



Financial Stability Committee
Fi 2013:09

Minutes from the meeting of the Financial Stability Council held on 10 June 2019

Summary

The Stability Council¹ discussed the stability situation.

The financial system operates well at present. At the same time, there are vulnerabilities and risks that may threaten financial stability in Sweden. The risks in the rest of the world are linked to trade conflicts, uncertainty concerning economic and financial effects of the United Kingdom's withdrawal from the EU (Brexit) as well as developments in the eurozone, for example as regards structural problems in the banking sector and weak public finances in several European countries. Globally and in Sweden interest rates have been low for a long period and they are now expected to remain low for some time. This development may also entail risks that are important to monitor.

Households' high level of indebtedness continues to be a major risk in the Swedish economy and the Stability Council therefore discussed the macroprudential measures taken to improve households' resilience. The regulations have led to new mortgage holders borrowing less, amortising more and buying cheaper housing, which is a positive development. In the same period, housing prices have stabilised, while turnover on the housing market is stable. It is important to retain the macroprudential measures that have been implemented.

¹ Present: *Ministry of Finance*: Per Bolund, Chair, Ulf Holm, Thomas Nielsen; *Finansinspektionen*: Erik Thedéen, Martin Noréus, Henrik Braconier; *The National Debt Office*: Jörgen Eklund, Mattias Persson, Pär Holmbäck; *The Riksbank*: Stefan Ingves, Kerstin af Jochnick, Olof Sandstedt; and *Financial Stability Council Secretariat*: Niclas Alsén.

As regards risks to the banks, the Stability Council in particular raised developments in the commercial property sector and that the banks need to hold more equity when lending to this sector in order to increase their resilience.

The Stability Council emphasised the importance of a continued focus on the inadequate protocols against money laundering at several banks in the Nordic-Baltic region, as they risk further damaging confidence in banks. Furthermore, the Stability Council discussed the significance of cyber security for the financial system. The authorities were agreed that more work needs to be done in the Stability Council on this matter.

Ahead of the next meeting of the Stability Council on 6 December 2019, the Council's members will continue to work together on the stability issues discussed at the meeting. This applies to work related to scenario exercises conducted in recent years, the resilience of the banking system, household indebtedness, stability issues linked to current EU matters, Brexit and cyber security.

§ 1 Stability assessment

The authorities (Finansinspektionen, the National Debt Office and the Riksbank) presented their stability assessments.

The financial system operates well at present, but there are risks. Somewhat dampened global economic and inflation prospects as well as central banks' communications have contributed to expectations of low interest rates for an even longer period, which may escalate risks in the long term. One experience of the 2008–2009 crisis is that low interest rates for a long period risks leading to a pursuit of yields that further depresses various risk premiums. This is a risk that needs to be monitored. At the same time, the trade war between the USA and China continues to create uncertainty around the outlook for world trade. Similarly, uncertainty linked to structural problems in the euro area remains, for example as regards Italian public finances and the profitability of the banking sector, geopolitical risks, Brexit and economic developments in China. In addition, the risk of cyber-attacks is one of the greatest threats to the international financial system and its participants.

Total lending in Sweden continues to increase rapidly and asset prices are high. However, slower growth in household debt has contributed to somewhat slower growth in aggregate debt than in recent years. Lending to non-financial companies and market funding is accelerating, however.

Finansinspektionen and the National Debt Office estimate that, on the whole, the resilience of Swedish banks is satisfactory, while the Riksbank is of the view that resilience needs to be improved, both regarding capital and liquidity. The authorities estimate that there are risks associated with lending to the commercial property sector, where companies have become increasingly interest-rate sensitive. The banks therefore need to hold more capital to cover the risks of that lending.

To be resolvable, the banks also need to have eligible subordinated liabilities. According to the National Debt Office, this requirement is to be met in 2022 and the authority views it as critical that the banks issue such securities. The authorities consider it important that the banks intensify their anti-money laundering efforts, as otherwise there is risk of further damage to confidence.

