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## MEMORANDUM



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### New Capital Requirements for Swedish Banks

#### Summary

Finansinspektionen (FI or the authority) is introducing changes to the authority's application of Swedish banks' capital requirements due to the changes to the capital requirement regulations from the EU's so-called banking package. At the time that this memorandum was published, the Swedish legislative amendments had not yet been decided, but the proposals are presented in the bill *Ändringar i regelverket om kapitaltäckning* (Govt Bill 2020/21:36). For the final application, FI will need to consider the changes that might be made in the final proceedings leading up to the decision in parliament.

Several regulatory amendments will be introduced in the next few years, including the EU implementation of the Basel Accord, which will complete Basel III. Therefore, it may be necessary for FI to revisit the design of the capital requirements in light of these amendments.

This memorandum describes how the new capital requirements will be applied and replaces the implementation memorandum that FI issued in 2014.<sup>1</sup> In this final memorandum, FI has considered and responded to the responses in the consultation memorandum.

#### *Changes to the risk-based capital requirement*

As a whole, the banking package will require banks to simultaneously meet two parallel capital requirements in the form of risk-based requirements and leverage ratio requirements.

The risk-based capital requirement consists of four main components:

1. *Minimum requirement.* Unchanged at 8 per cent of the risk-weighted assets.
2. *Additional own funds requirement* (the Pillar 2 requirement). FI will be able to continue to decide on an additional own funds requirement under Pillar 2 for risks that a bank is, or may be, exposed to and which are not covered by the minimum requirement. A new aspect is that the

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<sup>1</sup> *Capital requirements for Swedish Banks*, FI Ref. 14-6258, September 2014, [https://www.fi.se/contentassets/f9a0e4c448c2457d90a05467f9caf6c9/kapital\\_eng.pdf](https://www.fi.se/contentassets/f9a0e4c448c2457d90a05467f9caf6c9/kapital_eng.pdf).

additional own funds requirement will always be determined by a formal decision for each bank.<sup>2</sup>

FI intends to continue to be transparent about its assessment of the risks the banks are exposed to and therefore will continue to publish the assessment methodologies used by the authority. However, FI is to some extent both updating and clarifying the current methodologies. The authority also intends to both remove the 2 per cent add-on for systemic risk in Pillar 2, since Pillar 2 requirements only cover institution-specific risks and may not be used to cover risks that a bank imposes on the financial system, and take into account other changes within the banking package that raise the capital requirements. FI is also removing the assessment methodology that is set out in *Pillar 2 capital requirements for maturity assumptions* (FI Ref. 16-2703), primarily to avoid making application more complex than necessary.

3. *Combined buffer requirement.* This consists in practice of several buffers: the buffer for other systemically important institutions (the O-SII buffer), the systemic risk buffer, the countercyclical buffer and the capital conservation buffer.<sup>3</sup> The calculation of the combined buffer requirement will be changed by law, so the O-SII buffer, in contrast to today, will be added to the systemic risk buffer.<sup>4</sup> The limitations on what risks may be managed in Pillar 2 will thus be balanced by greater possibilities for managing risks through the combined buffer requirement.

This memorandum clarifies that the O-SII buffer reflects how important the individual bank is for the system. FI takes the position that the O-SII buffer must be lowered from 2 per cent to 1 per cent at the group level for the three major banks. FI also takes the position that the systemic risk buffer must remain at 3 per cent at the group level for the three major banks.<sup>5</sup>

4. *Guidance in Pillar 2.* Through this guidance FI can inform a bank which capital level the authority expects the bank to hold over and above the other main components to cover risks and manage future financial stresses. FI will communicate a risk-based guidance to the bank if the authority considers the capital conservation buffer to be

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<sup>2</sup> The additional own funds requirement will not affect the level since the automatic restrictions on value transfers go into effect first after the requirement has been formally decided for the banks according to the new regulations. This occurs after the first supervisory review and evaluation process for the bank after the legislative amendment has entered into force.

<sup>3</sup> There is also a buffer for global systemically important institutions (G-SII), but this buffer is not described since Sweden currently does not have any institutions of this category.

<sup>4</sup> In simplified terms, the current regulations state that the higher of the systemic risk buffer and the O-SII buffer applies.

<sup>5</sup> Nordea Hypotek AB will also continue to have an O-SII buffer of 0 per cent. The bank is subject, however, to an O-SII buffer of 2 per cent that the Finnish supervisory authority assigns to Nordea Bank Abp at group level.

insufficient for covering the risks to which the individual bank is exposed.

The Pillar 2 guidance replaces the capital planning buffer, which FI applies today. Currently, FI makes the assessment that the level of Pillar 2 guidance for most banks is likely to amount to around 1–1.5 per cent of their risk-weighted assets. However, this figure could vary between banks and be significantly higher for some, usually smaller, more specialised banks. FI also takes the position that the guidance, like the current capital planning buffer, must be met with Common Equity Tier 1 capital, the capital FI assesses to be the most useful in the presence of a financial stress.

#### *Changes due to the leverage ratio requirement*

The banking package introduces a leverage ratio requirement that will function as a backstop for how low the capital requirement may be. The total leverage ratio requirement is based on equivalent main components that correspond to those for the risk-based capital requirement.

