Memorandum

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Pillar 2 method for assessing additional own funds requirements for pension risk in credit institutions

Summary

Finansinspektionen (FI) has adopted a new method to cover pension risk in credit institutions (hereafter referred to as *banks*). The new method replaces the method that was used in the supervisory review and evaluation process for credit institutions in 2021 and will be applied starting in 2022.

In order to be able to meet their commitments, banks need to hold enough capital to cover losses that could arise in the event of a severe financial stress. FI makes the assessment that if a bank has defined-benefit pensions that are safeguarded in a pension foundation, this could contribute to the bank's own funds not being sufficient to cover these losses. In a failed bank, there is nothing to guarantee that the pension assets are large enough to meet the future pension payments. This can make it more difficult to manage a bank that is in resolution or bankruptcy. We therefore identify a potential capital need for banks with defined-benefit pensions that are safeguarded through a pension foundation.

FI takes the position that the risks that need to be covered are basically the same, regardless of whether the bank chooses to manage pensions itself or outsource this management to an occupational pension undertaking. We therefore assert that, if the bank chooses to manage pensions itself, a capital requirement should be calculated in approximately the same manner as if the pensions had been managed by an external undertaking subject to supervision. The previous method for assessing an additional own fund requirement for pension risks in banks was based on the traffic-light method. The new method is instead based on Finansinspektionen's

regulations and general guidelines (FFFS 2019:21) regarding occupational pension undertakings. One difference compared to the occupational pension regulations is that if the pension foundation invests in shares in the bank, these must be excluded when calculating capital requirements since these types of shares do not have a value following the bank's default.

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1 Introduction

1.1 Background

The pension risk method for credit institutions (banks) that was used in the 2021[1] supervisory review and evaluation process (SREP) was predominantly based on the so-called traffic-light model. Since the traffic-light for occupational pensions has been replaced by a regulation that is based on the Institution for Occupational Retirement Provision Directive[2], the pension risk method that has been used to date for banks must also be replaced with a new method.

1.2 Feedback received

On 3 February 2022, FI submitted for consultation a proposed Pillar 2 pension risk method. The proposal was sent to thirteen consultation bodies and also published on FI's website. The final date for responses was 11 March 2022. Eight consultation bodies responded: *Kommuninvest, the Swedish Competition Authority, the Swedish Investment Fund Association, Sveriges Riksbank (the Riksbank)*, *the Swedish National Debt Office, SEB, the Swedish Bankers' Association* and *the Swedish Savings Banks Association.* Kommuninvest, the Swedish Competition Authority and the Swedish Investment Fund Association had no comments on the contents of the consultation memorandum. The comments are addressed under each respective position below. FI has considered all submitted consultation responses, including those that we do not present in the memorandum.

2 Overarching legal basis

EU regulations on capital and liquidity are adopted at the EU level directly through a regulation (Capital Requirements Regulation, CRR)[3] and through a directive (Capital Requirements Directive, CRD).[4] The CRR applies directly in Sweden. The CRD has been implemented into Swedish law, in

[1] Pelare 2-metod för bedömning av kapitalbaspåslag för pensionsrisk, 2020-12-29, FI Ref. 20-30073. Available in Swedish.
[2] Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (IORP 2).
[3] 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.
[4] 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.

part through the Special Supervision of Credit Institutions and Investment Firms Act (2014:968) (the Supervision Act).

The capital requirement comprises two main components: Pillar 1 and Pillar 2. The detailed capital requirement calculations that are set out in the CRR are often referred to as Pillar 1. Pillar 2 is the collective name for the rules governing firms' internal capital assessment and FI's supervisory review and evaluation process, of which FI's overall capital assessment is an important part. The aggregate capital assessment is FI's assessment of individual firms' risks and capital needs and takes into account both risks covered by Pillar 1 and those that are not. Provisions on the supervisory review and evaluation process are set out in Articles 97–101 of the CRD.

