

## DECISION MEMORANDUM



FI Ref. 18-6251

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### **Changed method for the application of the risk weight floor for Swedish mortgages**

#### **Summary**

Finansinspektionen (FI) has decided to change the method it currently uses to apply the current risk weight floor for Swedish mortgages through Pillar 2 by replacing it with a requirement within the framework of Article 458 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR). The new requirement will be included in the Pillar 1 requirements.

Structural changes on the Swedish banking market could lead to a situation where the banks on the Swedish mortgage market face different capital requirements for their Swedish mortgage exposures. FI has therefore evaluated how to retain the Swedish banking system's resilience while at the same time counteracting a distortion in the competition on the market. FI makes the assessment that the manner in which the risk weight floor is currently applied needs to change. This is necessary both to safeguard financial stability by retaining the current level of capital requirements for mortgage exposures in Sweden and to maintain a level playing field on the Swedish mortgage market. Both of these goals can be achieved by replacing the current risk weight floor with a requirement under Article 458 of the CRR.

The credit institutions subject to the measure are those that have authorisation to use the IRB approach and have an exposure to Swedish mortgages. Branches of foreign credit institutions in Sweden that are exposed to Swedish mortgages and use the IRB approach for these exposures may also be affected.

The total capital need of the credit institutions is not significantly changed as a result of the measure. The capital requirements that previously were set through the risk weight floor for Swedish mortgages in Pillar 2 will now be set through Pillar 1. The decided measure has a limited effect on the capital requirements in SEK due to the design of the measure, which aims to keep the same capital requirements in nominal terms as the current requirements. The measure therefore ensures that Swedish credit institutions even in the future will have equally high capital buffers for systemic risks linked to Swedish mortgages as under the current capital requirements. Swedish credit institutions

will thus continue to be resilient. As a result of the measure, however, the capital requirements and capital levels expressed in per cent of risk-weighted assets will be reduced. This reduction is only a technical effect of replacing the Pillar 2 risk weight floor for mortgages with a Pillar 1 requirement. The change will result in an increase in the risk-weighted exposure amounts, which in turn will reduce the capital ratios. The effect on the Swedish credit institutions' capital levels and capital requirements in SEK is limited, however.

One consequence of introducing the risk weight floor through Article 458 of the CRR is that a larger share of the capital requirements will fall under Pillar 1. This reduces the margin to the level when the automatic dividend restrictions enter into force. This could mean that the level at which FI must intervene may occur earlier than given today's risk weight floor in Pillar 2. FI makes the assessment that Swedish credit institutions will continue to have satisfactory margins even after the measure has been implemented. FI is also able to reassess and withdraw a measure under Article 458 of the CRR, which would then apply to all credit institutions covered by the measure. This is in line with the purpose of Article 458, which allows a measure imposed under the article to be revoked if the macroprudential or systemic risk ceases to exist. This enables FI to achieve a similar buffer function at the systemic level as with today's risk weight floor in Pillar 2.

The application of the risk weight floor for Swedish mortgages as a requirement under Article 458 of the CRR enters into force on 31 December 2018.

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# **1 Introduction and background**

## **1.1 Purpose**

Finansinspektionen (FI) is changing the method it currently uses to apply the current risk weight floor for Swedish mortgages through Pillar 2 by replacing it with a requirement within the framework of Article 458 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. The new requirement will be included in the Pillar 1 requirements.

The change was preceded by structural changes to the Swedish banking market. Nordea Bank AB (Nordea) decided on 15 March 2018 to move its head office from Sweden to Finland. FI makes the assessment that this change in market structure could lead to a situation where the banks on the Swedish mortgage market will face different capital requirements for Swedish mortgage exposures. FI has therefore evaluated how to retain the Swedish banking system's resilience while at the same time counteracting a distortion in the competition on the market. FI makes the assessment that the manner in which the risk weight floor is currently applied needs to change. This is necessary both to safeguard financial stability by retaining the current level of capital requirements for mortgage exposures in Sweden and to maintain a level playing field on the Swedish mortgage market. Both goals can be achieved by replacing the current risk weight floor with a requirement under Article 458 of the CRR.

This memorandum describes the new method for the application of the risk weight floor and the impact of the change. In this memorandum, the term "credit institution" is used for all banks and credit market companies that are subject to the capital adequacy regulations.

## **1.2 Current and future rules**

### ***1.2.1 The current risk weight floor for Swedish mortgages***

The risk weight floor in Pillar 2 for Swedish mortgage exposures constitutes an important part of FI's current capital requirements. The floor applies to credit institutions that have authorisation to use the internal ratings-based approach (IRB approach). The floor was introduced as part of the supervisory capital assessment in Pillar 2. The Pillar 2 requirement is set for individual institutions to cover risks that are not fully captured by the regulations' minimum and buffer requirements, and it is evaluated on an ongoing basis as part of the supervisory review and evaluation process (SREP).

The risk weight floor was introduced on 21 May 2013.<sup>1</sup> The average risk weight at the portfolio level was set at 15 per cent with the argument that there is a risk that the credit institutions' IRB approaches do not fully capture the credit loss risk of Swedish mortgages.<sup>2</sup> In Sweden, internal credit risk models, which are based on historical outcome, often generate risk weights that are too low since credit losses in the mortgage portfolios have been very low for a long period of time. However, FI realised already when the floor was introduced that it was crucial for the stability of individual credit institutions as well as the Swedish financial sector for the credit institutions to hold own funds that cover the risks in the Swedish mortgage portfolios from a broader and more forward-looking perspective.

FI's assessment was therefore that the risk weight floor needed to be raised even higher to take into account the broader systemic risks that could arise from the Swedish mortgages of individual credit institutions. On 8 September 2014, FI raised the level of the risk weight floor to 25 per cent to also cover systemic risks related to mortgages.<sup>3</sup> The measure was justified by the Swedish mortgage market's size and importance for both individual credit institutions and financial stability in Sweden.

#### *1.2.1.1 Capital requirements and capital type in the current risk weight floor*

To estimate the impact of the current risk weight floor, the exposure amount for Swedish mortgages is first multiplied by the difference between 25 per cent (the risk weight floor) and the institution's actual risk weight in Pillar 1 for the corresponding portfolio. This amount is then multiplied by the applicable capital requirement, which includes all Pillar 1 capital requirements, including the capital conservation buffer and the countercyclical buffer rate for Sweden. For the four banks in Supervision Category 1, i.e. Handelsbanken, Nordea, SEB and Swedbank, the total capital requirement for systemic risk is also considered.<sup>4</sup>

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<sup>1</sup> *Risikviktsgränser för svenska bolån*, May 2013 (FI Ref. 12-11920), FI. An English translation is available at [www.fi.se](http://www.fi.se). When the risk weight floor was introduced, the "old" capital adequacy regulations were still in effect in Sweden, i.e. the Capital Adequacy and Large Exposures Act (2006:1371). The risk weight floor was therefore designed with its legal basis in the then-applicable regulations, which did not contain an explicit legal basis for an additional capital requirement for systemic risk.

<sup>2</sup> The conclusion that risk weights for Swedish mortgages should be at least 15 per cent was the result of an overall assessment of future loss levels in Swedish mortgages in a situation of intense financial stress.

<sup>3</sup> *Kapitalkrav för svenska banker*, September 2014 (FI Ref. 14-6258), FI. A translation is available at [www.fi.se](http://www.fi.se).

<sup>4</sup> This means that, besides the systemic risk buffer of 3 per cent, the capital requirement for systemic risk of 2 per cent imposed on the major banks within the framework of Pillar 2 must also be taken into consideration in the calculation of the capital requirement for Swedish mortgages.

This means that the current risk weight floor for the major banks is calculated using a total capital requirement of 15.5 per cent plus the countercyclical buffer rate. For other credit institutions, the risk weight floor is calculated using a capital requirement of 10.5 per cent plus the countercyclical buffer rate. The type of capital used today to meet the risk weight floor requirement for Swedish mortgages has the same distribution as the Pillar 1 capital requirement, including all buffer requirements.

### ***1.2.2 Future regulations***

The current design of the capital requirements for Swedish banks will change following the outcome of the ongoing review of the EU regulations for capital adequacy and the new standards from the Basel Committee for Banking Supervision (the Basel Committee), which will then be introduced into the EU regulatory framework.

The Basel Committee presented supplements in December 2017 that are intended to complete the global standards for credit institutions' capital adequacy (Basel III).<sup>5</sup> Several standards were revised and Swedish credit institutions will need to use new methods to calculate their capital requirements.<sup>6</sup> In addition to changing the method for the standardised approach, there will also be a new floor for risk-weighted assets for credit institutions that apply internal models. The Basel floor is expected to result in higher average risk weights for Swedish credit institutions' mortgage exposures than the risk weights calculated using internal models.