*The minimum leverage ratio requirement* is 3 per cent of the total exposure amount. In addition, FI may decide on an institution-specific additional leverage ratio requirement within Pillar 2. FI currently considers there to be only a few situations where such a requirement would be relevant. Most banks will therefore not be subject to an additional leverage ratio requirement. FI also is entitled to inform a bank of how much capital the authority intends for the bank to hold in addition to the other leverage ratio components to cover risks and manage financial stresses.<sup>6</sup> FI takes the position that this *leverage ratio guidance* must be met with Common Equity Tier 1 capital in order to maximise the ability to absorb losses. Currently, FI makes the assessment that the guidance for most banks will be around 0.2–0.5 per cent of the exposure amount for the leverage ratio. This figure could vary between banks.

For the major banks, in line with other capital requirements, FI intends to make public its expectations for the level of Pillar 2 guidance.

#### *Impact of the banking package*

The impact of the implementation of the banking package in Sweden will differ depending on the bank.<sup>7</sup> For the major banks that are already subject to extensive systemic risk requirements, the total risk-weighted capital

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<sup>6</sup> The leverage ratio buffer that is introduced in the Capital Requirements Regulation only applies to global systemically important institutions. As a result, no Swedish bank is currently subject to this buffer.

<sup>7</sup> The assumptions underlying the impact analysis include, for example, a risk-based Pillar 2 guidance of 1 per cent and a leverage ratio guidance of 0.35 per cent.

requirement is not expected to be significantly affected.<sup>8</sup> Medium-sized and smaller banks are expected to overall experience an increase in their capital requirement of approximately 5–10 per cent, but the effect will vary by bank. For some banks in Supervision Category 2, the capital requirement will be impacted largely by the leverage ratio requirement.<sup>9</sup> For banks in Supervision Categories 3 and 4, the increase is largely due to the introduction of the risk-based Pillar 2 guidance to the extent the banks have not already had a capital planning buffer imposed on them. These impact assessments do not take into account the fact that the banking package also contains some relaxation of the capital requirements.<sup>10</sup>

It should be noted in particular that the leverage ratio requirement has a large impact and, in many cases, makes it impossible to fully utilise the risk-based buffers without breaching the leverage ratio requirement's minimum requirement. The risk-based buffers, therefore, cannot be used to the same extent. For some banks that have low risk-weighted capital requirements, the leverage ratio requirement will be the most restrictive requirement.

FI makes the assessment that positions taken in this memorandum will not require the banks to change their business to any significant extent in order to adapt. For the few banks that currently have capital levels that are insufficient for the future capital requirement, FI makes the assessment that these banks will be able to reinforce their capital primarily through retained earnings instead of raising new funding.

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<sup>8</sup> The major banks are currently subject to systemic risk buffers of 5 per cent through a 2 per cent add-on for systemic risk in Pillar 2 and a 3 per cent add-on for systemic risk in Pillar 1. The proposed change entails that the major banks will be subject to a systemic risk buffer of 3 per cent in Pillar 1, an O-SII buffer of 1 per cent, and a Pillar 2 guidance that is estimated to be 1–1.5 per cent. The threshold at which the automatic restrictions on value transfers go into effect thus increases by 1 percentage point in addition to the increase resulting from the formal decision of the Pillar 2 requirements for each bank. For further information, see section 6.2.2.

<sup>9</sup> Medium-sized and smaller banks include banks in Supervision Categories 2, 3 and 4.

<sup>10</sup> For example through the introduction of expanded concessions on risk-weighted assets for exposures to small and medium-sized enterprises.

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# 1 Introduction and background

## 1.1 Purpose

The strengthening of the capital adequacy regulations in the aftermath of the financial crisis has led to banks in the EU generally being better capitalised than they were prior to the crisis. The EU's banking package concerning risk reduction measures (the banking package) aims to further reduce the risks within the EU banking sector by both strengthening banks' resilience to crises and ensuring that critical functions can be maintained in the event of a crisis.

The proposal was presented by the European Commission in 2016 and the banking package was adopted in the spring of 2019. The changes to the regulatory framework implement reforms that governments, central banks and supervisory authorities have agreed on at the international level within the Basel Committee on Banking Supervision (Basel Committee) and the Financial Stability Board (FSB) following the most recent financial crisis. In addenda, the European Commission has, on the basis of the action plan for creating a capital markets union, taken the initiative to introduce changes in order to, among other things, reduce the administrative burden and deal with the fact that member states are applying the regulatory framework in different ways. This means that there will be increased harmonisation within the EU in the application of the tools used by supervisory authorities to determine banks' capital requirements.

FI's application of the capital requirements is based primarily on the Special Supervision of Credit Institutions and Investment Firms Act (2014:968) (Special Supervision Act) and the Capital Buffers Act (2014:966). The implications of the banking package include that these acts and the Capital Requirements Regulation are being amended. Consequently, FI needs to review its application of the capital requirements.<sup>11</sup> Amendments to FI's regulations as a result of the banking package are not being covered in this memorandum, rather in FI's consultation memorandum *Förslag till regeländringar på grund av EU:s bankpaket*.<sup>12</sup>

The final legislative amendments are not yet decided, but a bill (Govt Bill 2020/21:36) has been submitted to Parliament. For the final application, FI will need to consider the changes that may take place in the final stages of the legislative process. FI may therefore subsequently amend this memorandum in order to ensure compliance with the regulatory requirements.

Any changes and measures related to disruption caused by the coronavirus will be dealt with separately if and when the need arises.

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<sup>11</sup> The amendments to the banking package concern several areas. However, this memorandum only covers the issues pertaining to capital.

<sup>12</sup> FI Ref. 20-4596.

