Minutes from the meeting of the Financial Stability Council[1] held on 6 December 2023

§ 1 Stability assessment, operational preparedness and measures

The authorities presented their stability assessments, view of operational preparedness and discussed possible measures.[2]

The Riksbank pointed out that the Swedish financial system in general functions well and to date has managed the challenges following from the rapid rise in inflation and interest rates. However, higher interest rates and geopolitical concerns continue to contribute to elevated risks, not least given the banks' exposure to the highly indebted commercial real estate companies, and high household indebtedness. The higher interest rates increase the commercial real estate companies' financing costs and lead to lower property values. The situation is particularly difficult for some commercial real estate companies. Price increases and interest rates also weigh on households, whose high debt combined with short interest rate fixation periods make them interest-sensitive and dampen consumption. The Riksbank briefly presented the in-depth analysis of deposits in Swedish banks made in the Stability Report. The analysis showed that some Swedish banks have a higher concentration of deposits from individual depositors, but there is no evidence that deposits are particularly concentrated in a single sector. The data also show that banks with a higher proportion of deposits that are not guaranteed by the deposit guarantee scheme hold a larger

[1]Present: *Ministry of Finance:* Niklas Wykman, Chair of meeting, Johan Almenberg, Anna Jegnell; *Riksbank*: Erik Thedéen, Anna Breman, Olof Sandstedt; *Finansinspektionen*: Daniel Barr, Henrik Braconier, Thomas Nielsen; *National Debt Office*: Karolina Ekholm, Fredrik Bystedt, Erika Färnstrand Damsgaard; and *Financial Stability Council Secretariat*: Niclas Alsén.

[2] Finansinspektionen presented its report Stability in the Financial System (2023:2) on 28 November and the Riksbank presented its Financial Stability Report 2023:2 on 9 November.

liquidity buffer. At the same time, the results suggest that deposits may be more volatile for some smaller banks, in particular deposits that are not covered by the deposit guarantee scheme.

The Riksbank considers that commercial real estate companies need to reduce their risks. The banks also play an important role, partly by maintaining the supply of credit to viable companies, and partly by requiring commercial real estate companies to take measures. The Riksbank also considers that for the time being the major Swedish banks should aim to have a margin down to the formal capital requirements that does not fall below the upper limit that the banks themselves set for their management buffers. This can be achieved by being restrained with dividends and share repurchases.

Operational preparedness is an important issue for financial stability and the Riksbank has been given a new statutory mandate to ensure that payments work in peacetime crisis situations and when there is a heightened state of alert. This means, among other things, identifying which companies conduct business that is of particular importance for payments and specifying their obligations regarding planning, preparation, training and exercise activities. The mandate partly merges with Finansinspektionen's sector responsibility and the Riksbank maintains a close dialogue with other authorities as well.

Finansinspektionen (FI) reported that their Stability Report for the first time contains a section on operational risks. Operational stability risks in general and cyber security in particular have become increasingly important for the financial sector as the security policy situation deteriorates. The picture is that the sector has a relatively good starting point. We have comprehensive regulation that places high demands on the actors and the DORA regulation[3] will also soon enter into force. In addition, the companies themselves have strong incentives to ensure that their services are continuously functioning and robust even in the event of disruption. However, the sector's development is market-driven, and this has led to streamlining that in some respects may have made the payment infrastructure more vulnerable from an operational perspective.

[3] Regulation (EU) 2022/2554 of the European Parliament and of the Council on digital operational resilience for the financial sector (Dora Regulation).

The State has the tools to deal with financial crises, but it does not have the same ability to manage an operational crisis. Therefore, there is a need to focus on preventive measures and fallback procedures. Finansinspektionen considers that a management body to coordinate the work in operational crises would be welcome, but at the same time stresses the importance of a clear division of roles and responsibilities between the parties concerned, not least in relation to prevention and crisis management measures.

Finansinspektionen believes that there is still an elevated risk to financial stability. High debt levels, short interest rate fixation periods and cost increases mean reduced margins – for both households and many companies – to deal with further shocks. Uncertainty has come down, mainly because of reduced concerns about what is needed to overcome inflation. A key question now is how long monetary policy will be contractionary. Risk-taking and debt build-up have been subdued and the level of risk should therefore decrease in the long term.