In section 9 of the Special Supervision and Capital Buffers Ordinance (2014:993), the Government has stipulated that FI's supervision must comply with the provisions on supervisory review and evaluation set out in Articles 97–101 of the CRD. The requirement set out in Article 104(1)(a) of the Directive that competent authorities determine an additional capital requirement on the basis of this supervisory review and evaluation has been implemented by Chapter 2, section 1 of the Supervision Act. Pursuant to Chapter 2, section 1 of the Supervision Act, FI shall decide under certain conditions that a bank, in addition to the own funds required under the CRR, must meet an additional own funds requirement for the risk of an excessively low leverage ratio and an additional own fund requirement for other risks. FI shall decide on a Pillar 2 requirement in part if one is necessary to cover risks to which the bank is or can be exposed.

The CRD does not regulate the methodology to be applied in the risk assessment under the supervisory review and evaluation process. In other words, it transfers this matter to the relevant supervisory authorities. The European Banking Authority (EBA) has been authorised to issue guidelines to national supervisory authorities in order to specify common procedures and methods for the supervisory review and evaluation process (Article 107(3)). The methods FI uses are consistent with the basic principles in the EBA's guidelines, i.e., that capital requirements for Pillar 2 risks are added in addition to the Pillar 1 capital requirements. The EBA guidelines are principle-based and do not aim to regulate the application of specific methodologies in detail.

Pursuant to Chapter 2, section 1 of the Supervision Act, FI shall decide on an additional capital requirement that is firm-specific, which could mean

that we cannot provide a general statement on our risk assessment. However, some risks that are not covered by Pillar 1 are shared by all firms with the kind of exposures that are detailed in this memorandum. By developing methods and general assessment practice for different risk types, FI is able to ensure that firms are treated equally. Section 3 of the Special Supervision and Capital Buffers Ordinance (2014:993) also states that we must provide on our website the general criteria and methods applied in the supervisory review and evaluation process.

In order to carry out a risk assessment as part of the supervisory review and evaluation process, we need to request and analyse data from individual firms. FI is also able to request data from individual firms as part of its supervision activities (see, for example, Chapter 13, section 3 of the Banking and Financing Business Act[5] and Chapter 6, section 1 of the Supervision Act).

3 Pension risk

3.1 Occupational pension agreements in general

Banks and several other employers often offer occupational pension benefits to their employees. These benefits can be defined-contribution or defined-benefit.[6] A defined-contribution pension agreement entails that the employer pays premiums for an occupational pension on behalf of the employee at an external party that itself is under supervision. How large the pension will be depends on how the value of the pension assets develops. Neither the employee nor the external party can direct any claim to the employer after the premiums have been paid in. A bank that uses defined-contribution pension agreements therefore has no future obligations for the agreements once the premiums have been paid to the external party.

A defined-benefit pension is normally linked to the employee’s final salary. However, the final salary is not known during the majority of the employment. The employee’s lifespan is also not known, but often influences how long the pension will be paid. There are also other uncertainty factors, such as future inflation, which mean that a bank does not know the value of the defined-benefit pensions that it will pay in the future. The bank still makes provisions for pensions based on an estimate of

[5] Banking and Financing Business Act (2004:297).
[6] There can also be pension agreements that combine features from both types.

probable future pension payments. In Sweden, there are three ways to manage defined-benefit pensions: through an external party, by safeguarding through a pension foundation, or by safeguarding in one's own balance sheet.

Occupational pensions in Sweden are often negotiated between employers and unions as part of collective agreements. Occupational pension agreements are normally grouped in so-called plans. A pension plan facilitates the employer’s pension administration since the pension promises in a plan are similar but vary between the beneficiaries (employees and former employees) depending on their age and term of employment.[7] An employer can have several different pension plans, for example several defined-contribution and several defined-benefit, or different types of defined-benefit, sometimes targeting different groups of employees.

