STATENS OFFENTLIGA UTREDNINGAR

13 June 2016

Financial Stability Council

Minutes from the meeting of the Financial Stability Council held on 7 June 2016

Summary

The Stability Council discussed the stability situation. The major Swedish banks have improved their resilience in recent years. But structural vulnerabilities in the Swedish banking system – due to the fact that it is large, interlinked and in addition has a high proportion of market funding – make it sensitive to shocks.

Housing prices have increased substantially in recent years. High housing prices and rapidly increasing indebtedness represent a vulnerability for the Swedish economy. Household debt currently corresponds to about 180 per cent of disposable incomes, which is a high level both historically and in an international perspective. There is broad consensus on the need for measures to reduce the risks of household indebtedness. Possible further measures were discussed at the Council meeting and at the same time it was noted that it is important to evaluate the effects of measures taken, such as the amortisation requirement.

One risk in the near future is the United Kingdom's referendum on the EU. If it results in the United Kingdom leaving the EU, this may lead to negative effects on financial markets. The authorities are prepared for such a situation.

The meeting also discussed the work of implementing scenario exercises to practice crisis management. In addition, an update was discussed of the 2009 Memorandum of Understanding (MoU) on the various roles of the authorities in the work of financial stability, aimed at further improving the authorities' cooperation and crisis management.

The National Debt Office presented its work to formulate the Minimum Requirement for Eligible Liabilities, MREL. The work concerning the

authorities' view of the banks' resilience and resolvability was also discussed.

The work of the Stability Council, that is the Financial Stability Committee, is to be evaluated in the autumn. There will be a first, partial, evaluation that is not intended to replace the evaluation to be carried out at the latest by 2019.

Ahead of the next meeting of the Stability Council on 7 December 2016, the Committee will continue to work on the following questions:

- The MoU on cooperation, and subordinate documents
- Scenario exercises
- Continued work on matters concerning capital and crisis management

Present:

Ministry of Finance
Per Bolund, Chair
Ulf Holm
Aino Bunge
Finansinspektionen
Erik Thedéen
Martin Noréus
Henrik Braconier
Swedish National Debt Office
Hans Lindblad
Mattias Persson
Tom Andersson
Riksbank
Kerstin af Jochnick
Per Jansson
Martin W Johansson
Financial Stability Council Secretariat
Niclas Alsén

§ 1 Stability assessment

The situation in the financial markets, assessment of macroeconomic and financial stability risks

The Chair opened by noting that the start of the year was somewhat more volatile in the financial markets, with falling stock market prices and uncertainty about global growth and European banks. There has been a calmer period lately, but there are a few dark clouds and so it is important to hear the authorities' assessments of the situation.

The Riksbank, Finansinspektionen and the Swedish National Debt Office then presented their respective assessments of the stability situation for the members of the Council.

The Riksbank presented its stability assessment. As mentioned, the year started with major falls in stock markets and rising risk premiums on riskier assets. However, since April there has been a reverse (i.e. higher asset prices, lower volatility and lower risk premiums) as a result of a rising oil price and expansionary monetary policy measures from a number of central banks.

However, the risks remain of weak global economic development, which may affect financial stability both in Sweden and in other countries. Weaker global growth impairs Swedish companies' capacity to repay their loans. In such a situation, if stress arises in the financial markets, banks and non-financial companies may find it more difficult and more expensive to raise funding in the market.

There are other additional risks, of a more idiosyncratic nature, mainly concerning developments in Greece and the referendum in the United Kingdom that warrant being monitored in the coming period.

However, regardless of developments in the rest of the world, Sweden has its own problems to manage, not least in the housing market, where both housing prices and debt continue to rise. These problems have built up over a long period and create increasing risks and vulnerabilities that may threaten financial and macroeconomic stability. This may lead to low growth for an extended period. There are several reasons of a structural nature for the problems the Riksbank sees in the housing market, but the low interest rate also plays a part. Low interest rates may lead to increased risk-taking. If risk-taking is exaggerated it may entail increased vulnerability in the financial system, assets may become overvalued and risks incorrectly priced. In such a situation the probability of major price falls in asset markets may increase, not least in the housing market.