Commercial real estate companies still need to reduce their debts. Commercial real estate companies' key ratios have deteriorated rapidly and will continue to deteriorate, not least due to expiring interest rate fixation periods and falling property values. For some companies, the situation will be critical if a higher interest rate situation persists for several years, unless more measures are taken. Large debts need to be refinanced in the near future and to roll over their debts, companies need to show that they have good viability even in an environment with higher interest costs. The most indebted companies have started adjusting – but more needs to be done.

The Swedish banks are currently very profitable, but with deteriorating conditions for companies and households, the probability of higher future credit losses in the banking system has increased. However, through their liquidity and capital buffers, Finansinspektionen assesses that Swedish banks have satisfactory resilience to meet the challenges that may arise.

The National Debt Office shares the view that the risks are elevated. In particular, the commercial real estate sector is vulnerable. In the secondary government bond market, Finansinspektionen's liquidity measures show that liquidity has stabilised after previous falls, but liquidity remains at a low level. One possible risk for government bond markets is the "basis trade" on the US government bond market, i.e. hedge funds exploiting small price differences between derivative contracts and the underlying government bonds. The Federal Reserve and others have pointed out that it constitutes a vulnerability that could amplify an initial disruption, and it could result in turbulence in the US government bond market. Such a development could also have negative effects on the Swedish government bond market and could also make it more difficult for Swedish banks to access dollar financing.

The National Debt Office welcomes the fact that the risks of volatile deposits are being raised. There are a number of non-systemically important banks that have recently rapidly increased their deposits, partly from abroad using deposit platforms. It is appreciated that the Riksbank has started to follow this with its more granular data. The fact that new technologies and social media in general may have made deposits more volatile makes it all the more important to continue monitoring the liquidity risks associated with deposits. The National Debt Office follows the ongoing international discussion on the importance of the deposit guarantee scheme for financial stability and possible reform needs, based on its mandate as the guarantee authority responsible for the deposit guarantee. It should be underlined that the design of the deposit guarantee scheme, including its funding, is governed by EU-wide rules, although there is some scope for Member States to adapt, for example, the risk differentiation in the levying of contributions.

It is important that the authorities that safeguard stability remain vigilant about the risks that deposit-financed operations may entail. In this context, it is particularly important to focus on those credit institutions that carry out the most offensive deposit business with the deposit guarantee as an explicit marketing argument. It is important to ensure that business models, risk controls, credit decisions, etc. are of high quality even in smaller banks that conduct more aggressive deposit business.

The National Debt Office will continue to strengthen its operational preparedness next year, including in terms of preparation for possible resolution cases. The National Debt Office looks forward to reading the important report from the inquiry on operational crisis management which will be published soon.

The Chair summed up the discussion. The financial system has so far managed the higher interest rates well. However, the risks remain elevated.

The authorities have long pointed out the risks associated with the high level of indebtedness. Many households and companies will face higher interest rates going forward as old loans mature and when the interest rate fixation period on existing loans expires. At the same time, higher unemployment, more bankruptcies, and weaker demand are expected. Resilience will be tested in the future, in the economy as a whole, as well as in the financial sector. Individual actors face challenges, but the key to stability is that these do not spill over to the financial system as a whole. The assessment today is that stability is good, with both buffers and the ability to handle various forms of disruption. It is important to monitor developments closely and to be prepared to act to safeguard financial stability, should the need arise.

One area that needs special attention is the commercial real estate sector. Additional areas that need to be monitored are the risks associated with household indebtedness, the banks' credit losses, despite their current favourable conditions, liquidity of bond markets, developments in the payment infrastructure and cyber attacks in light of the changed security situation.

§ 2 Future cooperation within the Financial Stability Council

The Chair presented information on the ongoing evaluation of the work of the Financial Stability Council and other parts of the Financial Stability Committee (ToR 2013:120). The Ministry of Finance started this evaluation in 2023. The aim is to preserve the functions but streamline and develop the work. The intention is for the evaluation to be completed in 2024.

§ 3 International questions

The Ministry of Finance presented information on the work on financial market issues in the European Union.

The Stability Council discussed the Capital Markets Union, digital euro, as well as the new framework for crisis management of insurance companies.

§ 4 Completed work within the Stability Council

The Stability Council Secretariat gave an account of the experiences of the autumn's scenario exercise. The focus was on dealing with the consequences of a cyber attack that affected a financial infrastructure company.

The Stability Council is agreed that there is a need for an exercise strategy and coordination of exercises conducted in different forums.

The next ordinary meeting of the Stability Council will be held in June 2024.