Occupational pensions can entail multiple types of risks for different stakeholders. Beneficiaries can risk receiving a lower pension than they expect based on the pension promises. Pension obligations can increase the probability that a firm will fail. The above-mentioned risks are not described in more detail or managed with the method we are describing. In this memorandum, we focus instead on the type of pension risk that is related to pension liabilities potentially obstructing the management of a failed bank.

3.1.1 Finansinspektionen's position

FI identifies a capital need linked to defined-benefit occupational pensions in banks. This justifies an additional own funds requirement in Pillar 2 for pension risk.

3.1.2 Feedback received

The Riksbank takes the position that it is important for FI, as part of the Pillar 2 assessment, to give full consideration to these types of pension risks and supports the proposal.

The Swedish National Debt Office notes that a capital requirement for pension risk ensures that there is adequate capacity to absorb losses that the risks in question may cause the bank. Without a capital requirement for pension risk, there is a risk that the bank’s total loss-absorbing capacity will

[7] Throughout this memorandum, we use the term *pension plan* to refer to all pensions with common conditions.

also not be sufficient in a crisis, which could obstruct the management of a bank in resolution.

The Swedish Savings Banks Association questions whether an additional own funds requirement pursuant to the Supervision Act may be used for the purpose FI presents, to facilitate the winding down or reconstruction of failed banks. The purpose of the capital adequacy rules is rather to make the banks sufficiently strong in terms of capital and thereby avoid a default. According to the Swedish Savings Banks Association, all legal requirements related to conditions for banks in resolution should be found in the Resolution Act.
The Association also points out that own funds in practice cannot be earmarked for certain use after a bank has failed, regardless of whether it is for bankruptcy proceedings or a resolution. According to the Association, this means that the capital requirement would not at all achieve the effect that FI refers to in the proposal.

The Swedish Bankers' Association expresses an understanding for FI's position that there are risks associated with defined-benefit pensions that are not fully covered by Pillar 1 and therefore for which there are grounds for including pension risk in the SREP.

3.1.3 Reasons for Finansinspektionen's position

Capital requirements for banks fulfil a function in that the capital can be used to cover losses after a default. This becomes possible by the banks, prior to default, adapting their own funds to the losses that could erode equity following a severe financial shock. The capital requirements applied consist of minimum capital requirements under Pillar 1 and Pillar 2 requirements for the institution-specific risks that FI assesses during SREP.

FI makes the assessment that, for the banks using defined-benefit occupational pensions, the agreements can give rise to significant deficits or a default since, following a financial shock, the value of the pension obligations may be larger than the pension assets. This can make it more difficult to manage a bank that is in resolution or bankruptcy. Pension risk, in the sense described above, is therefore a risk that FI needs to consider in the total capital assessment under Pillar 2.

The objective of capital requirements on banks is for a bank to have enough capital to be able to cover the losses that could arise following a severe

financial stress. At some point, FI may be forced to make an assessment about whether the bank has failed or probably will fail. If the bank's pension obligations then exceed the value of the pension assets, the bank's capital situation would deteriorate further. In and of itself, this could mean that there will not be enough capital and eligible liabilities to enable a recapitalisation of the bank.

FI agrees that a Pillar 2 capital requirement cannot be earmarked so there is specific capital for pensions after the bank has failed. But this statement is not unique for pension risk, but rather applies in general to all risks the capital requirements cover. By covering each risk individually, though, the total own funds will be large enough to be able to absorb the losses that can arise following a severe financial shock.

3.2 Pension risk in a consolidated situation

3.2.1 Finansinspektionen's position

FI intends to apply additional own fund requirements for pension risk at the individual level in the banks that are under FI's supervision. FI also intends to consider the principle of proportionality.[8]

FI intends to apply additional own fund requirements for pension risk in the banks at group level (consolidated situation) that are under our supervision if we have identified a capital need for pension risk in the group. The size of the capital requirement will be based on the capital need for pension risk identified for banks within the group. Own funds requirements for pension risk decided by foreign competent authorities will be considered in each supervisory college before FI decides on an additional own funds requirement for the consolidated situation.