## 1.2 Implementation and scope

The positions that FI describes in this memorandum are being implemented in various ways. The buffer requirements are being implemented via formal decisions sent directly to the banks, or through regulations. Pillar 2 requirements and Pillar 2 guidance are included in FI's supervisory review process. Pillar 2 requirements are also being implemented via formal decisions, while FI determines the level of the Pillar 2 guidance and informs the bank of this level.

The positions in the memorandum affect those firms that are subject to the Special Supervision Act and the Capital Buffers Act. In the memorandum, all of these firms are referred to as 'banks', even if other types of firm are included (see section 6.2.1).

Sweden does not currently have any global systemically important institutions (G-SII). Consequently, components of the capital requirements that affect G-SII are only covered in broad terms.

## 1.3 General description of the forthcoming regulatory framework

There are several ongoing initiatives to change the capital regulations that will affect banks' capital adequacy. In addition to the banking package, which is the background to the altered application that is described in this memorandum, two other important changes are the ongoing review of the regulatory framework for internal models and the completion of the Basel III agreement.

### 1.3.1 *The banking package*

Both the capital adequacy framework and the crisis management framework are affected by the banking package. Within capital adequacy, new rules are being introduced into the Capital Requirements Regulation<sup>13</sup>, including a leverage ratio requirement that is a binding minimum requirement and a net stable funding ratio (NSFR) requirement. In the Capital Requirements Directive<sup>14</sup>, the rules for the Pillar 2 requirement are being updated and guidance for additional own funds is being introduced in an addendum. In addition, the rules for the buffers are being amended. In the crisis management framework, the rules for resolution are being strengthened, including through more harmonised rules on the format of the requirements that guide how much

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<sup>13</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms is known as the Capital Requirements Regulation. The amendments in the banking package are being introduced through Regulation (EU) 2019/876 of the European Parliament and of the Council amending Regulation (EU) No 575/2013 and Regulation (EU) No 648/2012. This amending regulation has subsequently been amended slightly through Regulation (EU) 2020/873 of the European Parliament and of the Council as regards certain adjustments in response to the Covid-19 pandemic.

<sup>14</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms is known as the Capital Requirements Directive. The amendments in the banking package are being introduced through Directive (EU) 2019/878 amending Directive 2013/36/EU.



capital and liabilities a bank must hold in order for the state to be protected in the event of resolution.<sup>15</sup>

### ***1.3.2 Review of the internal models***

The European Banking Authority (EBA) has taken the initiative to make banks' capital requirements more comparable and to reduce undesirable variation. This is being done by updating and introducing several detailed provisions into implementation regulations and guidelines that apply to the internal models used by certain banks to calculate their risk-weighted assets.<sup>16</sup> These implementation regulations are, in the main, expected to be introduced over the course of 2021 and the subsequent couple of years. Banks are currently working to implement a range of substantial changes to their internal models. These changes require approval from FI before being introduced.

### ***1.3.3 Introduction of the Basel III agreement***

The first part of the Basel III agreement has entailed banks needing to hold more capital. In addition, this capital has to be of a higher quality, i.e. better able to absorb losses. This agreement was introduced in the EU in 2014.<sup>17</sup> The second part of the Basel III agreement was completed in December 2017 through an agreement to also strengthen, harmonise and make risk measurement of assets more comparable both between different calculation methodologies and between different jurisdictions. An important aspect of this agreement is the introduction of an output floor for banks that use internal models. The output floor limits the effect of internal models on risk-weighted assets. This second part of Basel III will be mainly introduced in 2023, with the output floor being phased in up to 2028.<sup>18</sup> Its application in Sweden is dependent on how and when these rules are introduced into EU law.

## **1.4 Constituent parts of the capital requirement**

The own funds requirements consists of several different parts that are presented briefly in this section. More details are provided in the other sections of the memorandum.

### ***1.4.1 The risk-weighted capital requirement***

#### ***1.4.1.1 Minimum requirement in Pillar 1***

The risk-based minimum capital requirement includes a capital requirement for credit risk, market risk and operational risk. This requirement amounts to 8 per cent of the firm's risk-weighted assets and is usually called the minimum requirement in Pillar 1.<sup>19</sup> The risk-weighted assets are calculated in accordance with detailed rules set out in the Capital Requirements Regulation.

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<sup>15</sup> Through requirements concerning own funds and eligible liabilities (MREL).

<sup>16</sup> For more information, please refer to <https://www.fi.se/contentassets/31f188fe797d4d2f8dd0c804f571e9bf/promemoria-irk-regelverk-eng.pdf>.

<sup>17</sup> Through the Capital Requirements Regulation and the Capital Requirements Directive.

<sup>18</sup> For more information, please refer to <https://www.bis.org/press/p200327.htm>.

<sup>19</sup> The Common Equity Tier 1 capital requirement is 4.5 per cent, the Tier 1 capital requirement is 6 per cent and the total capital requirement is 8 per cent. In other words, no less than three

#### 1.4.1.2 The additional own funds requirement in Pillar 2

Pillar 2 includes capital requirements based on supervisory authorities' supervision and evaluation of banks. The banking package makes it clear in which cases the supervisory authorities are entitled to decide on an institution-specific additional own funds requirement, i.e. a Pillar 2 requirement. The purpose of the Pillar 2 requirements is to, for example, cover material risks that are either not covered or only partially covered by the minimum requirement and certain other situations.