In addition to the Basel Committee's accord, there is also a review currently under way of the EU's capital adequacy regulations (the Capital Requirements Regulation and the Capital Requirements Directive<sup>7</sup>). The European Commission's proposal, which is under negotiation within the EU, could lead to a change in how national supervisory authorities may use Pillar 2. For example, the Commission proposes a limitation on Pillar 2 add-ons for systemic risks. If the Commission's proposal materialises, the application of today's systemic-risk-based risk weight floor for mortgages in Pillar 2 will be affected.

It is important to assess the total effect of regulation changes resulting from the new Basel standards and the ongoing EU negotiations. FI will adapt the design

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<sup>5</sup> See Basel III: Finalising post-crisis reforms, December 2017, Bank for International Settlements.

<sup>6</sup> The Basel standards need to be negotiated and implemented in the EU before they enter into force. The final design is thus not completed yet.

<sup>7</sup> 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.

and application of the capital requirements, including capital requirements for mortgages, once the new regulations are adapted and fully implemented.

### **1.3 Structural changes on the Swedish banking market**

The decided change in the design of the risk weight floor for Swedish mortgages is necessary given the structural changes on the Swedish banking market. Nordea decided on 15 March 2018 to move its head office from Sweden to Finland. Such a move requires permission from FI, Finland's supervisory authority, Finansinspektionen (FIVA), and the European Central Bank (ECB). The scope of Nordea's operations in Sweden will not change following the planned move. However, the move will have a major impact on the distribution of responsibility for supervision and crisis management between the authorities in the affected countries. Supervision responsibility for Nordea with regard to capital, liquidity and risk management will lie with the Banking Union's central supervisory body, Single Supervisory Mechanism (SSM)/ECB, while FIVA will be the responsible authority for macroprudential policy.

It is assumed that, after the move, Nordea's operations in Sweden will consist of a significant branch<sup>8</sup> and a number of subsidiaries, including Nordea Hypotek AB, which is classified as a credit institution. FI will become a host country authority for the Swedish branch and the competent supervisory authority for the Swedish subsidiaries. Since Nordea will be a significant branch, FI will participate in its supervisory college. FI makes the assessment, however, that the supervision practice applied by the SSM/ECB makes it difficult to apply the Swedish risk weight floor as it is designed today. One effect of this could be that Nordea, by moving its head office to another country, may at least initially be subject to lower capital requirements at the group level for its Swedish mortgage exposures than it is today.

Given Nordea's planned move, FI has therefore evaluated how to retain the Swedish banking system's resilience while at the same time counteracting a distortion in the competition on the market. FI makes the assessment that the manner in which the risk weight floor is currently applied needs to change. This is necessary both to safeguard financial stability by retaining the current level of capital requirements for mortgage exposures in Sweden and to maintain a level playing field on the Swedish mortgage market.

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<sup>8</sup> "Significant branch" is defined in Chapter 1, section 5, point 22 of the Banking and Financing Business Act (2004:297). According to the guidelines from the EBA regarding supervision of significant branches (EBA/GL/2017/14), which have been adopted in Sweden, and given the size of Nordea Bank AB and the significant role it currently holds on the Swedish market, Nordea's Swedish branch is most likely expected to also classify as a "significant-plus branch".



#### **1.4 Article 458 of the CRR helps safeguard capital requirements and a level playing field**

Credit institutions domiciled in other countries may be exposed to and give rise to risks in the Swedish mortgage market through branches or subsidiaries in Sweden. The Nordic market is highly interconnected directly through counterparty exposures and indirectly through similar business models and risk exposures. The financial stability in one country is thus greatly affected by the financial stability in the other countries and in the Nordic-Baltic region as a whole.

There is a principle of home country supervision according to the rules that apply to credit institutions. This means that the competent authority in a credit institution's home country is primarily responsible for the supervision of the institution's foreign branches.<sup>9</sup> Host countries with significant branches according to Article 51(1) of the CRD become members of a supervisory college and thus participate in information-sharing and risk assessment.

In order for macroprudential measures to achieve the intended effect, they need to cover all credit institutions active on the market in question, regardless of the legal domicile. Foreign branches should therefore also be subject to a measure that is taken in the host country to manage national systemic risks. The principle of reciprocity<sup>10</sup> for national macroprudential measures is important in this context. It ensures that the same macroprudential regulations apply to the same type of risk exposure in a country, regardless of the credit institution's legal status and domicile.

The capital adequacy regulations offer the possibility, on a voluntary basis, to request and achieve reciprocity of capital requirements in Pillar 2 within the framework of supervisory colleges. FI has used this opportunity to ensure that the current risk weight floor also includes the Swedish branches of foreign credit institution. Danske Bank's branch in Sweden is currently the only foreign branch that uses the IRB approach and conducts substantial operations on the Swedish mortgage market. FI requested in connection with the implementation of the current risk weight floor that the Danish supervisory authority take into consideration the systemic risks on the Swedish mortgage market in its supervisory capital assessment of Danske Bank. This resulted in reciprocal recognition of the risk weight floor in the bank's Pillar 2 requirements.

However, the capital adequacy regulations do not clearly define reciprocity for Pillar 2 requirements. Neither is there a clearly defined mandate for the

<sup>9</sup> Chapter 13 of the Banking and Financing Business Act (2004:297).

<sup>10</sup> Reciprocity means that a competent authority in a jurisdiction applies the same, or an equivalent, macroprudential measure as decided by a relevant authority in another jurisdiction to all financial institutions in the jurisdiction when they are exposed to the same risk in the latter authority's jurisdiction.



European Systemic Risk Board (ESRB) to issue recommendations to Member States regarding reciprocal recognition of capital requirements in Pillar 2.

FI notes in this context, however, that the possibility to request reciprocity is clearly stated for measures implemented within the framework of Article 458 of the CRR. A host country, in accordance with Article 458(5) of the CRR, is then able to apply for reciprocity of the measures and for other Member States to also apply them to nationally authorised branches located in the host country.

In this context, it is important to note that a risk weight floor in the form of a Pillar 1 requirement under Article 458 of the CRR will apply directly to foreign credit institutions' subsidiaries that are credit institutions in Sweden. The measure will thus affect their exposures at the group level as well. It is therefore not necessary to ask for reciprocity of the measure for these credit institutions' exposures to the Swedish mortgage market. However, reciprocity of the risk weight floor from other Member States is necessary in order for the measure to also apply to Swedish mortgage exposures in foreign credit institutions' branches in Sweden and thereby also at group level.

FI therefore believes that an implementation of the risk weight floor under Article 458 makes it easier to ensure that foreign credit institutions' exposures to Swedish mortgages are covered by the risk weight floor. The measure offers FI the opportunity to secure the current level of capital requirement for mortgage exposures in Sweden and maintain a level playing field on the Swedish mortgage market.

## **1.5 Legal basis**

According to Chapter 1, section 6, second paragraph of the Special Supervision of Credit Institutions and Investment Firms Act (2014:968) (the Supervision Act), FI is the competent authority that decides on special macroprudential measures in accordance with Article 458 of the CRR.

According to Article 458(2) of the CRR, the competent authority can decide on certain stricter national measures, if it “identifies changes in the intensity of macroprudential or systemic risk in the financial system with the potential to have serious negative consequences to the financial system and the real economy”. One example of such a measure is higher risk weights to target asset bubbles in the residential property sector. Before the measures are adopted, the authority shall notify the European Parliament, the Council, the Commission, the ESRB and the European Banking Authority (EBA) about the measures and, in accordance with Article 458(2)(a-f) of the CRR, submit relevant quantitative or qualitative evidence for why the measures are necessary. The Council, on the proposal of the Commission, may reject the national measures by adopting an implementing act. If this does not occur within given deadlines, the Member State may adopt and apply the macroprudential measure.

As a result, FI, within the framework of Pillar 1 and given certain conditions, may temporarily increase risk weights for mortgages and commercial properties. FI is now introducing, pursuant to Article 458(2) of the CRR, a risk weight floor of 25 per cent for Swedish mortgage exposures for credit institutions that have authorisation to use the IRB approach. This risk weight floor will apply directly in Pillar 1 and replace the corresponding risk weight floor that currently applies in Pillar 2. The risk weight floor entails that the risk calculated for the current exposures in accordance with Part Three, Title II of the CRR may not be less than 25 per cent.

The implementation of the decided measure is conditional on the Council, on a proposal by the Commission, not deciding to adopt an implementing act to reject the draft measure in accordance with Article 458(4) of the CRR.

The Commission decided on 17 July 2018 not to propose to the Council to adopt an implementing act to reject the measure. FI thereby adopts the measure immediately pursuant to Article 458(4) of the CRR through individual decisions for the credit institutions that have mortgage exposures in Sweden and apply the IRB approach. FI's mandate to announce decisions in accordance with the CRR is set out by the regulation itself. No national legislative measures are required for FI to be able to announce the individual decisions made possible through the CRR.<sup>11</sup>

The measure enters into force on 31 December 2018 and applies for a period of two years or until the macroprudential risk ceases to exist, with the possibility of an extension of one additional year at a time according to Articles 458(4) and 458 (9) of the CRR. It is not necessary to notify the EU bodies above in the event that FI, after the decision has been made, makes the assessment that the measure should be withdrawn since the macroprudential risk ceased to exist.