The major Swedish banks have improved their resilience in recent years. In addition, Finansinspektionen has taken measures and new regulations at international level have been added, entailing further capital requirements of banks in future. But structural vulnerabilities in the Swedish banking system – due to the fact that it is large, interlinked, exposed to the housing market and in addition has a high proportion of market funding – makes it extra sensitive to shocks. Measures are therefore required that strengthen and ensure increased resilience in Swedish banks. In that light the Riksbank, as expressed in the financial stability report, considers that:

- Finansinspektionen should now introduce a leverage ratio for major Swedish banks of 4 per cent and 5 per cent from January 2018. In addition to this, there may also be reason to consider further tightening of risk-weighted capital going forward.
- The countercyclical capital buffer should be set to 2.5 per cent as soon as possible.
- Finansinspektionen should increase the liquidity coverage ratio (LCR) to also cover Swedish kronor. The ratio should be set to at least 60 per cent and the major banks should also report their LCR in kronor at least once per quarter.
- The banks should reduce their structural liquidity risks and manage a minimum net stable funding ratio, NSFR, of 100 per cent and report their NSFR at least once per quarter.

Nordea’s plans for a branch structure mean that the extent of the Swedish State’s commitments will increase, since Nordea’s balance sheet total will be larger. This means greater possible central government recovery and resolution measures and greater possible liquidity assistance requirements of the Riksbank. Consequently, the Riksbank takes the view that Nordea should be subject to sufficient liquidity coverage ratios (LCR) in all important currencies, including Danish and Norwegian kronor. How the LCR requirements can be supplemented so that they include all currencies that are of great significance is something that needs to be investigated going forward. The premise should be that a bank must be able to handle its self-imposed liquidity risks. A branch structure also means that Finansinspektionen will have a more direct responsibility for supervision, which will require greater resources.

Another important question is the existence of cyber threats in the financial system. The financial system is becoming increasingly dependent on IT systems that are ever more interlinked. This increases vulnerability and the potential effects of cyber-attacks. A major cyber-attack could now threaten financial stability. The surveys conducted by the Riksbank, partly together with FI, with the banks and infrastructure companies show that measures have been taken, but also that awareness in the organisations must be improved.

The National Debt Office asked the Riksbank, in response to its recommendation to deal with the risks of household indebtedness, and in view of the fact that the Bank is responsible for the relative price of money in the form of the interest rate, why the effects of the low interest rate have not been highlighted more. The consequences of the recommendations on growth, inflation etc. are comparable with the effects of a raised interest rate. The National Debt Office pointed out that the Riksbank – besides its recommendations to other authorities – should elucidate the role of the policy rate more clearly.

The Riksbank stated that the effects of low interest rates have for a long time been a part of the Riksbank's analysis and also one of the underlying reasons for some of the Riksbank's recommendations. Inflation is on its way towards achieving the inflation target, but monetary policy will continue to be expansionary for quite a long time. The underlying reason for the indebtedness is structural problems in the housing market, and there the Riksbank has contributed analyses. At the same time, the Riksbank has been open about the fact that the low interest rate entails risks. A long period of low inflation and waning confidence in the inflation target have, however, necessitated a very expansionary monetary policy.

The fact that the Government has given Finansinspektionen the main responsibility for macroprudential supervision is on the margin also a reason for the Riksbank to focus on the inflation target. In addition, developments on the currency market have entailed a risk of substantial appreciation of the krona, for example in view of the ECB's monetary policy measures. The expansionary policy was necessary to dampen this risk.

Finansinspektionen welcomed the fact that the Riksbank is contributing to the analysis of various measures. It is evident that the Riksbank has endeavoured to raise inflation.

However, Finansinspektionen does not share the Riksbank's view concerning the need for further macroprudential supervision measures. As Finansinspektionen's analyses show, a very restrictive debt to income limit in line with the Riksbank's recommendations would have a considerable impact on the economy if implemented.

Finansinspektionen must constantly weigh up the effects of its proposals, both on financial stability and on the national economy; in other words, strike a balance. If Finansinspektionen were to follow all the Riksbank's recommendations the fall in demand would be very severe and the Riksbank would need to pursue an even more expansionary monetary policy to try to achieve the inflation target.