Since the previous meeting of the Stability Council, Finansinspektionen and the National Debt Office assess that the risks of household debt continue to be great but that they have been somewhat attenuated. The risks linked to banks' lending to commercial real estate companies have increased. The Riksbank considers that the risks of household indebtedness remain high and shares the other authorities' view of the risks of lending to commercial real estate companies. In order to decrease the risks of household indebtedness, more than Finansinspektionen's macroprudential measures have done, structural reforms are needed, of e.g. taxation and housing policy. Better access to data on households' assets and liabilities, as well as a central register of pledges for tenant-owned housing would also contribute to financial stability.

There is discussion in the media and elsewhere on the effects that Finansinspektionen's measures to counteract the high level of household debt have had. The authorities consider that the macroprudential measures implemented have had the intended effect without noticeably impairing the functioning of the housing market. It is therefore important to provide a correct impression of the situation in the debate. The proportion of new

mortgage holders with both high loan-to-value ratios and high debt-to-income ratios has decreased after the introduction of e.g. the amortisation requirements. Mortgage holders borrow less, amortise more and buy cheaper housing. In the same period, housing prices have stabilised, while turnover on the housing market is stable. Nor does Finansinspektionen's mortgage survey show any signs that young people have been squeezed out of the housing market as an effect of the amortisation requirements. On the contrary, the percentage of young people who are new mortgage holders is rising. There are considerable structural problems in the Swedish housing market but nevertheless, compared with most other EU countries, it is relatively easy for young people to enter the housing market. The authorities believe that it is very important to continue to uphold the macroprudential measures that have been introduced, and the importance of retaining the measures must be made clear in the debate.

The Riksbank presented its developed approach to stress testing banks' resilience to financial and economic turmoil. The Riksbank has stress tested the four largest banks in Sweden using the same macro-scenario as the European Banking Authority (EBA). The methods differ in several ways, one difference is that the Riksbank's stress tests identify risks in the banking system as a whole. The Riksbank's stress tests show considerably greater negative effects on the banks' capital relations compared with the EBA. The results illustrate that different choices of method and approach may give rise to great differences in outcome. The fact that choices of method and estimation period give rise to major differences between stress tests merits being raised and discussed both by authorities and banks. It also indicates a need to continue and deepen these types of comparison.

The Chair of the Stability Council shares the authorities' view of risk assessment and considers that the tone of the debate on macroprudential measures is heated. We see positive progress, in which debt growth is slower than before, while housing prices have stabilised. The picture given in the media is that the measures have had a very negative impact on the housing market, which is not correct. Housing construction continues to be high in a historic perspective. The Government has announced a review of taxation. If housing-related taxes are changed, assessments must be made of the effects of all measures in aggregate, including the introduced macroprudential measures.

§ 2 Discussion of analyses and potential measures

Cyber security

The Riksbank considers cyber risks to be a priority area and one of the greatest risks to the financial sector going forward. The Riksbank's work on cyber risk is conducted on two fronts; partly to strengthen its own resilience, partly from a broader perspective in which financial stability is central. The Riksbank conducts regular dialogue on cyber risk with other actors. Nationally the Riksbank chairs FSPOS (financial sector private-public cooperation group) and participates in FIDI-Finans (forum for sharing information between organisations in the financial sector) and internationally the Riksbank participates in various working groups within the BIS, the ESRB and the ECB. Work is in progress at the Riksbank to implement Threat Intelligence-Based Ethical Red-Teaming tests (TIBER tests) in Sweden. This is a framework created by the European Central Bank (ECB) to enable authorities to test resilience to cyber risk in systemically important financial infrastructure companies and banks in a standardised way.

Furthermore, the Riksbank proposes that the Stability Council takes a broad approach to the issue of cyber security in the financial sector. The work on cyber security takes place in several forums, in both national and international contexts where the authorities in the Stability Council collaborate with other authorities and also with private actors. Effective coordination is a key factor in sound cyber defence and as this work is done on many fronts there is a need to describe the current state of coordination on cyber security. It will then be possible to put forward proposals on how this coordination could be improved.