#### 1.4.1.3 The combined buffer requirement

The banking package retains the five buffers introduced in 2014:

- *The capital conservation buffer*, which amounts to 2.5 per cent of risk-weighted assets and applies to all firms.
- *The countercyclical capital buffer*, the level of which is determined at the national level by FI for credit exposures located in Sweden.<sup>20</sup> There are specific rules for reciprocation of credit exposures in other countries. As at the third quarter of 2020, the Swedish countercyclical buffer value amounted to 0 per cent of Swedish risk-weighted assets. Until 15 March 2020, the level was 2.5 per cent, but was reduced for preventive purposes in order to counteract reductions in the credit supply as a result of the spread of coronavirus and its impact on the wider economy.<sup>21</sup>
- *The capital buffer for global systemically important institutions (G-SII buffer) and the capital buffer for other systemically important institutions (O-SII buffer)*. Which banks are to be subject to these buffer requirements and the level of these requirements is determined primarily at the national level. As at the third quarter of 2020, Swedbank AB, Svenska Handelsbanken AB and Skandinaviska Enskilda Banken AB are subject at the group level to a requirement for an O-SII buffer of 2 per cent of risk-weighted assets.<sup>22</sup> Nordea Hypotek AB is subject to a buffer of 0 per cent.
- *The systemic risk buffer*. The level at which this buffer is to lie, which banks are affected and which exposures are included are determined at the national level. As at the third quarter of 2020, the systemically important institutions were subject at the group level to a systemic risk buffer of 3 per cent of risk-weighted assets.<sup>23</sup>

The sum total of a bank's capital conservation buffer, countercyclical buffer, systemic risk buffer and the higher of the buffers for global systemically

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quarters of the minimum requirement shall be met with Tier 1 capital, three quarters of which shall be met with Common Equity Tier 1 capital.

<sup>20</sup> Small and medium-sized investment firms are exempt from the requirement to maintain a countercyclical capital buffer in accordance with Chapter 9, Section 1 of FFFS 2014:12.

<sup>21</sup> For more information, please refer to <https://www.fi.se/en/published/news/2020/decision-by-fis-board-of-directors-the-countercyclical-buffer-rate-is-lowered-to-zero/>.

<sup>22</sup> Refer to section 4.3 for proposed application.

<sup>23</sup> Refer to section 4.4 for proposed application.

important institution and other systemically important institutions is known as *the combined buffer requirement*.

#### *1.4.1.4 The risk-based guidance in Pillar 2*

Within the scope of Pillar 2, FI is also able to inform the bank of how much capital the authorities expects it to hold in excess of the minimum requirement, the specific own funds requirement in Pillar 2 and the combined buffer requirement in order to cover risks to which the bank is exposed and to deal with future financial stress. In the Swedish translation of the directive, this is referred to as a ‘guideline’ but is called ‘guidance’ or Pillar 2 guidance’ in this document (as well as in the directive) in order to differentiate it from other forms of guideline such as those issued by the EBA. The guidance can also be referred to as ‘risk-based guidance’ in order to clearly differentiate it from leverage ratio guidance (see 1.4.2.3).

### **1.4.2 Leverage ratio requirement**

The banking package also includes provisions concerning a capital requirement based on leverage ratio. The purpose of this measure is to limit, i.e. constitute a backstop for, the lowest level of Tier 1 capital a bank has to hold.

#### *1.4.2.1 Minimum requirement in Pillar 1*

The minimum requirement for the leverage ratio is 3 per cent of the exposure amount for leverage.<sup>24</sup>

#### *1.4.2.2 The additional leverage ratio requirement in Pillar 2*

In a corresponding way to that set out in the risk-based provision, FI is able to decide on an additional leverage ratio requirement, which is called in law an ‘additional own funds requirement for the risk of excessive leverage’. Accordingly, this is a Pillar 2 requirement.

#### *1.4.2.3 Leverage ratio guidance in Pillar 2*

In a corresponding way to that included in the risk-based part of the capital requirements, FI is able to communicate to the bank a leverage ratio guidance within the scope of Pillar 2. When doing so, FI notifies the bank of how much additional own funds FI expects the bank to hold in order to cover risk and deal with future financial stress. In the Swedish translation of the directive, this is referred to as a ‘guideline’ but is called ‘guidance’ or ‘Pillar 2 guidance’ in this document. The guidance can also be called ‘leverage ratio guidance’ in order to clearly differentiate it from the risk-based guidance.

## **1.5 The overall capital requirement and its composition**

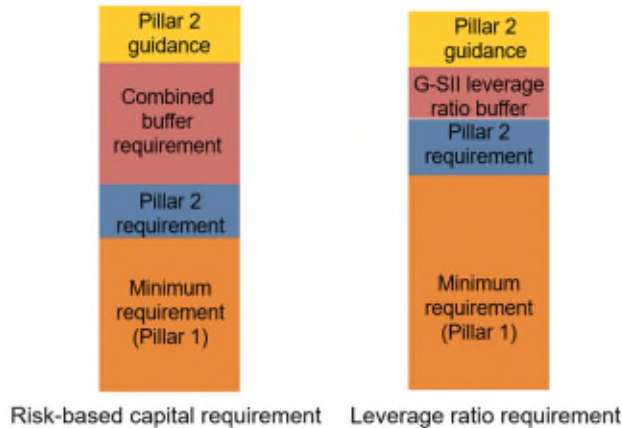
The introduction of the leverage ratio provisions mean that banks must comply with requirements under two parallel sets of provisions: the risk-based capital requirement and the leverage ratio requirement. Which of these requirements is