The Riksbank pointed out that in various reports and speeches they have presented calculations of what reduced tax relief on interest would correspond to in the form of an interest rate change. All this for the purpose of providing an analysis of the effects of different measures to restrict indebtedness. The Riksbank has also proposed that a debt to income limit should be considered, but has not recommended any particular level.

Finansinspektionen presented its analysis of the stability situation. The overall assessment is that resilience in the financial system is satisfactory, but that there are still vulnerabilities in the system. In the outside world, economic recovery is uneven and weak. The USA is progressing relatively well, while many emerging markets have been severely weakened. Recovery in Europe continues to be sluggish.

The turbulence in the financial markets has decreased since the turn of the year. At the same time, many European banks have low profitability, a large proportion of distressed receivables, while there is considerable overcapacity. A weaker European economy could create further problems and renewed turbulence. This could affect the markets where Swedish banks borrow.

The extremely low interest rates imply risks that are difficult to predict. There is a risk of upward pressure on asset prices, especially housing prices, and downward pressure on risk premiums, which may build further risks. This is particularly apparent in Sweden, where the extreme interest rates interact with high growth and rising resource utilisation.

The Swedish financial system is currently functioning well, and liquidity in systemically important markets for government and covered bonds continues to be good, even if this will not necessarily apply in a more critical situation. The stability risks from insurance companies are currently considered to be relatively limited. In the longer run, however, the low interest rate level will create problems for life insurance companies.

The banks' lending, above all to households, has continued to grow strongly. The banks hold a dominant position in the Swedish financial market and are therefore crucial for financial stability. Consequently, the major Swedish banks are subject to high capital and liquidity requirements and have priority in supervision. Since the meeting of the Stability Council last winter there have been several changes:

- Finansinspektionen has made decisions that will lead to a further increase in capital requirements on the banks, by raising the countercyclical capital buffer to 2 per cent and imposing more

stringent requirements on the banks' use of internal models. Finansinspektionen considers that risk-sensitive capital requirements are good, but that the banks must use internal models more conservatively.
- New resolution legislation is now in place. Finansinspektionen considers that the most important thing for the banks' resilience is to have large capital buffers that can be used before the banks are put into resolution. The resolution framework is important, however, as it makes it easier to handle distressed banks.
- Finansinspektionen has decided to say yes to Nordea's transformation of Nordic subsidiaries into branches. In the short term a branch structure will create certain adaptation risks, but in the long term the management of capital and liquidity will be more effective in the bank, which increases stability. A bank with a branch structure is also easier to deal with in resolution, which improves the authorities' capacity for successful crisis management.

The major Swedish banks' dependence on market funding constitutes a vulnerability. High liquidity requirements on the banks, including in global reserve currencies, help to create resilience and credibility if problems arise. The role and responsibility of the Riksbank for liquidity supply to solvent banks in a financial crisis situation should be made clear in the coming Riksbank inquiry.

<u>The National Debt Office</u> presented its stability assessment. In the world economy, low and negative interest rates and expansionary monetary policy have continued to have a major impact on pricing in financial markets. Investors' search for yield will probably continue. On 8 June the European Central Bank (ECB) will start buying corporate bonds in the market via its new CSPP programme, which risks affecting the market and risk-taking further.

It is a matter of concern that investors year after year increase their risk in the pursuit of higher yield by buying riskier assets or assets with longer maturities. Risk-taking is increasing. This risk needs to be monitored and analysed. There is a risk that the markets will function at their worst when they may be needed most, and that investors, in their pursuit of higher yield, have invested in assets they perhaps do not fully understand.

Globally there is also a risk that liquidity in financial markets has been impacted negatively by both new, much-needed, regulation and central bank measures.

As far as Sweden is concerned, the liquidity of the government bond market is good, though there are indications that it has deteriorated somewhat compared with a couple of years ago. In 2015 and 2016 the share of foreign ownership of the government bond stock gradually decreased from about 50 per cent to about 30 per cent. In the long term there is a risk of the investor base shrinking and that this decrease, if prolonged, will be difficult to rebuild. This risk naturally applies to other issuers and other debt instruments as well. This could result in less diversified investor bases and higher refinancing risks.