FI will also apply for reciprocity of the measure by affected Member States to ensure that other Member States apply it to nationally authorised branches located in Sweden in accordance with Article 458(5) of the CRR. If approved, the measure will then be applied to exposures to Swedish mortgages in foreign credit institutions' branches in Sweden. The application for reciprocity will also be sent to the ESRB, which can issue a recommendation to the Member States to reciprocate the Swedish risk weight floor for mortgages in accordance with Article 458(8) of the CRR.

## 1.6 Preparation

In its work to prepare a risk weight floor for Swedish mortgages within the framework of Article 458 of the CRR, FI has held a dialogue with an external reference group. This group included the Swedish Bankers' Association and the Swedish National Savings Banks Association as well as several of their

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<sup>11</sup> Bill 2013/14:228 p. 125.

affected members. FI also held bilateral meetings with most of the affected credit institutions, including both major banks and mid-size credit institutions, in order to obtain their view on the measure at an early stage. Moreover, FI has conferred with the Swedish National Debt Office to assure the quality of the calculation of the impact of the measure on the credit institutions' requirements on bail-inable debt (so-called MREL requirements) as well as the impact analysis in general in order to take into consideration other effects that may result from the measure. Finally, FI informed the members of the Financial Stability Council about the work on the now decided measure.<sup>12</sup>

FI submitted a memorandum on the proposal on 28 March 2018, and consultation bodies were given the opportunity to provide feedback on the implementation of the risk weight floor for mortgages under Article 458 of the CRR. The consultation period ended on 30 April 2018. Written feedback regarding the proposal was 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 and the Swedish National Board of Housing, Building and Planning. The Swedish Competition Authority, FAR and the Swedish Accounting Standards Board reported that they did not have any feedback regarding the proposal. FI will discuss the feedback from the consultation bodies in following sections.

On 24 May 2018, FI notified the European Parliament, the European Council, the EU Commission, the ESRB and the EBA about the proposed measure (EU notification).<sup>13</sup> In addition, the affected credit institutions were given the opportunity to express their opinion on the EU notification. Only Landshypotek Bank AB submitted feedback related to the EU notification. Nordea Bank AB and Nordea Hypotek AB submitted feedback in which the companies stated that they had no comments other than those submitted in the consultation response from the Swedish Bankers' Association.

In June 2018, the ESRB and the EBA submitted their opinions to the European Council, the European Commission and FI regarding FI's proposed measure. The ESRB finds FI's proposed measure to be justified, appropriate, proportionate and effective. The ESRB shares FI's assessment of vulnerabilities and risks associated with Swedish mortgages and the housing market. The authority also writes that structural changes on the Swedish banking market can reduce the efficiency of the current macroprudential measures in Sweden, particularly the use of Pillar 2 to handle systemic risks. This could lead to changes in the intensity of macroprudential or systemic risk associated with the housing market, which could impose a risk on financial

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<sup>12</sup> The Financial Stability Council is a forum for representatives from the Government, Finansinspektionen, the Swedish National Debt Office and the Riksbank. The Council discusses matter related to financial stability and how to counteract financial imbalances.

<sup>13</sup> EU notification regarding a changed method for the application of the risk weight floor for Swedish mortgages, May 2018, FI.

stability at a national level.<sup>14</sup> The EBA also supports FI's assessment of risks to the Swedish economy related to Swedish mortgages and does not oppose FI's proposed measure.<sup>15</sup>

Based on these opinions, and following its own assessment, the Commission decided on 17 July 2018 not to propose to the Council to adopt an implementing act to reject the measure. FI has now decided to implement the risk weight floor for mortgages under Article 458 of the CRR.

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<sup>14</sup> Opinion of the European Systemic Risk Board of 21 June 2018 regarding Swedish notification of a stricter national measure based on Article 458 of the CRR and related report, June 2018 (ESRB/2018/4), ESRB.

<sup>15</sup> Opinion of the European Banking Authority on measures in accordance with Article 458 Regulation (EU) No 575/2013, June 2018 (EBA/Op/2018/06), EBA.

## 2 Reasoning and considerations

### 2.1 FI's position

FI is changing the method it uses to apply the current risk weight floor for Swedish mortgages through Pillar 2 by replacing it with a requirement under Article 458 of the CRR. The new requirement will be included in the Pillar 1 requirements.

### 2.2 Feedback from the consultation bodies

*The Riksbank* supports FI's proposal to replace the risk weight floor for Swedish mortgages in Pillar 2 with a corresponding requirement in Pillar 1. This also leads to greater transparency and comparability between banks' capital requirements. As a result of the proposal, the affected banks' risk-weighted assets will increase, which in the long run could strengthen the banks' resilience and benefit financial stability.

*The Swedish National Debt Office (SNDO)* welcomes FI's proposal to change the method for applying the risk weight floor for mortgages and transfer the measure from Pillar 2 to Pillar 1. This improves the conditions for meeting the capital requirements and bail-inable debt (MREL requirement) placed on banks and other credit institutions issuing mortgages to Swedish households even when there are material structural changes on the Swedish banking market.

*The Swedish National Board of Housing, Building and Planning* supports Finansinspektionen's proposal to change the method for calculating the risk weight floor for Swedish mortgages. Under the proposal, the current capital requirements will be retained, which is important for macroeconomic stability and sustainable housing construction.

*The Swedish Bankers' Association* understands the reasoning for changing the application of the risk weight floor, namely to maintain a level playing field on the Swedish mortgage market given the changes in the market structure. The Bankers' Association also sees benefits with the change that FI is proposing based on a harmonisation perspective, i.e. that the Swedish regulation should be harmonised with the EU regulations to the greatest extent possible.

The Bankers' Association takes the position that the CRR clearly states that the Pillar 1 requirement that FI intends to implement is a measure for macrostability that can be removed by FI without special European decision procedures in the event the assessment is made that the risk underlying the introduction of the Pillar 1 requirement has ceased. In this respect, FI's view of the new Pillar 1 requirement as a buffer requirement is important in order for the change not to potentially introduce elevated systemic risks.

However, the Bankers' Association considers a risk weight floor of 25 per cent to be overambitious in international comparison, particularly given that

Sweden also has a strict amortisation requirement and a mortgage cap with a similar purpose as the risk weight floor. The Bankers' Association is of the opinion that the proposed risk weight floor should not be higher than 10 per cent since Article 458 of the CRR may only be applied to manage macro risks and not credit risks. The Bankers' Association takes the position that since FI is of the opinion that there has not been a change in the risk assessment that was conducted when the current risk weight floor was introduced, where 10 percentage points of the floor were justified by systemic risk, the current proposed risk weight floor should not be higher than 10 per cent. *The Association of Swedish Finance Houses* presented the same opinion in the matter and the same motivation, namely that a requirement greater than 10 per cent cannot be introduced under Article 458. According to the Association, requirements based on cited credit risks of 15 per cent cannot be based on Article 458 and such a requirement is thus rejected.

The Bankers' Association furthermore believes that measures taken under Article 458 should not affect the calculation of the countercyclical capital buffer and that FI's interpretation contradicts applicable regulation. The Bankers' Association provided a number of arguments in support of this viewpoint.<sup>16</sup> All of the arguments lead to the conclusion that the own funds requirement resulting from Article 458 of the CRR should not be considered when calculating institution-specific capital buffer amounts. The Bankers' Association also takes the position that the systemic risks Article 458 is supposed to manage do not entail an indirect increase in the countercyclical capital buffer through an increase in the basis for the calculation.

The Bankers' Association also states that, from a risk perspective, it is the domicile of the collateral and not the counterparty's domicile that should be the determining factor for whether or not an exposure is subject to the risk weight floor.

*The Board of Swedish Industry and Commerce for Better Regulation* finds that some points need to be supplemented before they are able to serve as a basis for legislation. Even if the reasons for the change on legal grounds are presented in the consultation memorandum, a clear description of the alternatives to the proposed new risk weight floor of 25 per cent is missing. The Board believes that a description of the effects from a scenario in which FI instead chooses a risk weight floor at half the amount, 12.5 per cent, is missing.

*Landshypotek Bank* states in its opinion to FI about the EU notification that the majority of its exposure volume in the household exposure class is to SMEs with collateral in agricultural property. The Bank therefore thinks it is reasonable that the risk weight floor be applied to exposures collateralised by housing and not by exposures collateralised by commercial real estate, which can be included in fixed property in the household exposure class.

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<sup>16</sup> For more information, see the Banking Association's consultation response (in Swedish), <https://www.swedishbankers.se/media/3769/i180425y.pdf>.