3.2.2 Feedback received

The Swedish Bankers' Association takes the position that considerable focus is placed on the individual level when both resolution strategies and accounting frameworks in the form of IAS 19 focus on the consolidated situation. A sum of individual levels can, according to the Association, generate a misleading view of the total pension risk. This is because, for example, there may be guarantees or similar commitments between individual firms in the group, if a break-down at the individual level is even available in each basis. The Association therefore proposes that the capital

[8] The principle of proportionality is a general legal principle that entails, in simplified form, that a measure should be proportionate to its aim.

requirements be set at the consolidated level and thereafter distributed to the individual level.

3.2.3 Reasons for Finansinspektionen's position

According to the reasoning in section 3.1.3, there is cause for a capital requirement for pension risk with the capital situation after a default. A default is strongly linked to an individual firm rather than a group, even if it is plausible that an entire group could fail and end up in resolution in some situations. In order for the capital requirement to fulfil its purpose in every conceivable situation, as we explain in section 3.1.3, FI makes the assessment that the additional own funds requirement needs to be applied at the individual level. With reference to the principle of proportionality, FI may choose not to apply the pension risk method, for example if the size of the pension obligations is of little importance.

FI applies additional own fund requirements at the group level, i.e., for the consolidated situation, for all relevant risks and where appropriate. We take the position that capital needs in banks at the individual level can be summed to capital requirements at the group level as long as the individual capital needs have been assessed in accordance with the same purpose and if no adjustments have been made according to the viewpoints in section 4.3.2 on own funds for pension risk. Where foreign subsidiaries have capital requirements for pension risk applied by foreign competent authorities, we must discuss in each supervisory college how capital requirements at the individual level should be aggregated to an additional own funds requirement at group level.

FI does not share the opinion that considering pensions at the individual level before the group-level capital need is assessed can generate a misleading view. Rather, the capital need at the group level should be the same size when the assessment is made as FI intends. If the final application entails adjustments pursuant to the viewpoints in section 4.3.2, at the individual level, we will adjust the group's capital needs to adequately reflect the risk even if it no longer is a sum from an individual level.

FI normally applies capital requirements to the individual level for the different types of capital requirements that are applied to the group level. Regardless of whether the capital requirements for pension risk at the individual level are assessed before or after the assessment at group level, it is difficult to apply a correct, or at least fair, capital requirement at the

individual level. As the consultation bodies quite correctly point out, it is difficult due to guarantee commitments within the group. However, it is unclear to what extent the guarantees are usable after the default of firms within the group. FI will therefore disregard such guarantees unless it can be shown that they are valid after a default. The Swedish Bankers' Association's proposal entails no obvious benefits in the assessment and is also not relevant in terms of FI's aim to contribute to a simpler procedure after a default, even for a bank at an individual level.

4 Method for assessing an additional own funds requirement for pension risk in banks

4.1 Scope of the assessment for pension risk

4.1.1 Finansinspektionen's position

The method primarily should be applied to defined-benefit pension that are managed on own account and safeguarded with assets managed by a pension foundation or for a corresponding arrangement for pensions outside of Swedish jurisdiction.

Pension plans safeguarded by the same foundation should be evaluated together.

The point of departure is that each pension plan contains a potential pension risk. If the pension risk is not managed by another regulated party, for example an occupational pension undertaking, a capital need arises according to the positions of the memorandum. The capital need is distributed among the firms that are covered by the pensions evaluated and can lead to decisions on capital requirements for the firms or groups that are covered by the position 3.2.1.

4.1.2 Feedback received

The Swedish Bankers' Association would like FI to describe in more detail what the individual assessment of which pension plans to include will look like. The Association asserts that there may not be a direct link between pension assets and each pension plan and therefore proposes that FI's assessment should be based on how individual pension plans are managed following a default.