In the Swedish market systemic risk continues to be low, but seems to have increased somewhat at the beginning of 2016. The National Debt Office analyses the systemic risk based on a CCA model. Standard & Poor's have Swedish banks on "negative watch" in light of developments in the housing market and household indebtedness, among other things. The introduction of the amortisation requirement should, however, be viewed as positive in this respect.

House price developments and household indebtedness are a risk and a source of concern. The development in house prices, measured as a 3-year moving average, has historically coincided with the peak for the GDP gap. There are indications that the peak of the economic cycle may come earlier than predicted in most forecasts. One possible development is therefore that the incipient slowdown in house prices will continue.

The Riksbank stressed the importance of the banks having buffers in the currencies where problems may arise in future.

The Chair summed up the discussion by stating that the assessment is that the markets are functioning well overall, but that there are risks and the risks need to be analysed. Several of these questions recur in other parts of the agenda.

The referendum in the United Kingdom

The Chair opened by noting that Sweden and the United Kingdom have often collaborated within the EU. For the financial sector, the United Kingdom is the most important country within the EU that does not use the euro as currency. A decision to leave the EU on 23 June will have both short-term and long-term effects. The Government would prefer that the United Kingdom remains in the EU. Today any risks to financial stability and the authorities' preparedness are to be discussed.

Finansinspektionen noted that the referendum is also important to Sweden and that Finansinspektionen has many dealings with the British supervisory authorities. This is a unique event and it is difficult to predict its effects. If the United Kingdom votes to leave the EU it is probable that this will trigger a market reaction: Sterling may be weakened, investors flee to safe assets, and in the worst case there may be major shocks in the financial markets, which would also affect Sweden. It is therefore important to carefully monitor developments.

The Swedish banking sector is fundamentally stable and resilient. The Bank of England has published information concerning liquidity provision preparations. In the long term there are growth risks that may affect Sweden. But at present it is difficult to quantify these possible long-term effects.

Swedish insurance companies are also affected by volatility and major price falls in the financial markets, but the companies have sufficient buffers. Finansinspektionen has started working with the Riksbank and the National Debt Office to monitor developments more closely and be prepared for taking any necessary measures.

The Riksbank stated that it continually follows developments in the financial markets and analyses possible consequences of a British exit, both in the short and the long term. There is contingency planning for the consequences, such as financial market shocks, that may arise from the referendum. Ahead of the referendum the Riksbank is in close contact with Swedish banks and authorities, as well as other central banks.

The National Debt Office stated that it sees a risk of increased volatility if the result of the referendum is that the United Kingdom is to leave the EU. There may also be pressure on Swedish government securities as part of the flight to safety. The National Debt Office is prepared for this. The National Debt Office has an internal group working on this and collaborates with other authorities. If the outcome of the referendum is an exit from the EU there will probably also be high volatility and uncertainty in the European market, due to speculation on the consequences.

The Chair expressed thanks for the information. Naturally this is a matter that the Government is following closely and it is important that the authorities keep the Ministry of Finance informed of developments on a continuous basis.

The housing market and household indebtedness

The Chair started by noting that there has been a substantial increase in housing prices, but that it now perhaps looks as though this may be subsiding somewhat. Substantial and rapid price rises create vulnerability, and tools are needed to manage the risks. Different questions must be discussed, such as Finansinspektionen's mandate, effects of the amortisation requirement that is now in place and the need for further measures. The Government is naturally also working on the question from a broader perspective in the context of the continuing housing talks.

The Riksbank pointed out that housing prices and household indebtedness have been increasing over a long period and in Sweden the household debt ratio, that is debt in relation disposable income, is currently around 180 per cent. This is a high level, both from a historical and an international perspective.

According to Finansinspektionen's latest mortgage survey, the proportion of households with new mortgages that amortise has increased since 2011. This is a positive development. In future it will be important to follow up how the amortisation requirement affects borrowers' amortisation and indebtedness. The Riksbank's analysis shows, however, that the amortisation requirement will probably not be sufficient to suppress the rising indebtedness of Swedish households and reduce the risks in the household sector appreciably.

