05/03/2019

CONSULTATION MEMORANDUM

Finansinspektionen
Box 7821
SE-103 97 Stockholm
[Brunnsgatan 3]
Tel +46 8 408 980 00
Fax +46 8 24 13 35
finansinspektionen@fi.se
www.fi.se

FI's liquidity coverage ratio requirements in individual currencies and diversification of covered bonds in the liquidity buffer

This is a revised version of FI's memorandum Pillar 2 Requirements on the LCR in Individual Currencies (FI Ref. 17-12809) that was published on 19 April 2018 (in Swedish only).

Summary

In this memorandum, Finansinspektionen (FI) develops its view on several specific areas of the EU regulatory framework for liquidity regulation. FI clarifies which Pillar 2 requirements the authority will apply in various currencies. In conjunction with this, FI develops its view on how the requirements on diversification of the liquidity buffer's composition should be met. This memorandum provides a comprehensive overview of the requirements that Finansinspektionen places on liquidity regulation and replaces FI's memorandum Pillar 2 Requirements on the LCR in Individual Currencies (FI Ref. 17-12809) that was published on 19 April 2018 (in Swedish only).

A fully binding minimum requirement on the liquidity coverage ratio (LCR) of European banks through an EU delegated regulation has been in effect since 1 January 2018.

FI describes in this memorandum the assessment method it applies in its supervision of the LCR in individual currencies under the supervisory review and evaluation process (SREP) in Pillar 2[1] and its view on concentration risks in the banks' liquidity buffers. FI also clarifies its view on Pillar 2 requirements for liquidity risks in significant currencies and how FI considers the requirement on diversification of the liquidity buffer's composition of liquid assets should be met.

[1] Pillar 2 is the umbrella term for the rules that govern the banks' internal capital and liquidity assessments and FI's supervisory review and evaluation process.

The assessments that served as the basis for the requirement in FI's liquidity regulations from 2012 still hold. The Swedish banking system is concentrated, highly interconnected and dependent on well-functioning financing markets. Large amounts are borrowed in EUR and USD, which explains why the separate requirement for the LCR ratio in each of these two currencies is at least 100 per cent. The LCR regulation furthermore prescribes that the currency composition in the liquidity buffer must be in line with the net outflows per currency. Given this background, FI also sees a need for the banks to maintain a good level of contingent liquidity in each of the other significant currencies, including SEK.

As part of Pillar 2, FI requires banks in Supervision Categories 1 and 2, i.e. the largest banks[2], to meet an LCR ratio in both EUR and USD respectively that is at least 100 per cent. FI also intends to apply a Pillar 2 requirement to each individual significant currency, including SEK.[3] The LCR ratio for each of these currencies (excluding EUR and USD) needs to be at least 75 per cent.

The LCR regulation allows a high percentage of covered bonds in the banks' liquidity buffers. At the same time, the regulation contains operational requirements on the diversification of the composition of liquid assets in the liquidity buffers. It is FI's opinion that this diversification requirement means that, when calculating the LCR ratio, there should be a limit on what percentage of the buffers may consist of covered bonds issued by Swedish issuers. The justification for this is that issuers' risk exposure is heavily concentrated to Swedish mortgages, which can affect the bonds' market liquidity if the mortgage market were to suffer shocks. FI takes the position that the percentage of Swedish covered bonds[4] should not exceed 50 per cent of the total liquidity buffer. The diversification requirements set out in the LCR regulations also entail that the banks should ensure that their liquidity buffers are not excessively exposed to any one individual issuer of covered bonds.

It is FI's assessment that the positions it takes in this memorandum will mean that banks will continue to hold significant liquidity reserves in EUR and USD in relation to outflows in these currencies. At the same time, FI's positions will ensure that the banks are holding sufficiently large liquidity buffers in other significant currencies to meet the regulatory requirements.

FI makes the assessment that its positions on the LCR ratio in individual currencies and the liquidity buffer's diversification will have a relatively

[2] Banks and credit institutions are both called "banks" in this memorandum.
[3] A currency is significant if the currency amounts to at least 5 per cent of the bank's total liabilities in accordance with Article 415(2) of the CRR.
[4] Bonds that are issued by Swedish issuers and where the cover pool consists of loans granted against real property, site leasehold rights or tenant-owner rights in Sweden.

limited impact. Most banks already meet these requirements today, and the others will only need to make minor adjustments.

When it comes to the limitation on the percentage of Swedish covered bonds in the liquidity buffer, it is primarily the banks in Supervision Category 2 that will need to adapt. These adaptations will also be minor, even if the limitation affects more banks than the expanded Pillar 2 requirement for the LCR ratio in individual currencies.

FI intends to apply the expanded Pillar 2 requirement of an LCR ratio of at least 75 per cent in SEK and all other significant currencies (excluding EUR and USD) and the diversification requirement for covered bonds in the liquidity buffers starting with SREP 2019.

Any viewpoints on the positions presented in this memorandum should be submitted to FI no later than 10 April 2019.