The Association also asserts that the position creates more work for a bank that must break down the aggregate pensions into pension plans. According to the Association, it would therefore be appropriate to introduce a proportionality threshold so, for example, smaller plans may be aggregated with other plans and covered together.

4.1.3 Reasons for Finansinspektionen's position

Pensions managed in an external firm engaged by the bank are protected in part by EU directives when the external firm is under supervision. The external party cannot direct any new requirements on banks if the bank has failed. Therefore, Pillar 2 capital coverage in this situation is not justified. Pensions safeguarded in an own balance sheet and credit insured by an external firm that is also under supervision, but does not administer the pensions, are also protected. A default by the bank triggers the credit insurance, and therefore capital coverage by the bank is not justified.

Thus, FI intends to primarily assess capital needs for pensions where no regulated insurance or occupational pension undertaking guarantees that the obligations are met if the bank has failed. In a Swedish context, this means pensions safeguarded by a pension foundation and pensions safeguarded in a balance sheet but without credit insurance. For pensions outside Swedish jurisdiction, an assessment in made on a case-by-case basis. However, the point of departure is that if a pension plan to a great enough extent can be considered to be under supervision in a regulated firm in an EEA country, the pensions should not be subject to an additional own funds requirement.

Normally, there is no link between a defined-benefit pension obligation and a specific pension asset. The obligation also normally is not linked to a certain amount of the total pension assets. One possibility is therefore to assess all pensions together in a method for pension risk. But pension plans may be managed individually and in different ways after a default, even if they, for example, are safeguarded by the same pension foundation. For example, some variable pension benefits that are not regulated by collective agreements are eligible liabilities under resolution.[9] Pension plans also can react differently during a financial stress due to varying terms for obligations.

FI notes that there is considerable uncertainty surrounding the resolution procedure, in particular since the regulation has not been tested yet. Some

[9] Chapter 2, section 2, point 7a of the Resolution Act (2015:1016).

pension benefits admittedly can be eligible liabilities in a resolution, but it is also possible to exempt pension benefits from impairment.

We also assert that pensions should be assessed in a way that is as similar as possible to how the same pensions would have been evaluated in an occupational pension undertaking. Therefore, multiple pension plans will be evaluated together if they are safeguarded by shared pension assets in a pension foundation or a corresponding arrangement outside of Sweden.[10] This also means that if a pension plan has pension assets in several foundations, the set-up will be evaluated per foundation when the method is applied.

Despite this, there is still sometimes a need to remove some assets from the evaluation.

- A pension foundation may safeguard obligations that belong to firms outside a bank's consolidated situation.
- A foreign equivalent of a pension foundation may contain assets that are used for pensions by a firm in a consolidated situation under FI's supervision but that are also used for firms outside of this consolidated situation.
- A pension foundation may safeguard obligations that belong to several firms in a group whose consolidated situation is not under FI's supervision but at least one of the firms is under FI's supervision.

If there is an economic link between obligations that will be evaluated and pension assets that are intended for the obligations, this economic link should be used. But if there is no economic link, a standardised distribution of assets can be applied. Normally, this entails dividing the assets in proportion to the size of the obligations.

For pension plans with smaller obligations, FI may use a simpler standard to assess capital needs; see section 5.

[10] Given that the evaluation otherwise does not deviate from how an evaluation would have been performed in a regulated occupational pension undertaking.

4.2 Risk-based capital requirement

4.2.1 Finansinspektionen's position

For each foundation, or where applicable a pension plan, a so-called risk-based capital requirement will be calculated pursuant to Chapter 7 of Finansinspektionen's regulations and general guidelines (FFFS 2019:21) regarding occupational pension undertakings. However, some risk types that FI assesses to be less relevant will be exempted: lapse risk, additional risk and operational risk.