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<sup>24</sup> The Capital Requirements Regulation governs how the exposure amount for leverage is to be calculated. In exceptional circumstances, there is an exemption under Article 429a(7) of the Capital Requirements Regulation.

higher may vary between banks and over time. The various parts of the capital requirement are shown in Graph 1.1 below.<sup>25</sup>

Graph 1.1. The structure of the overall capital requirement



Source: FI

Note: The size of the various parts of the graph, and how the bars relate to one another are not to be seen as an indication of how the provisions will actually be implemented. Instead, the structure that will be implemented in Sweden is described in subsequent sections. Graph 4.1 shows all the buffers in the risk-based capital requirement. Subsequent parts contain a simplified description in which the Pillar 2 requirement is excluded in terms of leverage ratio because it is currently only expected to apply to a small number of banks. Correspondingly, buffers that only affect G-SII are also excluded.

## 1.6 Consequences in the event of breaches of the various components of the capital requirement

The term ‘capital requirement’ indicates that a firm is obliged, as a general rule, to have at least as much capital as stipulated under the requirement. It also follows that FI is able to and shall intervene if a firm does not have as much capital as stipulated under the requirement.

FI’s intervention possibilities increase the longer down in the capital requirement the bank is. In other words, the potential to intervene is affected by the degree to which the bank is in breach of the requirement. FI determines what measures will be put in place on the basis of which parts of the capital requirements the bank is in breach of and the circumstances in general. The regulatory framework also gives FI the possibility to refrain from intervening under certain circumstances. This means that the bank is able to operate despite the fact that it is not complying with the capital requirements for a period of time. However, the bank must – under in-depth supervision from FI – take adequate action to rectify the situation. FI also has the possibility to reconsider the level of the capital requirements to some extent.

Falling below certain parts of the capital requirements results in certain restrictions that are specified by the regulatory framework. A bank receives

<sup>25</sup> The internal relationship between the different parts of the capital requirement are clearly set out in the draft statutes. Refer, for example, to Chapter 8, Section 7 of the Capital Buffers Act and Chapter 2, Section 1d of the Special Supervision Act.

automatic restrictions on certain value transfers if it does not have sufficient capital to comply with the combined buffer requirement. There may be limitations placed on dividends and on coupon payments on Tier 1 capital instruments. In addition, the bank must submit a capital conservation plan to FI that describes how the capital is to be reinstated.

FI also has the opportunity to take action if the bank is failing to hold sufficient own funds to comply with the guidance FI has notified the bank of. For example, FI can conduct an intensified follow-up of the bank as part of its supervision or decide on a Pillar 2 requirement. Described in simple terms, FI is therefore able to entirely or partly replace the guidance with a specific own funds requirement. In turn, this can lead to failure to comply with the combined buffer requirement, at which point the bank receives automatic restrictions. In this way, breaches of the guidance have no automatic consequences, at the same time as FI has the possibility to intervene and require action on the part of the bank when this is justified on the basis of the current situation.

If a bank breaches the minimum requirement or Pillar 2 requirement, the regulatory framework requires action on the part of FI. However, the authority has to conduct an assessment of the cause of the regulatory infringement and of the feasibility of the bank's recovery. If the bank is able to recover, FI can give it time to implement appropriate measures to make it compliant with the requirement once again.

If FI's analysis shows that the bank's problems are, or are likely to become, very sizeable and the prospect of recovery is small, FI must adopt a position on whether the bank meets the criteria for likely failure. If this is the case, the authority is obliged to determine that the bank is failing and hand over the bank to the Swedish National Debt Office, which decides whether resolutions is to be initiated.<sup>26</sup> If the bank is placed in resolution, the National Debt Office takes over control and ensures that the business continues to be run or that it is wound up in an organised manner. If the National Debt Office decides that the bank will not be placed in resolution, which primarily reflects the fact that it has not been deemed systemically important, it may instead be pertinent for FI to withdraw the bank's authorisation and place the bank in liquidation. The bank will then be wound up. If this is the case, depositors' funds are protected under the rules of the deposit insurance scheme.<sup>27</sup>

The regulatory framework specifies that FI's analysis shall be forward looking. Accordingly, FI is able to make the assessment that a bank has failed or is likely to fail even though the measured capital exceeds the minimum requirement. However, for the same reason, FI is able to make the assessment that a bank which is in breach of the minimum requirement has not failed if, following recovery measures, there are reasonable chances of it complying

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<sup>26</sup> The Swedish National Debt Office is the Swedish resolution authority. For more information, please refer to <https://www.riksdagen.se/en/>.

<sup>27</sup> For more information about the deposit insurance scheme, please refer to <https://www.riksdagen.se/en/our-operations/deposit-insurance/>.

with current requirements within a reasonable time. The point of failure may therefore be both above and below the minimum requirement.

## 1.7 Overarching legal basis

### 1.7.1 *The banking package and its implementation in Sweden*

The Capital adequacy rules are established at the EU level via a directly applicable regulation (Capital Requirements Regulation) and a directive (Capital Requirements Directive). The Capital Requirements Regulation stipulates rules for the lowest requirements that a bank must comply with. The Capital Requirements Directive contains provisions concerning competent authorities' right to supervise the banks, including regular evaluations. It also contains provisions concerning the Pillar 2 requirements, Pillar 2 guidance and the capital buffers. In addition, the directive sets out the main elements of the rules that apply to sanctions in the event that banks breach the rules.

