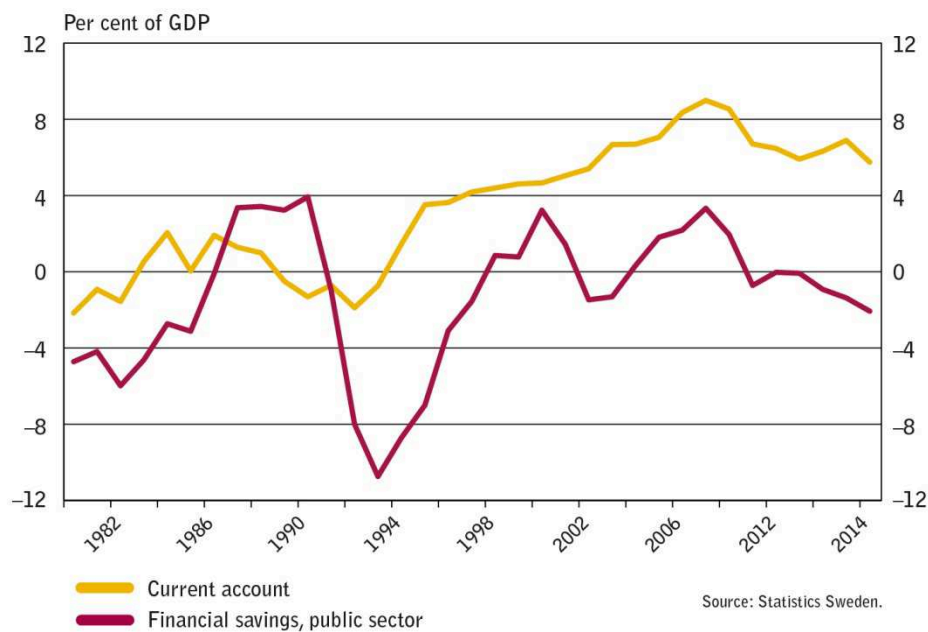
on both qualitative and quantitative rationales when deciding on the buffer rate. Finansinspektionen already conducts such tasks as part of its ongoing work regarding capital requirements for Swedish financial institutions and financial stability. An increase to the buffer thus does not involve any additional costs for the authority.

Appendix 1

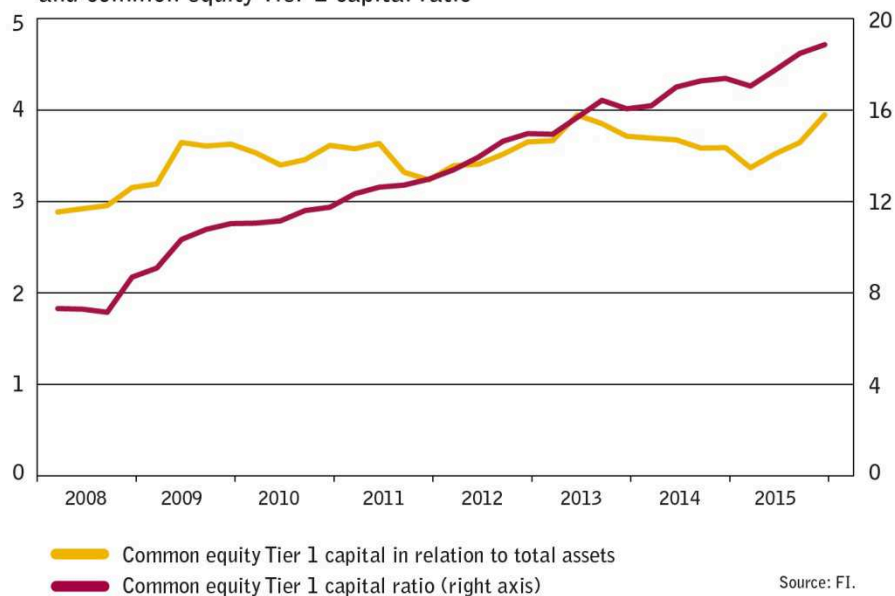
B 1.1 House prices in relation to disposable income



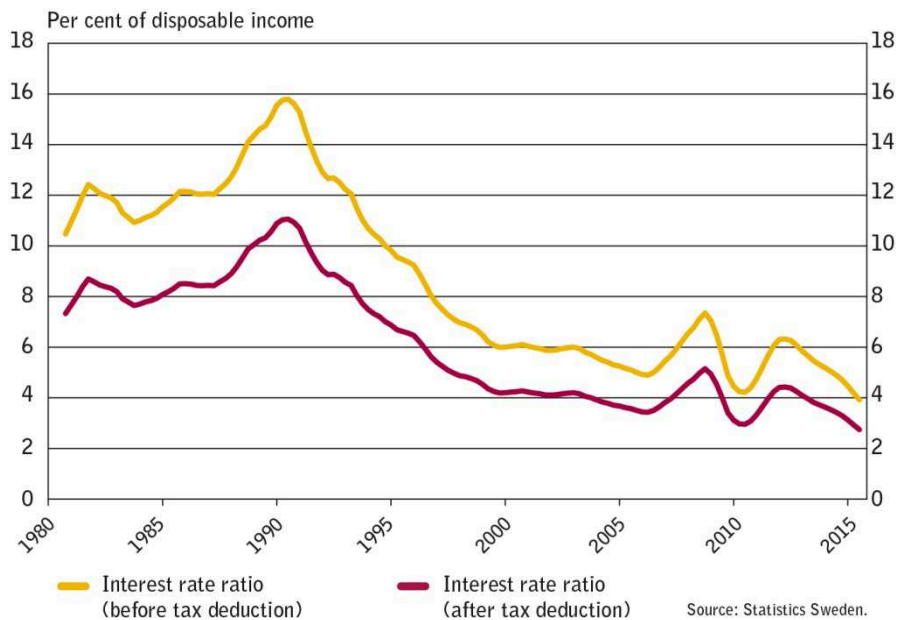
B 1.2 Current account and financial saving in the public sector



B 1.3 Common equity Tier 1 capital in relation to total assets and common equity Tier 1 capital ratio



B 1.4 Interest rate ratio of households



B 1.5 Real equity prices

Note: Real equity prices have been calculated by deflating the OMX by CPIF.

Source: Statistics Sweden and Reuters Datastream.