To reduce the risks posed by housing prices and household indebtedness the Riksbank believes that a combination of measures in several different policy areas is needed. The measures taken by Finansinspektionen to date – loan-to-value cap, risk weight floor for mortgages and amortisation requirement – are steps in the right direction but there is scope for more measures:

- A debt to income limit, that limits the size of the mortgage in relation to the disposable income, is an effective tool to reduce household debt. Another appropriate measure is to introduce minimum levels for the standard values used by the banks in their left-to-live-on (LTLO) estimates. Another example of a measure is to limit the percentage of loans at a floating interest rate.
- But all responsibility cannot be assigned to macroprudential supervision, measures are needed that do not address the underlying reasons for the increased indebtedness and the responsibility for such reforms rests with the Riksdag and the Government. Therefore, it is of the greatest importance that the political talks now being conducted lead to concrete measures.

- One component of getting to grips with the imbalances in the housing market involves creating tax rules that reduce lock-in effects.
- Other components may concern reforming the rent-setting system, improving competition in the construction and civil engineering industry and reviewing the municipal planning monopoly.
- A question that is broader, but cannot be disregarded in this context, is the framework for macroprudential supervision, where the Riksbank has called for a review, for example together with the announced review of the Sveriges Riksbank Act.

However, it will probably take several years before any inquiry on the framework for macroprudential supervision is completed and new legislation is in place. At the same time, reducing the risks of Swedish household indebtedness is an urgent matter. Consequently, it is of the greatest importance that Finansinspektionen is given the tools and legal authority to mitigate existing risks. It should be made clear that Finansinspektionen has a mandate to take measures to correct financial imbalances regardless of whether there are risks to financial stability or macroeconomic development.

The Riksbank further emphasised that Finansinspektionen should be able to make independent decisions on the macroprudential supervision tools they have been given responsibility for. A balance must be struck between autonomy and democratic control in macroprudential supervision. However, the Riksbank considers – in line with the arguments of Goodfriend and King in the evaluation of the Riksbank's monetary policy in 2010-2015 – that an appropriate way of achieving this is that the political level should determine which tools are to be delegated, but the authority responsible should then decide their application independently. This is also in line with the European Systemic Risk Board’s (ESRB) recommendation in this area.

Finansinspektionen stated that developments in the housing market are difficult to assess at present. Housing prices are increasing much slower than six months ago, and there is now talk of falling prices in metropolitan regions. Different factors point in different directions, where amortisation requirements and tougher banking requirements indicate a weaker trend, while low interest rates, good growth and demographics indicate continued expansion. The fact that construction is now picking up is good, but that may also ultimately entail risks, bearing in mind earlier developments in Spain and Ireland, for example.

Household indebtedness is growing too fast and has accelerated recently. This is a consequence of the substantial previous price increases, a growing housing stock and probably also mortgages taken out to avoid the amortisation requirement. Increased debt growth will probably continue for several years to come, even if housing prices stagnate.

Many new mortgage holders are taking out larger mortgages in relation to their incomes. This means an increasing macroeconomic risk, as consumption may fall considerably in a crisis situation, even if households can pay interest and amortise. Finansinspektionen noted that in this situation they see a restriction on new mortgages in relation to household incomes (a debt to income limit) as a good complement to the mortgage loan-to-value ceiling and the amortisation requirement.

Finansinspektionen has therefore made in-depth analyses of what a debt to income limit would entail. In the short term a binding regulation would dampen growth, but in the longer term it would also dampen risks. Finansinspektionen therefore considers that any debt to income limit would above all be an insurance against events continuing in the wrong direction, i.e. that it should not be binding on introduction. A limit that was far too low would threaten economic growth.

Finansinspektionen considers it reasonable to first observe the effects of the amortisation requirement, but wants to have the legal powers to implement further measures as soon as possible. Reforms in other areas may reduce the need for a limit.

Since an increasing number of new borrowers' mortgages are large in relation to their incomes, Finansinspektionen will meet the banks and discuss their debt ratios. Neither the banks nor the economy gain from high indebtedness that could lead to a deeper economic crisis in the future.

It is important to see that the extended powers that Finansinspektionen needs to fulfil its remit to correct financial imbalances fulfil a long-term need. Hence the powers are not needed solely to manage today's problems and to be able to introduce a debt to income limit, but also to give Finansinspektionen the tools to fulfil its macroprudential supervision remit in the long term.