4.2.2 Feedback received

The Riksbank supports harmonisation of the method for pension risk regardless of whether it is a bank or an occupational pension undertaking that provides the pension plans.

The Swedish Bankers' Association takes the position that it is good that the stress assumptions for the additional capital requirement are based on the regulations for occupational pension undertakings. But it asserts that FI has not given enough consideration to some aspect of the own funds for pension risk, which is presented in section 4.3.2.

4.2.3 Reasons for Finansinspektionen's position

The previous pension risk method for banks was based on the traffic-light model. When the traffic-light for occupational pensions was replaced by occupational pension regulations, it became reasonable to make a corresponding switch so that a new pension risk method for banks is based on the occupational pension regulations. This way we draw upon the development work that FI has already completed to cover risks that arise in the same or similar activities, namely occupational pension activities. As with the previous pension risk method for banks, however, there are some types of risks for occupational pension undertakings that are less relevant or of small scope in banks. All firms face operational risks, and they are assessed as part of the regular supervision for banks. FI therefore takes the position that operational risk does not need to be covered specifically for occupational pensions. We also make the assessment that lapse risk and additional risk are not applicable for defined-benefit pensions managed by the employer itself. Adjustment amounts are normally not applicable when we assess banks' occupational pensions with the method but may need to be applied for some pensions in order for the capital need under the method to be similar to what would have been the case if the same pensions had been managed in a regulated occupational pension undertaking.

4.3 Own funds for pension risk

4.3.1 Finansinspektionen's position

Every risk-based capital requirement must be set against so-called own funds for pension risk. These own funds are defined as the net amount of pension assets and pension obligations measured in accordance with Finansinspektionen's regulations and general guidelines (FFFS 2019:21) regarding occupational pension undertakings.

This position means that the own funds for pension risk can be positive or negative. The capital need for the evaluated pensions is the net of the risk-based capital requirement and the own funds for pension risk.

4.3.2 Feedback received

The Swedish Bankers' Association takes the position that FI has not given enough consideration to the interaction between the Pillar 2 guidance and the additional own funds requirement. The pension-related stress that is applied in these two methods is basically the same conceptually – to simulate an impairment in the net of pension assets and pension obligations. These two methods give rise to their own capital requirement, which are then added together. Since a bank must hold capital for the total of the capital requirements, the Association takes the position that it is of utmost importance for there not to be any overlap between these two types of capital requirements. The Association points out that, according to Article 104(b)(4) of the CRD, the competent authorities' guideline (the Pillar 2 guidance) must cover risks that are covered by Article 104(1) only to the extent that it covers aspects of these risks that are not already covered by the requirements. The Association proposes that, to the extent that pension stress contributes to capital requirements under the Pillar 2 guidance framework, a corresponding amount should be added to the own funds for pension risk in the pension risk method to avoid counting any capital coverage from the two methods twice.

The Association also asserts that the interaction between the additional own funds requirements for pension risk and interest rate risk are not sufficiently considered.

In addition, the Association takes the position that the bank regulations differ from the regulations for insurance in that future profit is included in the own funds for insurance undertakings but not for banks.

SEB takes the position that double counting of capital requirements should be avoided. The own funds for pension risk at the consolidated level should therefore be increased by any accounting deficits under IAS 19. These deficits have already lowered the consolidated level's common equity Tier 1 capital compared to the level of common equity Tier 1 capital without the recorded deficit.

4.3.3 Reasons for Finansinspektionen's position

Own funds for pension risk correspond on a conceptual level to what is called own funds in an occupational pension undertaking. Most of the opportunities available to an occupational pension undertaking to influence its own funds, though, are not applicable to the banks' pension management. For example, occupational pension undertakings can issue subordinated loans while a bank cannot issue a separate subordinated loan to cover solely its occupational pension management after a default. FI takes the position that the definition of own funds for pension risk should be simple but still relevant for its purpose, i.e., covering realised losses. FI therefore maintains that the net of pension assets and pension obligations is an appropriate balance, if the measurement occurs in accordance with the occupational pension regulations (FFFS 2019:21).