## 2.3 Reasons for FI's position

### 2.3.1 *Risks associated with Swedish mortgages*

The assessment of the risks associated with mortgage lending that FI presented in connection with the introduction of the risk weight floor for mortgages in Pillar 2 has not changed.<sup>17</sup> Both house prices and household debt have increased rapidly over a long period of time and at a faster rate than household income. The high and rising debt of households represents a significant vulnerability in the Swedish financial system. This increases the risks in the macroeconomy and, by extension, the risks posed to financial stability in Sweden.<sup>18</sup>

Mortgages make up the majority of Swedish households' total debt. High indebtedness, combined with a large share of loans with short interest rate adjustment periods, makes households sensitive to changes in interest rates. The home is also many households' single largest asset. If house prices were to fall or interest rates rise, there is a risk that household behaviour could amplify a downturn in the economy through reduced consumption. This, in turn, could weaken the credit quality in other sectors to which the credit institutions are exposed. Such a development could ultimately threaten financial stability in the long run.

Swedish mortgages also comprise a large share of credit institutions' total assets. They constitute as well the majority of the cover pool that serves as a basis for one of the banks' most important funding sources - covered bonds. A shock to the supply of credit to households could create or enhance a negative trend on the housing market and household sector. This could cause serious problems for both the financial system and the Swedish economy at large. It is therefore important for firms on the mortgage market to have sufficient resilience for handling shocks without needing to dramatically change their lending procedures. By holding enough capital for their mortgage exposures, the credit institutions increase their capacity for managing any losses without reducing their lending. Sufficient capital also reduces the risk that investors will lose confidence in the credit institutions' ability to manage shocks to household finances and the Swedish economy. In turn, this reduces the risk of shocks to the credit institutions' funding.

As a whole, rising house prices and household debt have elevated the systemic risks. These risks are not fully covered by the institution-specific capital

<sup>17</sup> See also Chapter 4 of "Höjning av riskviktsgolvet för svenska bolån" in *Kapitalkrav för svenska banker*, September 2014 (FI Ref. 14-6258), FI. A translation is available at [www.fi.se](http://www.fi.se).

<sup>18</sup> The systemic risks posed by Swedish mortgages and the developments on the Swedish housing market have also been highlighted by international bodies such as the International Monetary Fund (IMF), the ESRB and the European Commission. These bodies highlight the risks of high and rising household debt and house prices that are judged to be overvalued. There is also a risk for potential cross-border effects in other Nordic and Baltic countries if risks materialise.



requirements in accordance with Pillar 1. Thus, there remains a need for the risk weight floor to ensure that credit institutions that issue mortgages are sufficiently resilient for managing shocks without being forced to adapt in such a manner as to create or strengthen a negative development.

### ***2.3.2 A risk weight floor of 25 per cent for mortgages***

#### ***2.3.2.1 Calibration of the risk weight floor***

The risk weight floor's current level at 25 per cent shall continue to apply even after the changed method for the application of the requirement. FI does not share the viewpoint presented by the Swedish Bankers' Association and the Association of Swedish Finance Houses that a requirement that is greater than 10 per cent cannot be introduced pursuant to Article 458.

The risk weight floor for Swedish mortgages was introduced in 2013 and revised in 2014. The floor is currently an important component in FI's capital requirement. FI realised already when the floor was introduced that it was crucial for the stability of individual credit institutions as well as the Swedish financial sector for the credit institutions to hold own funds that cover the risks in the Swedish mortgage portfolios from a wider and more forward-looking perspective. The floor was first set at 15 per cent with the argument that there is a risk that the credit institutions' IRB approaches do not fully capture the credit loss risk of Swedish mortgages.<sup>19</sup> It was then raised to 25 per cent to take into account the broader systemic risks that could arise from the Swedish mortgages of individual credit institutions.<sup>20</sup> The assessment of the risks associated with mortgage lending that FI presented in connection with the introduction of the risk weight floor for mortgages in Pillar 2 and then its increase has not changed.

The risk weight floor has thus been set in such a manner that it both covers future loss levels in Swedish mortgages in the event of high financial stress and takes into account the broader systemic risks that Swedish mortgages can give rise to. A risk weight floor of 25 per cent is judged to be sufficient for these objectives. FI makes this assessment based on the continued increase in the vulnerabilities associated with the Swedish housing market and the Swedish mortgages. As a whole, these vulnerabilities lead to greater risks in the macroeconomy and, by extension, greater risks to financial stability in Sweden.

FI also does not share the Swedish Bankers' Association's viewpoint that a risk weight floor of 25 per cent is overambitious given that Sweden also has a strict amortisation requirement and a mortgage cap that strive for a similar purpose as the risk weight floor. The measures complement one another but target

<sup>19</sup> *Risikviktsgolv för svenska bolån*, May 2013 (FI Ref. 12-11920), FI. An English translation is available at [www.fi.se](http://www.fi.se).

<sup>20</sup> *Kapitalkrav för svenska banker*, September 2014 (FI Ref. 14-6258), FI. A translation is available at [www.fi.se](http://www.fi.se).

different dimensions in the vulnerabilities associated with the development on the housing market and household indebtedness. The risk weight floor ensures the credit institutions' resilience (supply side) while the amortisation requirement and mortgage cap strengthen household resilience (demand side).

FI continuously monitors the development of both the housing market and household indebtedness and the development of Swedish mortgages in particular. Depending on this development, FI may assess and consider a change in the level of the risk weight floor. In line with Article 458(4) of the CRR, FI will consider withdrawing the measure if the macroprudential risk ceases to exist. Furthermore, the framework for the European capital requirement is going to undergo considerable changes once both the ongoing overview of the EU capital adequacy regulations is concluded and the most recent Basel Agreement is implemented within the EU. This means that FI will need to review the Swedish capital requirements, including the calibration of the risk weight floor, when there is more clarity surrounding the formulation of future international regulation.

#### *2.3.2.2 Definition of the covered portfolio*

The portfolio covered by the measure and that in this memorandum, similar to the current treatment of the risk weight floor in Pillar 2, has been given the simplified name "Swedish mortgages" consists of exposures in Sweden collateralised by real estate within the exposure class "exposures to households". In other words, this means exposures located in Sweden that are managed in accordance with Article 147(2)(d) of the CRR. The exposure class by far largely consists of mortgages for consumers, but can also include certain exposures to small corporations with loans collateralised by real estate and exposures collateralised by real estate other than residential properties.

The Swedish Bankers' Association considers the domicile of the collateral and not the counterparty's domicile to be the determining factor for whether or not an exposure is subject to the risk weight floor. FI takes the position, however, that the definition of covered portfolio that applies in this context ensures that no additional burden is created for the credit institutions subject to the requirements since the definition uses an already existing definition from the CRR. FI is aware that there can be differences in the definition of relevant exposures used when calculating the risk weight floor compared to how other countries have opted to implement a risk weight floor for mortgages through Article 458. However, FI considers these differences to be limited and that the benefits of basing the calculations on reported data in existing COREP templates outweighs any overlapping.

With regard to Landshypotek Bank's viewpoint on which exposures should be covered by the measure, FI's position is as follows. Landshypotek Bank's household exposures are already covered today by the risk weight floor for Swedish mortgages. FI's change in the method of application of the floor does not change which exposure classes are subject to the risk weight floor for

Swedish mortgages compared to before. It is Finansinspektionen's assessment that agricultural and forestry real estate in the exposure class subject to the risk weight floor for Swedish mortgages are largely used for residential purposes and to a lesser extent for commercial activities. Landshypotek Bank's response therefore does not change FI's view that the exposures classified as household exposures will continue to be subject to the risk weight floor for Swedish mortgages.

Thus, and like in the current calculation of the risk weight floor in Pillar 2, the calculation will be based on reported data in the COREP template based on the following cells:

- C 09.02 – Geographical breakdown of exposures by residence of the obligor: IRB exposures (CR GB 2), Sweden.
  - Row 070, columns 105 and 125.

The institutions that are subject to the measure but do not report in accordance with C 09.02 may use the following:

- C 08.01– Credit and counterparty credit risks and free deliveries: IRB approach to own funds requirements (CR IBR 1)
  - Row 010, column 260.

### 2.3.2.3 Definition of average risk weight

The measure refers to the exposure-weighted average risk weight. This is calculated by dividing the portfolio's risk-weighted exposure amount by the exposure amount (EAD). This means that:

$$\begin{aligned} \text{Additional risk – weighted assets according to Article 458} \\ = \text{EAD} \times (25\% - \text{current risk weight}) \end{aligned}$$

For an institution that reports in template C09.02, the calculated requirement in accordance with Article 458 shall be as follows:

$$\begin{aligned} \text{Added risk – weighted assets under Article 458} \\ = C\ 09.02, \text{row } 070, \text{column } 105 \times \left( 25\% - \frac{C\ 09.02, \text{row } 070, \text{column } 125}{C\ 09.02, \text{row } 070, \text{column } 105} \right) \end{aligned}$$

### 2.3.2.4 Reporting

The additional risk weighted assets through Article 458 must be reported in template C 02.00, rows 730 and 710. The measure therefore also affects row 010, "total risk-weighted exposure amount", in the template.

### 2.3.2.5 Calculation of capital requirements

To estimate the impact of the risk weight floor when it is applied through Article 458 of the CRR, the exposure amount for Swedish mortgages is first multiplied by the difference between 25 per cent (the risk weight floor) and the institution's risk weight in Pillar 1 for the corresponding portfolio. This amount is then multiplied by the applicable capital requirement.