The National Debt Office stated that they consider that a debt to income limit is a new type of measure to the extent that it restricts how households can fulfil their preferences. Previous measures have mainly affected the relative price of borrowing, while a debt to income limit is a credit restriction. It should also be taken into consideration that the debt to income limit is a risk-insensitive measure and in some respects is similar to the credit regulation of the 1980s.

The Ministry of Finance stated that they consider the debt to income limit as well as the amortisation requirement to be another type of measure than for example changes in capital requirements or the countercyclical buffer, which are mainly aimed at creating buffers at the banks. Such measures give a greater effect on indebtedness, but also risk entailing negative effects on growth depending on calibration, i.e. a more powerful weapon against the problem for better or worse. This was one reason for creating a process of submission of proposals to the Government for the amortisation requirement.

The Riksbank emphasised that all measures have advantages and disadvantages. If high debts are achieved they will remain for a long time, compare Denmark, for example. If the outcome of the housing talks is successful there will be less need to focus on macroprudential supervision. It is important to deal with the basic problem; which means undertaking reforms in the housing market that create a better balance between supply and demand.

Finansinspektionen agreed that the debt-to-income limit is essentially different from capital requirements, in that it entails a restriction on how much you can borrow, but it will not return Sweden to a pre-deregulation situation. At the same time, a fully deregulated credit market is not desirable, as households themselves find it difficult to understand and manage the risks that arise from high indebtedness. Nor is a debt to income limit unique; it has many similarities with measures such as the mortgage loan-to-value ceiling and the amortisation requirement, which also restricts in various ways how much households can borrow. On the other hand, increased capital requirements above all augment banks' resilience to credit losses and usually have a minor impact on lending volumes. Consequently, measures are needed that have a more direct impact on households, which has been pointed out by the EU and the IMF, among others.

The Chair noted that there is agreement that the evolution of household indebtedness entails risks. Several measures have been taken; most recently the amortisation requirement, and it is important to analyse the impact carefully. This is a question we will have to revisit. The requirement has only been in place for one week, so it is not possible to draw clear conclusions about effects. As regards the housing market as a whole, there is now a proposal from the Government for a major initiative to increase construction and the result of the housing policy talks will be presented before the summer.

§ 2 Discussion on the need for analyses and further measures

Scenario exercises

The Secretariat of the Stability Council gave an update on the progress of implementing scenario exercises to practice crisis management. The authorities in the Stability Council share responsibility for financial crisis management. To maintain preparedness, coordination and exchange of information must be rehearsed regularly, and in that the new rules for bank recovery and resolution have come into force, it is also appropriate to rehearse various aspects of the new regulatory framework.

The scenario exercises are intended to:

- rehearse coordination and exchange of information between the Swedish authorities in crisis management
- identify any ambiguities in the bank recovery and resolution framework
- increase knowledge and understanding in the Swedish authorities for how, and on what terms, assessments are made and decisions made in the event of a crisis.

The participants include people from each authority who would be dealing with real crisis situations. Participation must to the best possible extent represent the ordinary decision-making procedures in the respective authorities.

The National Debt Office welcomed the exercises and considers that it is worth studying how other organisations conduct exercises.

The Riksbank pointed out that it is positive towards the planned scenario exercises. It is important that the authorities learn from the experiences of the exercises and develop the contents of the authorities' agreement on financial stability work (see next agenda item). The exercises are not time-critical but should be carried out at an appropriate pace.

Finansinspektionen stated that they fully support the scenario exercise work. It is especially important to rehearse the new Resolution Act.

The Chair shared the view of the authorities. It is important to rehearse interaction between the authorities in a crisis, not least when a new regulatory framework is in place.

Memorandum of Understanding (MoU) between the authorities in the Stability Council

The Secretariat of the Stability Council presented the work on a new MoU between the authorities on the Stability Council, which is to replace the MoU of 2009. The purpose of the MoU is to promote the authorities' cooperation to achieve effective crisis management. In the long term several underlying documents will be produced, which will be annexes to the agreement.

The Riksbank stated that it is important that the central payment system is mentioned in the agreement, as this is an important factor for the stability of the financial system. It is of importance to have a draft in August for the IMF visit, but it is not necessary for the authorities to have signed the MoU by then. Instead, it may be worth waiting so as to take into consideration experiences of the scenario exercises.