The Capital Requirements Regulation is directly applicable in Sweden.<sup>28</sup> However, the amendments to the Capital Requirements Directive need to be implemented into Swedish law in order to make them applicable.

Parliament has not yet decided which legislative changes are to be made in order to implement the banking package. The Government submitted a bill concerning amendments to the regulatory framework for capital adequacy to Parliament on 14 October 2020.<sup>29</sup> This bill is based on an inquiry into legislative changes for the implementation of the EU banking package on risk reduction measures.<sup>30</sup> The references to sections of law in this memorandum are based on how the legal text is presented in the bill.

It is primarily the Special Supervision Act and the Capital Buffers Act that need to be amended as a result of the Capital Requirements Directive.<sup>31</sup> In turn, these acts authorise the Government or the authority the Government appoints – in practice FI – to issue regulations. As a consequence of this, and of amendments to the Capital Requirements Regulation, amendments to related ordinances are also expected, for example the Special Supervision and Capital Buffers Ordinance (2014:993) and FI's regulations.<sup>32</sup>

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<sup>28</sup> Nonetheless, the Capital Requirements Regulation presupposes that Sweden implements certain national measures such as appointing a competent authority.

<sup>29</sup> For more information, please refer to <https://www.regeringen.se/4a9d2e/contentassets/52af8f5d323548d19bb8fe84eff2dc28/andring-ar-i-regelverket-om-kapitaltackning-prop.-20202136.pdf>.

<sup>30</sup> For more information, please refer to <https://www.regeringen.se/rattsliga-dokument/statens-offentliga-utredningar/2019/12/sou-201960/>.

<sup>31</sup> This memorandum has been written on the basis that the legislation that is presumed to be applicable is that which ensues from the proposal in the bill (Govt Bill 2020/21:36). Consequently, the references to legislation do not differentiate between currently applicable law and that which is proposed.

<sup>32</sup> Please refer to the consultation memorandum *Förslag till regeländringar på grund av EU:s bankpaket*, FI Ref. 20-4596.

The Special Supervision Act states that FI is the competent authority. FI's positions in this memorandum are to be viewed in light of this.

Through the Capital Requirements Directive and the Capital Requirements Regulation, the EBA has been given the authority to draw up proposals for binding implementing regulations that have to be adopted by the European Commission before they enter into force. In addition, the EBA, and in some cases the European Systemic Risk Board (ESRB), has the possibility to issue guidelines and recommendations. Application in Sweden may be affected if some of these documents are updated, or if new ones are added, as a consequence of the banking package.

### **1.7.2 Time of implementation**

The bulk of the amendments to the Capital Requirements Regulation will be applied from 28 June 2021.<sup>33</sup>

Under the Capital Requirements Directive, member states shall have implemented the amendments to the directive so that they start being applied under national law from 29 December 2020. It is only possible for the vast majority of the positions in this memorandum to start being applied once the amendments to Swedish law enter into force. This is described in more detail in section 5.

## **1.8 Comments received**

A total of ten bodies have submitted responses to the consultation. FI has considered all of the consultation responses, even those that are not described here in the memorandum. *The Swedish Competition Authority* has no comments on the content of the consultation memorandum or proposals. *The Swedish Investment Fund Association* has no comments on the proposals in the memorandum.

*The Riksbank* supports FI's proposals in all material respects. In certain cases, the Riksbank is of the opinion that, when the problems due to the Covid-19 pandemic wear off, FI should start applying the capital requirements more strictly. Consequently, they make three comments that are addressed in various parts of this section.

*The Swedish National Debt Office* is positive towards FI's proposals concerning new capital requirements for Swedish Banks and supports the positions taken by FI. In this context, the National Debt Office highlights some consequences that the format and application of the capital requirements has on the MREL requirement and on effective crisis management of institutions in resolution. The National Debt Office states that the changes pursuant to the banking package risk creating worse conditions for ensuring the need of sufficient resources for resolution purposes, both through their impact on the

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<sup>33</sup> In addition to the original introduction, some concessions have been brought forward as support measures as a consequence of the coronavirus pandemic. For more information about support measures, please refer to <https://data.consilium.europa.eu/doc/document/PE-18-2020-INIT/en/pdf>.

capital requirements and directly through the MREL requirements. The National Debt Office is of the opinion that these are aspects that FI should, in dialogue with the National Debt Office, take into account in the overall assessment of how the capital requirements are structured and also in the authority's view of how capital requirement breaches should be dealt with.

Other comments are addressed in the relevant section. To the extent that comments relate to further clarification, this has been dealt with directly in the text where possible.

## **2 FI's comprehensive view of the application of capital requirements**

One objective of FI's work is for the resilience of the financial system to be satisfactory. This means that it shall be possible for the financial system to perform its basic functions even in the event of major shocks such as financial crises without substantial cost to taxpayers. Banking operations have specific characteristics that justify specific regulations and, in some cases, state intervention in the event that the regulations are not complied with.

Individual banks have a need for capital as a result of the various risks there are in their operations, for example the risk of not recovering the money they have lent out. Substantial risks can be mitigated to a certain extent by good risk management but capital is required in order to ensure protection against unexpected losses. When banks run into problems or, in the worst case, fail and are unable to maintain the services they provide to the economy, the costs can be very substantial. Consequently, there is also a substantial public interest in ensuring that these banks have adequate capital; an interest that the banks themselves cannot be expected to take into account.<sup>34</sup> The supervision of banks is therefore based on assessing individual risks and the level of capital that the supervisory authorities assess covers these risks adequately and on an assessment of the level of capital required in order to manage the systemic risk created by bank operations. The capital requirements increase the resilience of banks. This reduces the risk of financial crises occurring, at the same time as it improves the conditions for dealing with shocks that do still occur.