In terms of *the Swedish Banks' Association's* fear of overlap in the coverage of pension risk, FI takes the position that the additional own fund requirement and the Pillar 2 guidance always serve different purposes. The additional own funds requirement refers to risks that need to be covered after a default, and the Pillar 2 guidance aims to reduce the probability that a default occurs. FI's use of the same or similar types of conceivable shocks (stress factors) to assess the size of any capital need does not change the fact that the purposes are different. Moreover, the Association has previously submitted similar feedback in the consultation on the General approach to assessing Pillar 2 guidance for Swedish banks.[11] FI's position was and still is that the Pillar 2 guidance should constitute a first line of defence against falling capital coverage when the bank has not failed.

Because the additional own funds requirement and the Pillar 2 guidance have different purposes, FI does not intend to accept the Association's

[11] Övergripande ansats för att bedöma pelare 2-vägledningen för svenska banker, 2021-05-31, FI Ref. 20-28036. A translation in English is available at www.fi.se.

proposal of including deficits in one method for use as a surplus in another method.

The Association has also highlighted an interaction between pension risk and market risk, namely the part of the market risk that previously had its own method – interest rate risk in the banking book. Already in 2014, when FI submitted for consultation methods for these two risks, we presented a position to not consider any covariation between the risk types addressed in the consultation memorandum.[12] FI is now making the same assessment as then, namely that the actual importance of a risk-mitigation effect is strongly dependent on the circumstances and the fact that own funds for pension risk are not available to any significant degree for other types of risks. The total impact of covariation between the two risk types therefore is not large enough for consideration.

In terms of the Swedish Bankers' Association's feedback on including future profits in the own funds, FI's method is based on the regulation for occupational pension undertakings, which does not include future profits when calculating own funds.

FI agrees with *SEB*'s feedback that there are items in the accounts that relate to pensions and directly or indirectly can decrease or increase the own funds compared to what they would have otherwise been. FI will consider any significant effects from accounting items as part of the SREP for those banks affected.

4.4 Own shares as pension assets

4.4.1 Finansinspektionen's position

Any own shares held by the bank must be excluded from the calculations of both the risk-based capital requirement and own funds for pension risk.

4.4.2 Feedback received

The Riksbank considers this adjustment to be reasonable.

4.4.3 Reasons for Finansinspektionen's position

[12] The consultation resulted in the memorandum "FI:s metoder för bedömning av enskilda risktyper inom pelare 2", 2015-05-08, FI Ref. 14-14414. A translation into English is available at www.fi.se. The memorandum does not mention any feedback received on the position in section 5 – Covariation between pension risk and interest rate risk.

Holdings of own shares should not be viewed as an asset, but rather excluded from the calculation of both the risk-based capital requirement and own funds for pension risk. After the bank's default, these shares hold no value and therefore cannot help cover a deficit caused by other pension assets and obligations.

4.5 Desirable confidence level for capital coverage

4.5.1 Finansinspektionen's position

FI intends to apply the same confidence level to the additional own funds requirement for pension risk as pursuant to Finansinspektionen's regulations and general guidelines (FFFS 2019:21) regarding occupational pension undertakings.

This position means that the additional own funds requirement will not be calibrated to achieve the higher confidence level that applies under the banking regulations.

4.5.2 Feedback received

The Swedish Bankers' Association supports this view and considers this principle to be important to ensure equal treatment of banks and occupational pension undertakings that manage occupational pensions.

4.5.3 Reasons for Finansinspektionen's position

When a business conducts occupational pension activities, there are rules that apply, such as EU directives. FI takes the position that it is basically the same risks that need to be covered, independent of whether the bank chooses to manage the pensions itself or outsources this management to an external occupational pension undertaking. We therefore make the assessment that it is not necessary to raise the additional own funds requirement to a higher confidence level when the bank chooses to manage occupational pensions itself.