The National Debt Office welcomed the MoU and pointed out the importance of clarifying the need for coordinated action by the authorities in a crisis.

The Ministry of Finance underlined that the MoU must relate to current legislation, so it is not possible to formulate it too sharply. However, that can be managed in the subordinate documents that are to be linked to the MoU.

Finansinspektionen emphasised that the MoU is not legally binding, but that it is an important document. It would be better to formulate the document with a general text in which the authorities' joint responsibility for financial stability is stressed and thereafter formulate the respective authority's responsibility in line with the existing legislative texts.

The Chair pointed out that as regards the legal basis, there is legislation to fall back on. It is a good thing to clearly describe the joint responsibility in a crisis.

The Riksbank mentioned that the MoU should describe collaboration and information sharing both in a normal situation and when managing a crisis. Therefore, it is also important that the subordinate documents are prepared as far as possible before the MoU is signed.

The Ministry of Finance recommended an introduction with a clear statement of ambition, i.e. why the MoU exists and what applies.

The Chair expressed thanks for the comments. The MoU should be completed as soon as possible. It is a reasonable ambition to do this after the summer and at least as regards the general part it should not be necessary to await the scenario exercises.

MREL, Minimum Requirement for Eligible Liabilities

The National Debt Office presented its proposed model for how the minimum requirement for eligible liabilities (MREL) will be determined. The National Debt Office's authority to determine the MREL follows from the new resolution framework and the requirement is aimed at ensuring that the banks are resolvable, i.e. possible to be dealt with in a crisis without serious systemic shocks and without direct costs to the taxpayer. The framework for how the MREL is to be determined follows from legislation and EU rules. The National Debt Office's proposals describe how these rules will be applied:

- For the banks that may be expected to be subject to resolution, as a principal rule the MREL will be twice the current capital requirement, excluding the combined buffer requirement and systemic risk surcharge in pillar 2. For banks that can be managed through bankruptcy/liquidation the capital requirement times one is applicable.
- The part of the MREL that corresponds to the recapitalisation requirement may only be met by eligible liabilities.
- Special requirements will be imposed on groups for how eligible liabilities are localised within the group.
- A requirement will be introduced stipulating that only subordinated liabilities may be used to meet MREL criteria. The National Debt Office intends to present a proposal in the first quarter of 2017 on the form, scope and phasing-in. The Ministry of Finance is responsible for the question of legislative measures.

The consultation comments on the National Debt Office's proposal mainly concern questions of level, claim requirements and subordination.

The Chair expressed thanks for the information and underlined the importance of this work as a part of ensuring that the financial system is stable. High capital requirements form the first line of defence, but resolution is also an important part of the system. The fact that further demands linked to capital requirements are emerging in the form of MREL, requires intensified collaboration between the authorities concerned. In addition, an international process and negotiations in the EU must be addressed, which leads the discussion into the next item.

The view of the Government and authorities of the banks' resilience and resolvability

The Ministry of Finance presented information about a working group tasked with discussing the authorities' view of the banks' resilience and resolvability. One key point has been the November Accord of November 2011, in which the Ministry of Finance, Finansinspektionen and the Riksbank agreed on higher requirements on major Swedish banks.

The Accord was based, in brief, on four fundamental circumstances:

- The Swedish banking system was concentrated and the major Swedish banks had large exposures to each other.
- The Swedish banking system was large in relation to the Swedish economy and had extensive foreign operations.
- The major Swedish banks had substantial market funding in foreign currency.
- The lack of a framework enabling orderly management of banks in distress without central government economic support, which entailed market expectations of an implicit state guarantee ("too-big-to-fail").

It is almost five years since this Accord and there are several reasons to update the assessments on which it was based. A new framework for management of distressed banks has been introduced. The major banks' risk-weighted capital adequacy has also increased considerably since 2011. For this to correspond to increased resilience it is important that the risk weightings measure the banks' risks adequately. Measured as leverage ratio, the increase in capital adequacy has been lower. At global level, within the Basel Committee on Banking Supervision, a major overhaul of the capital adequacy regulations is in progress, which will later be implemented in the EU. In addition, regulation aimed at reducing liquidity risks has been introduced in the form of an LCR, but even with this regulation, the major dependence of the Swedish banking system on market funding in foreign currency remains.