It is FI's intention to achieve the same effect as today's handling through Pillar 2. This means that the risk weight floor for the major banks is calculated using a total capital requirement of 15.5 per cent, plus the countercyclical buffer rate. For other credit institutions, the calculation uses a capital requirement of 10.5 per cent plus the countercyclical buffer rate.<sup>21</sup>

FI notes the Swedish Bankers' Association's viewpoints that measures taken under Article 458 should not affect the calculation of the countercyclical capital buffer. However, FI maintains its assessment that the capital requirement that will result from the higher risk weight for exposures in Sweden collateralised by real estate in the exposure class "exposure to households" shall be included in the minimum capital requirement for relevant exposures that are used when calculating the institution-specific countercyclical capital buffer. By using Article 458, the risk weights in Part Three, Title II of the CRR increase and thus the risk-weighted assets for the credit risk exposures. Both the ESRB and the EBA have stated in previous opinions that the risk-weighted assets increase when additional capital requirements are introduced in Pillar 1. This means that the higher capital requirements will also be considered when determining the extra capital that must be held for other capital buffers, such as the countercyclical capital buffer.<sup>22</sup>

FI's starting point is that it is the underlying credit risk exposures that form the basis for which relevant exposures and related capital requirement are to be included in the calculation. This assessment is not changed by the fact that risk weights increase with support of Article 458.

The effect of the countercyclical buffer on the capital requirement, both in nominal terms and in per cent, is affected by the level of the relevant exposures, their geographic distribution and the level of the countercyclical capital buffer that applies to Sweden in relation to the institution-specific buffer rate. The decided method therefore entails that the countercyclical

<sup>21</sup> In other words, in the same manner as the current risk weight floor, see also section 1.2.1.1. The design of the measure also entails that the share of the requirement that will be met by CET 1 capital is the same as before.

<sup>22</sup> Assessment of the Belgian notification in accordance with Article 458 of Regulation (EU) No 575/2013 concerning the application of a stricter national measure for residential mortgage lending, February 2018, ESRB; and Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013, February 2018, (EBA/Op/2018/01), EBA.

capital buffer requirement could have varying consequences for the affected credit institutions.

A more detailed description of the effect of the capital requirement and its components is found in the box below.

- **The risk weight floor for Swedish mortgages in Pillar 2** of 25 per cent in total is removed and replaced with a risk weight floor for mortgages in Pillar 1.
- **The minimum requirement** increases as a direct effect of the increase in the risk-weighted assets.
- **Capital requirements in Pillar 2** are changed due to requirements that are expressed in relation to the risk-weighted assets.
- **The capital conservation buffer** of 2.5 per cent increases in nominal terms due to higher risk-weighted assets.
- **Capital planning buffer.** FI's stress tests for 2017 that aim to set the capital planning buffer have shown that the capital planning buffer does not exceed 2.5 per cent. A buffer requirement other than the capital conservation buffer is therefore not included in the example.
- **The systemic risk buffer/buffer for systemically important institutions** of 3.0 per cent (for the major banks) as part of the combined buffer requirement increases in nominal terms due to higher risk-weighted assets.
- **The systemic risk buffer in Pillar 2** of 2.0 per cent (for the major banks) increases in nominal terms due to higher risk-weighted assets.
- **The countercyclical capital buffer** increases in nominal terms due to higher risk-weighted assets. The Swedish buffer rate is 2 per cent.

## 2.4 The risk weight floor's buffer functionality

The overall capital requirements are made up of different components, minimum requirements and buffers, which in turn can be applied in Pillar 1 or Pillar 2. Minimum requirements and buffers are meant to fulfil in part differing purposes. A credit institution that does not meet the minimum requirement has not fulfilled the conditions for the authorisation to conduct business. This means that FI must intervene, which could result in the credit institution being wound up or placed into resolution. A high minimum requirement can reduce the risk that lenders will suffer losses due to a default, but does not necessarily reduce the probability that a default will occur. Capital buffers in part fulfil a different function than the minimum requirements in that credit institutions under certain circumstances and given certain restrictions can use the buffers without risking default. Large buffers thus make credit institutions more

resilient to losses. This reduces in turn the probability that they will breach the minimum requirements and that the problems that can arise as a result of this will spread to other parts of the financial system. Large buffers therefore increase the stability of both the credit institutions and the financial system.

The Pillar 2 increment is the supervisory authority's requirements on individual institutions and aims to cover risks that are not fully captured by the regulation's minimum and buffer requirements. This may mean a higher capital requirement for risks that are not at all covered by Pillar 1, a risk that is partly covered by Pillar 1 or an additional buffer for risks to which the credit institution exposes the financial system. Both the level of the Pillar 2 requirement and the consequence of not maintaining this level are determined by FI and depend on the circumstances at any given point in time. If a credit institution is under severe financial stress, its risk profile can change in a short period of time. For example, certain risks included in the assessment of the Pillar 2 requirement might have materialised, which might mean there are no longer grounds for requiring the credit institution to hold capital for them. Large parts of the Pillar 2 requirement, therefore, can be viewed in practice and under certain circumstances as an additional capital buffer. FI can also reassess the Pillar 2 requirements.

When a measure under Article 458 of the CRR is implemented, the share of Pillar 1 capital requirements increases. This reduces the margin to the level when the automatic dividend restrictions enter into force. This could mean that the level at which FI must intervene may occur earlier than given today's risk weight floor in Pillar 2. It is therefore in this context very important to emphasise that FI is able to reassess and withdraw a measure under Article 458, which is in line with the intent of this article. Article 458(4) of the CRR states that the measure can apply for a period up to two years or until the macroprudential risk or systemic risk ceases to exist, if this occurs earlier. This means that if the risk materialises, FI may reassess the measure, lower the level and, as a last step, deactivate the measure. This enables FI to achieve a similar buffer function at the systemic level as with today's risk weight floor in Pillar 2.

## **2.5 Application area of the measure**

### **2.5.1 Scope**

The credit institutions that are proposed to fall under the measure are the credit institutions that have authorisation to use the IRB approach and have an exposure to Swedish mortgages.<sup>23</sup> The requirement applies to the individual institutions as well as the consolidated situation.

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<sup>23</sup> This includes the Sweden-based subsidiaries of foreign credit institutions.

If a new credit institution were to receive authorisation to use the IRB approach to calculate its capital requirement for Swedish mortgages, it would also be subject to the measure. Credit institutions using the standardised approach to calculate the capital requirement for credit risk are not affected.

Branches of foreign credit institutions in Sweden that are exposed to Swedish mortgages and use the IRB approach for these exposures may also be affected. The conditions for this are described in section 2.5.2.

### ***2.5.2 Foreign branches may be covered through reciprocity***

Section 1.5 describes the legal basis for FI to implement a national measure within the framework of Article 458 of the CRR. FI has decision-making powers for the capital requirement for credit institutions domiciled in Sweden, but not for foreign branches in Sweden. However, FI is able to influence the capital requirement for foreign branches' operations in Sweden by requesting reciprocity of the Swedish measure.

FI will apply for reciprocity of the decided measure to ensure that the requirement also includes foreign branches. Reciprocity means that other EU Member States will apply the Swedish risk weight floor for mortgages set in accordance with Article 458 to nationally authorised branches located in Sweden in accordance with Article 458(5) of the CRR. This in turn means that the measure will be applied to Swedish mortgage exposures in foreign credit institutions' branches in Sweden.

## **2.6 Entry into force**

The measure enters into force on 31 December 2018.



### 3 Impact of the measure

The following section describes the impact of a risk weight floor through Article 458 of the CRR on individual credit institutions, competition, the market, households and the economy. The impact was estimated based on the data reported to FI and refers to Q4 2017.

#### 3.1 Feedback from the consultation bodies

*The Swedish Bankers' Association* does not share FI's opinion that the impact of the measure on the Swedish banks' capital levels and capital requirements in SEK will be negligible, an expression used in the consultation memorandum. In total, the capital requirements will increase by approximately SEK 1.5 billion, which cannot be considered "negligible". The Bankers' Association believes that FI should choose a methodology that ensures that the requirements in SEK do not increase as a result of the risk weight floor being moved from Pillar 2 to Pillar 1. *The Board of Swedish Industry and Commerce for Better Regulation* also states that the measure's effect on the capital requirements in nominal terms cannot be considered "negligible". The Board therefore takes the position that the impact assessment needs to be supplemented with the exact sum of the increased capital requirements for the banks in order for decision-makers and consultation bodies to have the opportunity to form their opinion about whether the amount is negligible or not.

The Bankers' Association also considers the decrease in the banks' buffer capacity as a result of the measure to be a serious and negative impact of the proposal. Swedish banks will appear less capitalised in European comparison even though they will be just as well capitalised after the change as they are today.