5 Simplified standard procedures in some cases

It can be justified to use a simplified procedure for some smaller pension plans if a complete assessment would require a lot of resources in relation to the size of the risk. If several smaller pension plans are safeguarded in the same foundation, a standard procedure can be applied to them if each pension plan meets the requirements to do so. Alternatively, the foundation may be evaluated like normal in accordance with the method.

5.1 Point of departure for a standardised approach

The point of departure is that, if FI applies a simplified standard for pension risk, it needs to be conservative rather than represent the underlying pension risk as fairly as possible. Another way to express this is that a standardised approach on average should not generate the same capital need as the underlying risk would have generated, but rather that it with high probability will generate at least as high a capital need as the underlying risk would have generated given a correct evaluation. A standard adds extra uncertainty that it may be beneficial to also cover.

5.2 When a standard may be applied

In the following, the pension obligations that are evaluated are measured under the occupational pension regulations (FFFS 2019:21). If this measurement is missing, 150 per cent is applied to the value according to IAS 19.

The standardised procedure can be applied to pensions where the value of the pension obligations is less than

- 5 per cent of the value of the group's total pension obligations,
- SEK 100 million, or
- 10 per cent of the value of the total pension obligations in an individual firm where other individual firms in the consolidated situation do not use the same pensions.

A standardised procedure can also be applied if the bank has not reported the information that FI needs to determine the capital need in accordance with that set out in section 4.

5.3 Capital need according to the standardised approach

FI will use the following assessment for pensions for which the bank would like to apply the standardised procedure and where the pensions meet the requirements to apply the standard:

The assets are stressed as if they were maximally sensitive to market risk according to the occupational pension regulations (FFFS 2019:21), i.e., as if all pension assets were Type C shares. This might be considered to be conservative, but on the other hand there is no add-on for currency or concentration risks for these intended assets.

The obligations are stressed as if both interest rate risk and insurance risk were included.

Risk-based capital requirement = pension assets · 45% + pension obligations · 20%

Such that
capital need = pension obligations · 120% - pension assets · 55%
if positive, otherwise zero.

6 Implementation

FI will use the described method to assess additional Pillar 2 own requirements for pension risk in the 2022 SREP.

7 Impact analysis

In the 2021 SREP, seven banks from Supervision Categories 1 and 2 were included in an assessment of pension risk. At these banks, FI reviewed in total 20 defined-benefit pension plans. We make the assessment that approximately half as many defined-benefit pension plans will be subject to the new method since it primarily refers to pensions safeguarded in a pension foundation. Based on this, we make the assessment that the banks that primarily will be subject to an additional own funds requirement are SEB, Handelsbanken and Nordea Hypotek AB. Other banks or bank groups may be subject to an additional own funds requirement for pension risk.

In terms of the size of the additional own funds requirement for pension risk, FI notes that the requirement historically has varied, both between banks and over time. The latter is partly because the value of the assets that safeguard the pensions can vary. If there are pension assets in the form of shares in a pension foundation, it is often the case that the developments on the equity market have a significant impact on the capital requirement from

one year to the next. If the equity market's valuation increase, the capital requirement normally decreases. Pension risk methods, in other words, have the ability to produce procyclical capital needs. At the end of 2021, the equity markets in many countries were valued higher than in previous years, including in Sweden. The described tendency would thus indicate low capital requirements in SREP 2022. At the most, the requirement previously amounted to around SEK 6 billion for a single bank group.

FI makes the assessment that, in general, the new method should generate a slightly lower capital requirement, because fewer pensions are included and the confidence level is somewhat lower. For 2022 SREP, FI makes the assessment that the requirement will not exceed approximately SEK 0.5 billion for any individual banking group. The capital requirements can change significantly in the future, perhaps already next year, depending on whether, for example, the equity market's valuation changes significantly.