The National Debt Office welcomes continued cyber security efforts. It is important to develop a capacity to assess the extent of the threat to the financial system, as well as its resilience. Here the Stability Council must work further on the question of a framework for analysis of cyber risk. In addition, it is important to review the roles of the authorities and how the Stability Council works on cyber security. There should be cooperation with other authorities and the private sector should be involved in the work, where that is central. The National Debt Office also presented information on its review of the state payment model, which has an annual turnover of SEK 7,000 billion. To ensure that these payments can continue to be

effected in a secure and stable manner, the National Debt Office is now reviewing the model.

Finansinspektionen pointed out that there is a proposal on how responsibility for the payment system in times of crisis and war should be distributed. Finansinspektionen stated that it is important that the work of guaranteeing the functioning of the payment system in crisis and war is also conducted before the new division of responsibilities is in place. Cyber security issues may be added to that work. Finansinspektionen stressed that at present there is a clear legal basis and guidelines to enable Finansinspektionen to exercise financial supervision in the cyber area. There are currently clear rules on the banks' responsibility and Finansinspektionen is authorised to monitor it. Internationally there are various working groups and the EBA is continually developing guidelines. In Sweden new security protection legislation has been in force since April this year and Finansinspektionen's supervision and mandate to intervene has been extended. At the same time the analysis of cyber risk needs to be further developed.

The Chair of the Stability Council is positive towards future deepened collaboration on cyber security. As there are also expert agencies outside the Stability Council that are familiar with the matter it is important to expand cooperation with them.

Money laundering

The Chair of the Stability Council started by relating that the Government has presented a bill concerning supervision of and intervention against lawyers and law firms. In May the Government also made a proposal to the Council on legislation concerning the fifth Anti-Money Laundering Directive, which entails tightening existing anti-money laundering legislation. Much work is also being done at EU level and within the framework of the Financial Action Task Force (FATF). The European Commission has given Sweden a country-specific recommendation on ensuring effective supervision of the money laundering framework.

Finansinspektionen considers that it would be useful to review the money laundering regulations in the region. Discussions are also ongoing within EU institutions on how responsibility for monitoring money laundering should be organised in the EU, but it is not certain that centralisation of

responsibility is preferable. Sweden is now working with other Nordic and Baltic countries to prepare a cooperation agreement, which entails closer cooperation than is customary between EU countries. Finansinspektionen has employed more money laundering specialists and has requested funds to strengthen the authority's work on these issues. Finansinspektionen's survey of SEB and Swedbank is ongoing and will be completed in the autumn. That work is coordinated with the supervisory authorities in the Baltic region. A decision will be made in the autumn on whether to initiate sanctions.

The National Debt Office pointed out that the market has reacted strongly to the events that have emerged, which is reflected in share prices and interest rate spreads and is an example of how banking is fundamentally about confidence. One consequence of this is that consideration needs to be given to how resolvability is affected when confidence in an institution is damaged for other reasons than the exhaustion of capital due to credit losses. The Debt Office also notes that the events of this spring raise questions concerning the banks' ability to actively and transparently clarify the situation and restore as well as safeguard confidence.

The Riksbank also deems that inadequate procedures for money laundering in several Swedish banks have impacted confidence in the banking system in the Nordic and Baltic regions. It is important to act forcefully against money laundering, otherwise confidence in our banking system is at risk. To identify and rectify any shortcomings in national and regional anti-money laundering efforts, the involvement of the IMF would be beneficial for analytical support and recommendations, as an important complement to other ongoing evaluations.

The role of the State in the payments market

The Riksbank's starting point is that development of the payments market is a long-term and structural issue. What constitutes "money" when technology is rapidly changing? No-one was able to predict the rapid marginalisation of cash. The Riksbank has made a request to the Riksdag, which is now with the Committee on Finance, that a committee should be tasked with reviewing the concept of legal tender, the role of state means of payment in a digitalised economy and the respective roles and responsibilities of the State and the private sector in the payments market. The Riksbank is working internally on an e-krona project and has a pilot project aimed at preparing a means of payment issued by the Riksbank. The Riksbank will

shortly also be negotiating with the ECB on TIPS (Target Instant Payment Settlements), which is a system for immediate settlement of small payments around the clock and which could be implemented in Sweden in 2021.

Finansinspektionen and the National Debt Office hold the view that the changes taking place in the payments market may impact financial stability. A good example of this is how bank runs should be dealt with when it is extremely fast and easy to move money between different actors. It is therefore important that the consequences of these changes for stability are carefully investigated.