The Bankers' Association also takes the position that the new regulations that are currently being negotiated in the EU will further reduce the buffer capacity for the Swedish banks, which could make it more expensive and more difficult to issue AT1-instruments. The Bankers' Association notes that the proposal has an impact on the banks' conditions for issuing AT1-instruments in another aspect as well. FI today assigns an 8-per cent trigger level to the largest Swedish banks' AT1-instruments due to the high Swedish capital requirements. The Bankers' Association takes the position that, since the capital ratios will be lower, these trigger levels need to be adapted to an EU level so the banks will be able to continue to issue such instruments with a good rating. The Bankers' Association therefore considers there to be a need, due to the proposed change, for the trigger levels communicated by FI for the banks' AT1-instruments to be adapted to the level of the CRR, 5.125 per cent. There is otherwise a risk that it will become both more expensive and more difficult for Swedish banks to issue AT1-instruments.

*The Swedish Savings Banks Association* rejects the proposal on the basis of insufficient impact analysis. The Association takes the position that FI's assessment of the measure's impact only covers the impact of the activation of Article 458. The impact of what would happen if the status quo is maintained and the risk weight floor continues to apply through Pillar 2 has not been analysed. The Association also considers there to be an obvious benefit associated with a capital requirement based in Article 458 of the CRR and that a transition to formally decided capital requirements is desirable.

*The Swedish National Debt Office (SNDO)* agrees with FI's analysis of the measure's impact on the MREL requirements, namely that the change in the application of the risk weight floor plays a role in both the level and composition of the MREL requirement. The overall effect is that the MREL requirement decreases slightly for the affected banks, and the impact on MREL is largest for the banks that have a large share of mortgages in their balance sheet.

Finally, the SNDO shares FI's analysis that the measure could also impact the principles linked to the MREL requirement, for example the liabilities proportion principle, which entails that the minimum requirement should be met with a certain percentage of liabilities. The SNDO therefore sees a need to make some corrections to how the liabilities proportion principles is applied to neutralise the effects.

### **3.2 Effects of the capital requirement**

The total capital need of the credit institutions is not significantly changed as a result of the decided measure. The capital requirements that previously were set through the risk weight floor for Swedish mortgages in Pillar 2 will now be set through Pillar 1. The change in the method used to apply the risk weight floor for Swedish mortgages still results in an increase of the total capital requirements by approximately SEK 1.4 billion as per Q4 2017. Seen in isolation, this amount can be considered to be large, as noted by the Swedish Bankers' Association and the Board of Swedish Industry and Commerce for Better Regulation. However, FI makes the assessment that the affected Swedish credit institutions have the capital to easily cover this amount. For comparison it can be mentioned that the four major banks had a net profit of SEK 105 billion in 2017. FI therefore considers the impact on the total capital requirement to be limited in nominal terms for all credit institutions subject to the measure.

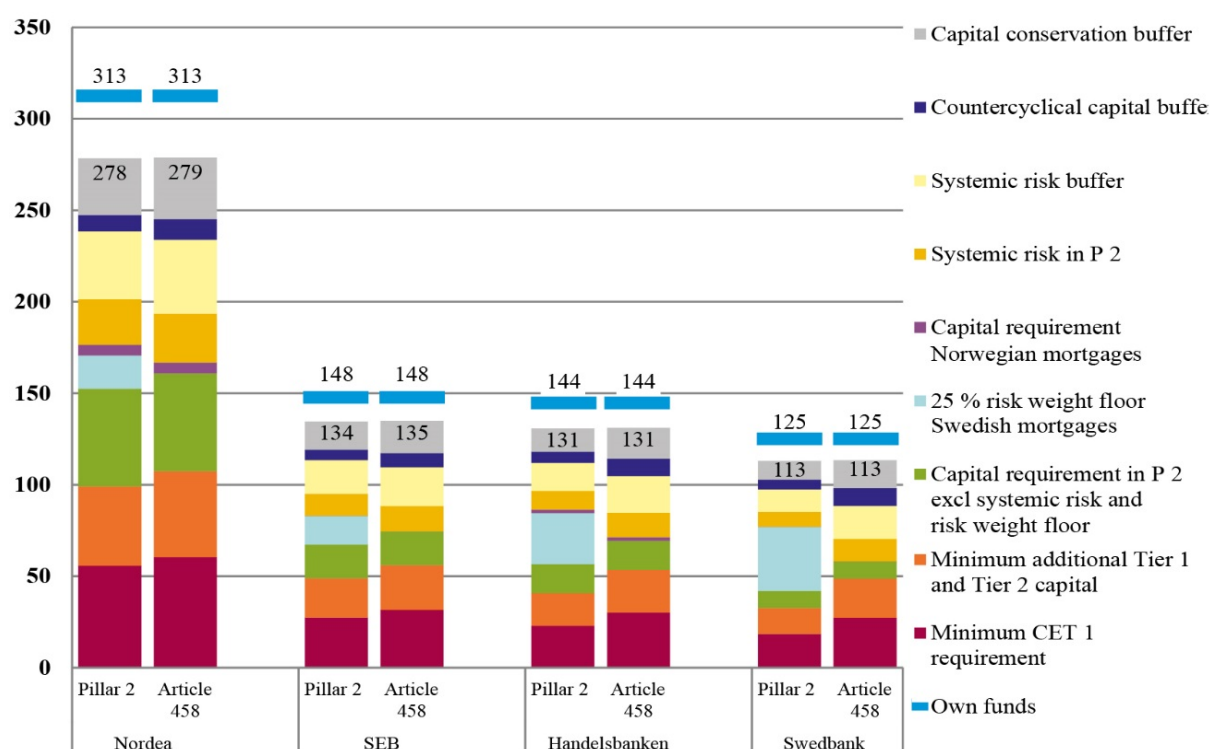
This can also be compared to the situation that would arise if FI did not make any change but rather continued to apply the risk weight floor through Pillar 2, as mentioned by the Swedish Savings Banks Association. FI makes the assessment that the change in market structure resulting from Nordea's move could lead to a situation where banks on the Swedish mortgage market face different capital requirements for Swedish mortgage exposures. Such a scenario would mean reduced resilience for the Swedish banking system, with

negative consequences for financial stability, and an unlevel playing field, which would not be beneficial for the Swedish credit institutions for which the current risk weight floor would continue to apply. By replacing today's risk weight floor with a requirement under Article 458 of the CRR, FI can safeguard financial stability and maintain a level playing field on the Swedish mortgage market.

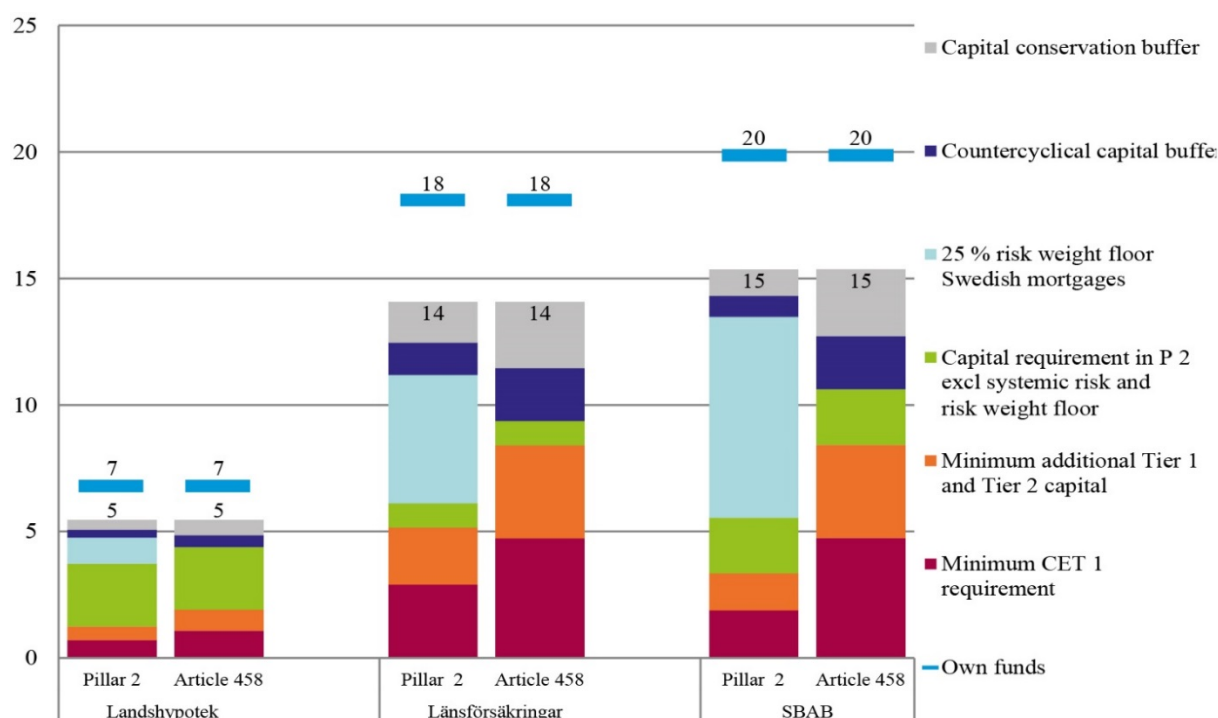
The Bankers' Association believes that FI should choose a methodology that ensures that the requirements in SEK do not increase as a result of the risk weight floor being moved from Pillar 2 to Pillar 1. FI always considers different available alternatives with the objective of finding the most cost-efficient solution that achieves the purpose of the regulation at the smallest possible cost for the affected credit institutions. FI makes the assessment that the application of the risk weight floor through Article 458 of the CRR achieves this goal.