The role banks play in the economy means that banks which are important to the system are not allowed to become insolvent in the same way as other firms. Therefore, as a complement to the capital requirements, and as an additional adaptation to what has been learned from the financial crisis, a specific procedure has been introduced for managing crises in systemically important banks without disrupting critical functions. This procedure is called resolution. In combination with capital requirements, the regulatory framework for

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<sup>34</sup> For a more comprehensive description of these risks and information about FI's work with financial stability, please refer to <https://www.fi.se/contentassets/be52777b45194e2892a243793817b7ff/fi-och-finansiell-stabilitet-20191219.pdf>.



resolution means that banks' owners and lenders have to carry the cost of any losses caused by a crisis. This strengthens banks' motivation to keep their risk-taking at a level that is appropriate from the perspective of the wider economy.

Banks that are at risk of failing and are not deemed to be systemically important can be declared bankrupt. Depositors are then protected by the deposit insurance scheme. Capital requirements also play a central role for these banks, including by protecting creditors other than depositors. Capital requirements also keep down the costs of the deposit insurance scheme in the event that a non-systemically important bank were to fail.

## 2.1 FI's principles for this memorandum

The banking package means that FI needs to adopt a position on a large number of different matters that, in combination, may have an impact on the total capital requirements and how well they function. Consequently, FI has used a number of principles as a starting point when conducting the analysis of the positions reported in this memorandum. These principles can, when looked at in isolation, point in different directions, which demonstrates the need to weigh up different aspects against one another in order to strike a good balance between different considerations.

The principles are as follows:

- **The capital requirements should be structured so that banks' capital consists to a large degree of capital that banks are able to use to cover losses.** In other words, the capital requirements should consist of a large portion of Common Equity Tier 1 capital that can be used in the event of financial stress without the bank failing or being forced to make adaptations to its operations that are so great the economy is damaged. Usable capital creates room for manoeuvre in the form of time and better possibilities for the bank and the authorities to implement recovery measures and thus avoid resolution or liquidation.
- **The structure and composition of the capital requirements shall contribute to resilience on the basis of the risk taken by the bank and to which the bank exposes the Swedish financial system.** This means that banks which take more risk should hold more capital in order to allow them to deal with losses that may be the result of greater risk-taking. To achieve sufficient resilience, the capital requirements has to be higher for banks that are important to the financial system and for banks that expose the financial system to risks.<sup>35</sup> In turn, this means that risks specific to the Swedish economy and the Swedish financial system need to be dealt with.
- **For the banking system as a whole, the level of the capital requirements should not be altered as a consequence of the banking package.**<sup>36</sup>

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<sup>35</sup> This does not exclude the possibility that firms may need to cover other risks, for example those that are created by the system.

<sup>36</sup> However, there are certain changes that apply pursuant to legislation such as the introductions of the leverage ratio requirement.

Introduction of the banking package does not in itself entail any change to the banks' underlying risk.<sup>37</sup> However, the level can be altered on the basis of legislative changes and because FI needs to ensure sufficient buffer functionality. FI would also like to avoid temporary falls in the capital requirements if a possible result of forthcoming changes to the regulatory framework are taken into account.

FI has also taken the following aspects into account when drawing up the positions in this memorandum.

- **Application of the capital requirements shall endeavour to make them simple and predictable.** Accordingly, FI has to be **transparent** with respect to the capital requirements. Clarity concerning the banks' capital requirements and how banks are living up to them reduces uncertainty among the banks' stakeholders, especially their financiers, and thus contributes to financial stability. Simplicity also improves the potential to deal with future changes to the regulatory framework. The regulatory framework is itself complex, which is why FI's positions should aim to not increase this complexity even more than is necessary.
- **Any divergences in the structure of the Swedish capital requirements compared with the capital requirements applied in the rest of the EU need to be justified.** An explicit objective of the banking package is to increase harmonisation in terms of how the capital requirement is applied within the EU. In addition, the Swedish banks, especially the major banks, operate in the EU internal market. They compete there for both financing and customers with other banks from primarily other EU and EEA countries. Consequently, there is a cost associated with unjustified divergences from how the requirements are generally applied in these countries.
- The capital requirements should be structured such that they **function for various types of bank** that are subject to them. The Swedish banking system is dominated by three systemically important Swedish banks and two foreign banks that operate in Sweden<sup>38</sup>, but the system as a whole consists of a significantly larger number of banks with various business models and of varying sizes.

## 2.2 FI's view of usable capital

FI is of the opinion that it is essential for both the individual banks and for financial stability that banks have sufficient usable capital to allow them to deal with financial stress. Usable capital is capital that enables the banks to absorb

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<sup>37</sup> Nevertheless, should any regulatory change lead by extension to a higher underlying level of risk, this is something that needs to be dealt with.