§ 3 International questions

The Ministry of Finance presented current EU negotiations.

As regards Brexit, the United Kingdom conducted the EU elections, and the outcome gave a slight majority to those who wish to remain in the EU. The Conservative Party (the Tories) is looking for a new party leader, and many in the party are against a no-deal Brexit. Regardless of the outcome, the EU Commission is prepared for a withdrawal, as are Swedish authorities and the companies that would be affected.

The year was marked by the EU parliamentary elections and the upcoming replacement of the European Commission. The Romanian Presidency focused on reaching a number of agreements before the election recess, as no new proposals were presented by the Commission. The outgoing Presidency has been successful and has concluded several negotiations. The incoming Finnish Presidency's focus will include cyber security, a theme we discussed earlier today.

In the negotiations on central counterparties (CCPs), discussions on recovery and resolution for CCPs were delayed but have now resumed after a long break. Of three legislative proposals to promote a sustainable financial market, two are in principle ready; disclosure requirements and a carbon dioxide index. The discussion on the definition of green activities is more complicated and has been prolonged. In the negotiations on a banking union, the joint deposit guarantee scheme continues to be a difficult issue and there are several deadlocks.

The National Debt Office highlighted the importance of implementing the updated EU rules on capital requirements and crisis management so as to ensure effective crisis management. It is essential that the flexibility provided by the updated rules is fully reflected in the Swedish legislation.

§ 4 Other stability issues

Scenario exercises

The Stability Council Secretariat reported on the financial crisis exercise carried out in January. The exercise took place in the framework of the Nordic-Baltic cooperation in the Nordic Baltic Stability Group, with more than 200 participants from eight different countries and several EU institutions. The purpose of the exercise included testing communication between authorities, decision-making processes in crisis management of banks and regional crisis preparedness. Three fictitious banks were dealt with during the exercise, and for Sweden the focus was on a major Swedish bank with subsidiaries in the Baltic region. The banks were exposed to liquidity problems at both subsidiary level and group level, default, solvency problems and upheaval in the financial markets that spread throughout the Nordic-Baltic region. The exercise was instructive and valuable to test both internal processes and coordination between authorities in the Nordic-Baltic region. The Swedish authorities in the Stability Council have identified a number of issues to work on to improve the crisis management processes.

The Chair of the Stability Council stressed that the exercise was successful and that there are several lessons to be gleaned in order to strengthen the work on crisis management.

Finansinspektionen agrees that it was a good exercise and that work is now needed to clarify the issue of liquidity support both before, during and after resolution.

The Swedish National Debt Office shares the view of Finansinspektionen. The exercise has also attracted strong international interest. A key area that needs to be addressed in more detail is the liquidity of banks in resolution. The National Debt Office notes that there are outstanding issues that need to be resolved, not least as regards the provision of liquidity by the Riksbank in the context of a resolution procedure. This lack of clarity risks seriously impairing the conditions for effective crisis management. There is also a

tension between the fact that the resolution strategy of the banking groups that are active in the Nordic area is '*single point of entry*', meaning that they should be handled together and based on the home country of the parent company, and that central bank liquidity is supplied without coordination to the subsidiary in the respective host country and thus not from the Riksbank. This issue needs to be further analysed in order to ensure the feasibility of the resolution strategy. The exchange of information in the Stability Council is of great importance. At the same time, it is crucial for efficiency and accountability to be particular in respecting the responsibilities and powers of the respective authorities. And that all the authorities contribute in the way intended by the legislator.

The Riksbank is also of the opinion that it was a good exercise. One lesson learned is the need to work further on the liquidity supply arrangements in resolution. Another important lesson is the need for coordination between authorities for the various decisions that need to be taken in connection with resolution. These lessons are dealt with by Swedish authorities under the direction of the Stability Council.

§ 5 Future work

Ahead of the next meeting of the Stability Council on 6 December 2019, the Council's members will continue to work together on the stability issues discussed at the meeting. This applies to work related to experiences from scenario exercises, the resilience of banks, household indebtedness, stability questions linked to current EU matters, Brexit and cyber security.