There are differences in how the authorities have regarded these questions in the working group, but there is also consensus on a number of important questions.

The Government and authorities are agreed that the November Accord has served Sweden and financial stability well. Capital requirements should continue to be high in relation to the minimum levels agreed globally, in particular for the four major banks. The aim continues to be to ensure that the banks are stable, to prevent future crises and reduce the risks to the Swedish economy. Even if the introduction of the new resolution framework means more effective management of defaulting banks it can be noted that the economic costs to society associated with financial instability, for example in the form of a credit crunch, lower production and employment, may nevertheless be considerable.

A supplementary leverage ratio is to be introduced as of 2018 and the Government will negotiate the details in the EU.

As regards liquidity there are currently requirements for LCR in euro, dollars and overall. Swedish banks should have good liquidity buffers in relevant currencies even after the implementation of the European Commission's Delegated Act on LCR. A structural liquidity measure in the form of the NSFR is to be introduced as of 2018 and here too there will be negotiations.

The Council has already discussed resolvability and that it is important to impose appropriate requirements on eligible liabilities for the purpose of ensuring that the resolution framework can be applied as intended and without direct costs to the State if a systemically important bank were to become distressed. At the same time the priority continues to be ensuring that such problems do not occur.

The eligible liabilities that may be included in this requirement should be subordinate to an appropriate extent and in time such a requirement will be introduced. There will be further analysis and a discussion is ongoing in the EU.

The combined requirement, capital requirements and requirement for eligible liabilities should be formulated to enable an appropriate financing structure for both individual banks and for the financial system as a whole. To reduce any market stress, it is important to have the greatest possible predictability and transparency.

At the same time, both capital requirements and requirements for eligible liabilities should have an element of buffers, which means that the authorities gain a certain level of freedom of action.

<u>The Riksbank</u> stated that it is a good thing that Swedish authorities have a shared view on important questions and is positive towards a continuation of the work. Many people wish to point out that Swedish authorities have different views, but there is consensus in principle on many issues. One interesting observation is that internationally it is often maintained that strict requirements on banks only lead to

problems, but there are indications from Swedish experiences that the opposite is true.

Finansinspektionen pointed out that there are situations, above all in international contexts, where Sweden's official standpoints are in demand. Unlike many other countries, Swedish authorities sometimes adhere to different standpoints. Even though the authorities may make different assessments on issues, the premise should of course be that the responsible authority's decision and assessment is presented as Sweden's position.

The Riksbank agreed with Finansinspektionen, but given that the resilience of the financial system influences the probability of the Riksbank needing to provide liquidity assistance, there must be scope for the Riksbank to put forward its views. In its consultation response on the evaluation of monetary policy in 2010-15 by Goodfriend and King, the Riksbank proposes as a possibility that the Riksbank should regularly present its views to the Riksdag Committee on Finance. This is with a view to creating a clearer structure for how the Riksbank presents its views.

The Chair pointed out that it is important that the authorities hold to one line in international work, since that can make a greater impact.

§ 3 Evaluation of the way the Committee works

The Ministry of Finance reported on a future evaluation of the work of the Stability Council. Under the terms of reference for the Financial Stability Committee (ToR 2013:120) the Government must conduct an evaluation of the Committee by 2019 at the latest. In autumn 2016 the Ministry of Finance wishes to conduct a first, partial evaluation. This is not intended to replace the evaluation to be conducted by 2019.
The evaluation can be led by the preparatory group and coordinated from the Ministry of Finance. It is proposed to evaluate:

- The Committee's achievement of objectives mid-term.
- The role and function of the Secretariat.
- Records and minutes of meetings of the Financial Stability Council and preparatory group.

§ 4 Future work

Ahead of the next meeting of the Stability Council on 7 December 2016, the Committee will continue to work on the following questions:

- The MoU on cooperation, and subordinate documents
- Scenario exercises

- Continued work on matters concerning capital and crisis management

The work on the approved interim evaluation of the Committee's work and working methods will also be conducted.