Diagrams 1 and 2 illustrate the impact on the total capital requirement for several of the credit institutions subject to the measure. As a result of the design of the measure, the risk weight for Swedish mortgages in Pillar 1, and in turn the risk-weighted assets, will increase. The effect is that the minimum requirement increases as do the increments and buffers that are based on the risk-weighted assets. At the same time, there is an equivalent decrease in the capital requirement since the existing Pillar 2 requirement of 25 per cent for mortgages is removed.

**Diagram 1. Impact on the total capital requirement (SEK billion)**



Note: Based on the capital requirements as per Q4 2017.

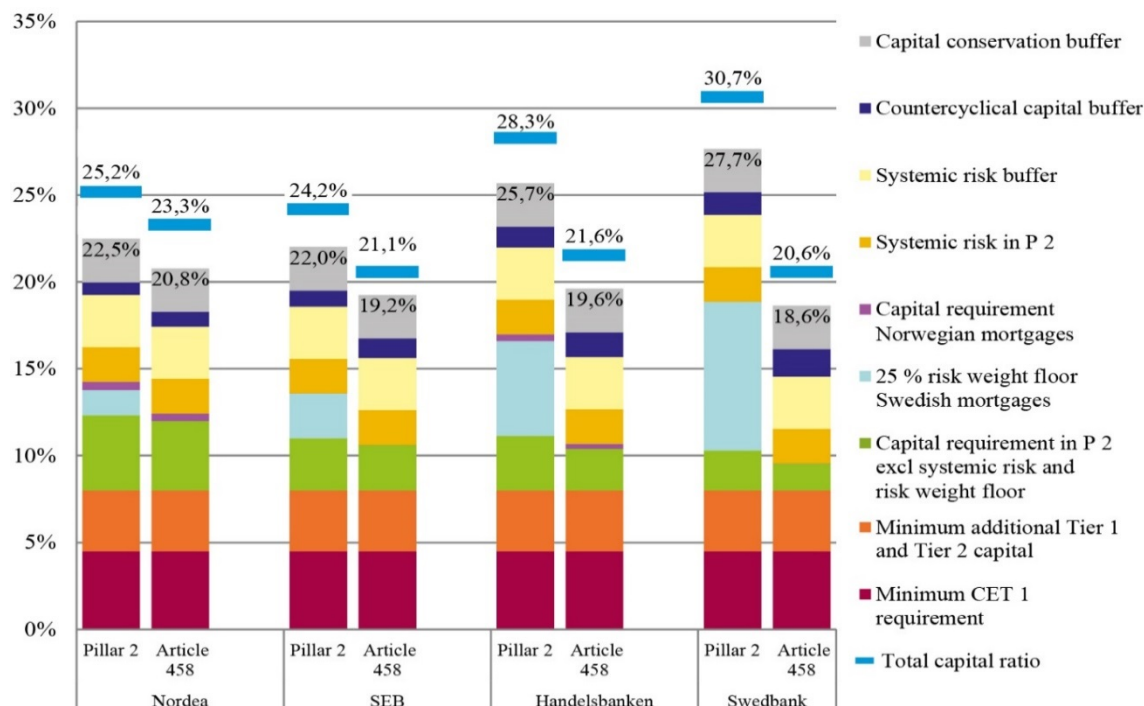
**Diagram 2. Impact on the total capital requirement (SEK billion)**

Note: Based on the capital requirements as per Q4 2017.

The total capital requirement expressed as a percentage of the risk-weighted assets will decrease, however, as a result of FI's decided measure (see Diagrams 3 and 4). This decrease is primarily an effect of removing the risk weight floor for mortgages from Pillar 2 and instead increasing the risk-weighted exposure amount, i.e. the denominator in the capital ratio. The size of the effect for each credit institution is dependent on the percentage of Swedish mortgages in the balance sheet. The credit institutions that have a relatively high percentage of Swedish mortgages will experience a more tangible decrease than credit institutions with more diversified operations. The remaining Pillar 2 requirements as a whole will decrease when expressed as a per cent following an increase in the risk weighted assets. The total effect is also dependent on the impact of the countercyclical buffer requirement, which can vary for each credit institution.

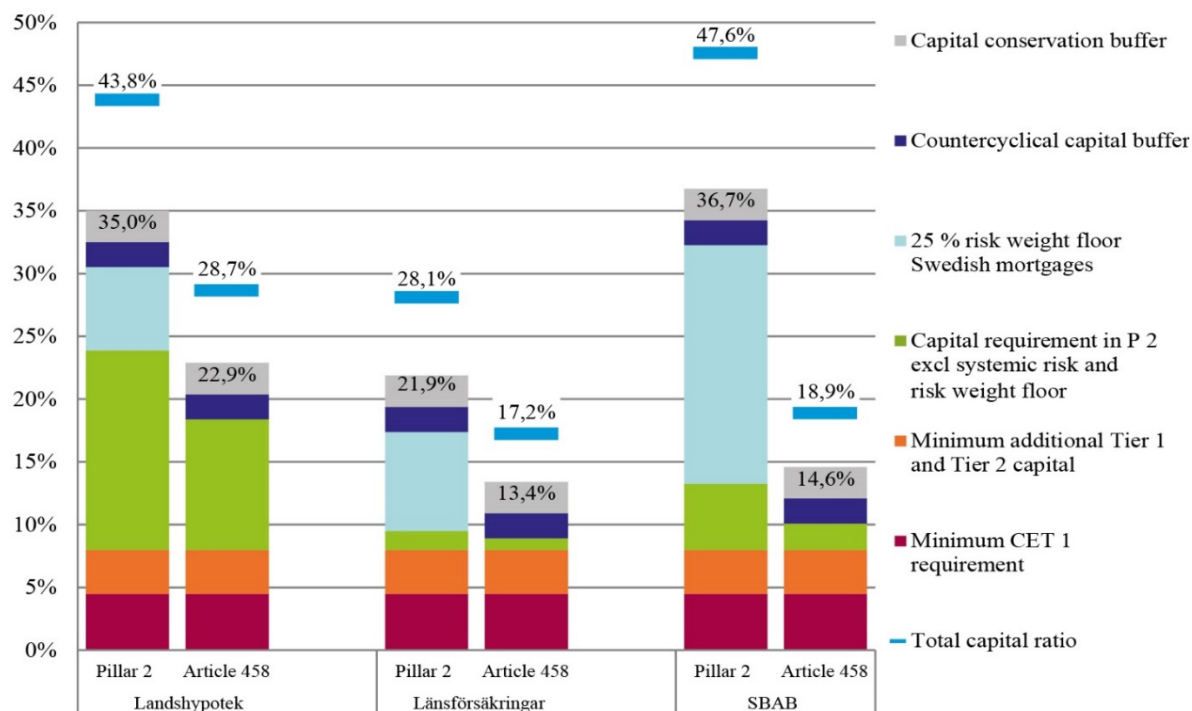
The same reasoning applies to the credit institutions' reported capital ratios. These will decrease when the risk-weighted assets increase as a result of higher risk weights for Swedish mortgages in Pillar 1. This is also presented in Diagrams 3 and 4, which show that the total capital ratios are decreasing. However, it is important to note in this context that the credit institutions' possibilities for meeting the total capital requirement are not affected.

**Diagram 3. Impact on the total capital requirement (percentage of risk-weighted assets)**



Note: Based on the capital requirements as per Q4 2017.

**Diagram 4. Impact on the total capital requirement (percentage of risk weighted assets)**



Note: Based on the capital requirements as per Q4 2017.

FI has noted that the measure has a direct impact on FI's supervisory capital assessment regarding the capital requirement for credit-related concentration risk.<sup>24</sup> This impact only affects the credit institutions that have more than 90 per cent of their total exposure amount in Sweden. For these institutions, FI makes the assessment that the capital requirement for geographic concentration risk may not be less than 8 per cent of the capital requirement for credit risk in Pillar 1. FI does not intend to allow the capital requirement for geographic concentration risk to increase as a result of an increased capital requirement for credit risk in Pillar 1. Within the framework for the information request for SREP, FI intends to adjust the requirements for what must be reported as a basis for FI's supervisory capital assessment of the credit institutions' capital requirement for credit-related concentration risk.

In summary, the measure has a limited effect on the capital requirements in SEK due to its design, which aims to keep the same capital requirements in nominal terms as the current requirements. The measure means that the requirement continues to be met with a high percentage of CET 1 capital. It furthermore ensures that Swedish credit institutions even in the future will have equally high capital buffers for systemic risks linked to Swedish mortgages as under the current capital requirements. Swedish credit institutions will thus continue to be resilient. The measure, however, will reduce the capital requirements and capital levels expressed in per cent of risk-weighted assets. This is only a technical effect since the impact on the Swedish credit institutions' capital levels and capital requirements in SEK is limited. In practice, this means that the capital requirements that previously were set through the risk weight floor for Swedish mortgages in Pillar 2 will now be set through Pillar 1. The requirement is more or less the same, and this means that Swedish credit institutions already fulfil the requirements, regardless of how they are applied.

The change in the design of the capital requirements entails that the capital requirements in Pillar 1 (and thus the risk-weighted exposure amounts) no longer only cover institution-specific credit risks, which is the case today. One consequence of the risks to the financial system in general being reflected in Pillar 1 through the Article 458 measure is that the capital ratios (the capital level as a percentage of risk-weighted assets) become less comparable between credit institutions in different countries to the extent that the systemic risk assessments differ.

### ***3.2.1 Reduced margin to the level for automatic dividend restrictions***

The risk weight floor for mortgages in Pillar 2 is not a formally decided requirement. Insofar that a formal decision has not been made, the capital requirement under Pillar 2 does not affect the level at which the automatic restrictions on distributions linked to the combined buffer requirement come

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<sup>24</sup> *FI:s metoder för bedömning av enskilda risktyper inom Pelare 2*, May 2015 (FI Ref. 14-14414), FI. A translation is available at [www.fi.se](http://www.fi.se).



into effect. One consequence of introducing the risk weight floor through Article 458 of the CRR is that the share of the capital requirements in Pillar 1 will increase. This reduces the margin to the level when the automatic dividend restrictions enter into force. FI is well aware of the potential effects expressed by the Swedish Bankers' Association, for example pricing of AT1-instruments, that might arise as a result of reduced buffers. However, FI makes the assessment that the Swedish credit institutions will continue to have a satisfactory margin even after the introduction of the measure, which should not have any material impact on the Swedish credit institutions' ability to issue this type of instruments.

It is also important to keep in mind that FI is able to reassess and withdraw a measure under Article 458 of the CRR, which would then apply to all credit institutions subject to the measure. This is in line with the purpose of Article 458(4), which allows a measure imposed under Article 458 to be revoked if the macroprudential or systemic risk ceases to exist. This enables FI to achieve a similar buffer function at the systemic level as with today's risk weight floor in Pillar 2.

FI does not share the Swedish Bankers' Association's viewpoint that the trigger levels for the banks' AT1-instruments communicated by FI must be adapted to the level of the CRR solely due to the decision to implement the measure. This is also a matter that FI will investigate further in conjunction with the EU implementation of the most recent Basel standards.

### **3.3 Effects of MREL – bail-inable debt**

The decided measure can also have direct or indirect effects on regulations that lie outside of FI's direct area of responsibility. One example is the capital requirements and minimum requirements on bail-inable debt (the MREL<sup>25</sup> requirements). These aim to regulate the debt in credit institutions' balance sheets so the institutions can handle losses that arise and recapitalisation needs. The Swedish National Debt Office is responsible for deciding on the size of the MREL requirement. The institutions that are affected must meet the requirement as of 1 January 2018. FI has informed the Swedish National Debt Office that the decided measure may affect the MREL requirement and principles related to it.<sup>26</sup>

Given the method decided by the Swedish National Debt Office, where the MREL requirements shall comprise the sum of a loss absorption amount and a

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<sup>25</sup> Minimum Requirement for own funds and Eligible Liabilities.

<sup>26</sup> One example is the liabilities proportion principle. The proportion of liabilities must correspond to the size of the recapitalisation amount expressed as a percentage of a risk-weighted exposure amount. In 2018, firms affected by the liabilities proportion principle shall apply the percentage for the recapitalisation amount that has been calculated in conjunction with the Swedish National Debt Office's decision regarding the minimum requirement.



recapitalisation amount, the following is an account of the effects from FI's decided measure according to Article 458.

The Swedish National Debt Office's published method<sup>27</sup> for the design of the MREL requirements states which parts of the capital requirement are judged to be relevant to safeguard loss absorption and recapitalisation needs in resolution. The loss absorption amount shall be equivalent to the institution's total capital requirements, excluding the combined buffer requirement and, where applicable, macroprudential elements within the Pillar 2 requirements. The recapitalisation amount shall be the equivalent to the credit institution's total risk-weighted capital requirements after removing the combined buffer requirement.

FI makes the assessment that a risk weight floor for mortgages in Pillar 1 affects the MREL requirement in that the loss absorption amount increases at the same time as the recapitalisation amount decreases. This means that the total MREL requirement may go down for the affected institutions.

### 3.4 Effects on the resolution fee

The management of crisis-stricken credit institutions according to the Resolution Act shall primarily consist of losses and recapitalisation costs being financed through shareholders and lenders. In extraordinary circumstances, external financing may be required. A resolution reserve has therefore been established using fees from the institutions. The reserve can be used for an institution that is placed into resolution, for example to provide temporary financing or under extraordinary circumstances to contribute to the recapitalisation of the institution.

The resolution reserve is financed by annual fees that are paid by the credit institutions and securities companies subject to the Resolution Act.<sup>28</sup> The total resolution fees for one year shall amount to a percentage of the institutions' estimated fee basis, as set forth by law.<sup>29</sup> The total fee is then divided among the institutions. The fees for smaller institutions are set using a standardised approach, while larger institutions pay a fee in proportion to the risk they pose to the system. The risk adjustment is based on a combination of different performance indicators that, among other things, include the institutions' total risk-weighted assets.

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<sup>27</sup> *Application of the minimum requirement for own funds and eligible liabilities*, February 2017 (Ref. RG 2016/425), Swedish National Debt Office.

<sup>28</sup> The risk-adjusted fee is calculated in accordance with Commission Delegated Regulation (EU) 2015/63 of 21 October 2014 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to ex ante contributions to resolution financing arrangements.

<sup>29</sup> The fee for 2018 is 0.125 per cent. The fee basis consists of the sum of the institutions liabilities, following deductions for guaranteed deposits, and other debt items.

The introduction of a risk weight floor for mortgages in Pillar 2 will not affect the total annual fee charged. However, the distribution of the fee between institutions may change since the key ratios included in the fee model will change. Because the fees charged for 2019 will be based on the 2017 year-end report, the decided measure will not affect the resolution fee until 2020.

### **3.5 Effects on the fee for deposit insurance**

The deposit insurance scheme contributes to strong consumer protection and financial stability. Every institution that is covered by the deposit insurance must pay an annual fee to the insurance authority. The calculation of the fee for the deposit reserve uses risk-based methods and the institutions' risk level. The aim of the fee model is – in addition to financing the costs of the deposit insurance over time – to contribute to stronger incentives for institutions to reduce their risk profile.

The internal distribution of the fees for the deposit insurance, much like the resolution fee, is also steered by a number of key ratios that may be affected by FI's proposal. The fees of individual institutions may therefore change, but not the total fee charged for the deposit insurance.<sup>30</sup>

### **3.6 Impact on competition and the market**

By continuing to apply the risk weight floor to Swedish mortgages but in a different form than today, the decided measure contributes to maintaining a level playing field and equal capital requirements for the credit institutions that are active on the Swedish mortgage market. Unjustified changes to the capital requirements that risk arising as a result of institutions changing their legal domicile are limited in that FI applies measures that other Member States can more easily reciprocate. FI makes the assessment that a level playing field is positive for the risk management of the Swedish mortgage market.

FI also makes the assessment that the measure will have a limited impact on the market. First, the measure has a limited effect on the capital requirements in SEK due to its design, which aims to keep the same capital requirements in nominal terms as the current requirements. The affected credit institutions already fulfil the requirements, which will continue to be met with a high percentage of CET 1 capital. Swedish credit institutions will therefore even in the future have equally high capital buffers for systemic risks linked to Swedish mortgages as under the current capital requirements and thus continue to be resilient. Second, FI is also able to reassess and withdraw a measure under Article 458 of the CRR if the macroprudential or systemic risk ceases to exist. This enables FI to achieve a similar buffer function at the systemic level as with today's risk weight floor in Pillar 2.

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<sup>30</sup> The total fee charged amounts to 0.1 per cent of the institutions' total guaranteed deposits.

### **3.7 Impact on society and consumers**

By maintaining capital requirements for all credit institutions active on the Swedish mortgage market, FI ensures that the affected credit institutions remain resilient. A credit institution that is well capitalised and has good earnings will find it easier to carry credit losses and to a greater extent be able to provide households and non-financial firms with loans even during periods of stress. This contributes to a stable development in the real economy as well as stability in the Swedish financial system, which benefits consumers and society at large.

The measure does not materially affect the total capital level in the banking system in nominal terms. FI therefore makes the assessment that the economic costs, for example in the form of the impact on lending rates to households and non-financial firms, should be negligible.

### **3.8 Impact on Finansinspektionen**

The measure is not considered to entail any major changes to FI's tasks or area of responsibility since the follow-up and impact analysis should be able to be conducted as part of the regular supervisory activities.