<sup>38</sup> Danske Bank and Nordea both operate in Sweden through branches and subsidiaries. Nordea Hypotek AB is designated as an other systemically important institution in Sweden. FI determines the capital requirements for the Swedish subsidiaries. The Swedish branches of Danske Bank and Nordea are designated significant-plus branches. Branches are not subject to own capital requirements. However, the bank to which the branch belongs is subject to the capital requirements determined by the competent authority in its home country.

losses without failing, at the same time as it provides motivation not to reduce lending. In this way, the bank is able to meet its commitments and continue operating, including continuing to lend to creditworthy customers, and thus also to support an economic recovery. A sufficiently large amount of usable capital also gives FI and the bank time to evaluate the situation and act accordingly. At the same time, it gives the bank better opportunities and more time to take action to restore its capital to an appropriate level and thus avoid default and resolution.<sup>39</sup>

Usable capital is important to all banks, irrespective of differences in terms of, for example, business model or size. What is adequate in an individual case is primarily dependent on the risks being taken and created by the bank and its potential to manage these. FI believes it is important that banks which are systemically important, either directly or because they expose the financial system to risks, have more usable capital in order to make them better equipped to deal with any problems.

One prerequisite for ensuring capital is able to act as a buffer under financial stress is that the requirements, including the guidance, are complied with under normal circumstances. This means that all parts, including the guidance, should be part of banks' capital planning. Consequently, FI also has the right, as described in section 1.6, to intervene in the event of non-compliance with the capital requirements. Another prerequisite for ensuring capital is able to act as a buffer is that banks are able to temporarily fall below the capital requirements during financial stress. FI has a right to permit banks to temporarily fall below various parts of the capital requirement, which is set out in the regulatory framework. However, the banks must implement adequate measures to deal with the situation and FI must deem these measures sufficient to rectify the situation. In line with this, all parts, including the guidance, should be taken into account in the recovery planning.

Aside from temporarily allowing a bank to fall below the requirements, FI is able to remove or reduce certain parts of the capital requirements, either generally or for individual banks. For example, this may be pertinent if risks that have been included in the assessment of the various parts of the capital requirement have already materialised and if FI wants to encourage a certain behaviour or suppress the economic impact of shocks. In the same way as systemic risk may vary over time, the capital requirements for systemic risk can also be changed before, during and after a systemic crisis. One reason is that, historically, the bank's behaviour has often shown itself to be procyclical, i.e. it lends a lot in good times and limit its lending when times are worse. By removing a capital requirement, FI is able to give the bank expanded room for manoeuvre because this increases the probability that the bank complies with

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<sup>39</sup> If a firm were to meet the criteria for default, this is associated with a costly and complicated process, regardless of whether or not the firm is being managed in resolution. The regulatory framework for resolution is a complement to the capital adequacy framework in the event that a firm defaults and its aim is to at least reduce the total cost for firms that are being managed via resolution.

the requirement. For example, FI is able to remove or reduce the countercyclical buffer in order to stimulate continued lending in a situation where the banks would otherwise reduce its lending in order to avoid breaching the capital requirements. Consequently, the level of the capital requirement, in terms of the buffers, Pillar 2 requirements and the guidance, needs to be evaluated in the specific situation.

Capital is itself usable, but the potential for the bank to fall below the capital requirements without FI making the assessment that the bank has failed or is likely to do so declines the further down the various parts of the capital requirement the bank is. FI's actions therefore also depend, in line with the regulatory framework (see section 1.6), on which requirement it is the firm is not complying with. For example, if the guidance is not being met, or it is likely that it will not be met, FI expects to be informed of this by the bank and expects the bank to explain the cause and make it clear how it intends to rectify its capital position, including the guidance. FI is therefore of the opinion that it is not just the overall size of the total requirement that is important, but also its composition.

How FI acts when a bank is not complying with the requirements also depends to a large extent to the situation, primarily the cause of the financial stress and how feasible it is that the bank will recover.<sup>40</sup> FI's actions are therefore dependent on the authority's appraisal of the forthcoming sequence of events and the credibility of the bank's recovery measures. For example, large credit losses in a bank with an unprofitable business model and weak owners will have different consequences to losses of the same size in another bank that is otherwise profitable and has owners that are willing and able to provide new capital. FI's actions are important from the perspective of resolution as they influence when the firm is handed over to the National Debt Office and when it is thus able to have an impact on the conditions for resolution. In this context, FI notes that the response to the consultation from the National Debt Office points out the importance of a close dialogue between FI and the National Debt Office on these matters. FI shares this view.

The rules that govern FI's actions during financial stress provide FI with room for manoeuvre. The authority is of the opinion that this room for manoeuvre is of value, especially in situations that are difficult to predict. Accordingly, there are both legal and practical reasons for not applying the capital requirements in a mechanical way during financial stress.

### **2.3 FI's view of risk-based requirements for institution-specific risk**

The risk of banks' exposures can be calculated in various ways. In rough terms, various regulatory methodologies can be arranged on a scale where internal models are the most detailed and risk-sensitive method, while at the other

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<sup>40</sup> A firm's lack of compliance with the capital requirements may be due to losses, which may in turn have institution-specific or systemic causes. However, there may also be other circumstances underlying a worsened capital position, for example difficulties refinancing own funds instruments or changes in the size of the risk-weighted assets.

extreme can be found the leverage ratio requirement, which in no way takes into account differences in risk between different assets. In between are the standardised approach, which specifies set levels of risk for various groups of assets but does not take into account differences between different exposures within the same group of assets or differences in different banks' risk management.

FI is of the opinion that banks' risk management, risk measurement and capital assessment should be based on all available relevant information. There is great value in banks being incentivised to have sound risk management and to continually improve their management, measurement and pricing of risks, which is the basic idea behind the framework for internal models. However, for the regulation and supervision of banks, there is an important consideration to be made. This is because internal models provide, in some cases, an outcome that is not necessarily the most accurate. This can be due, for example, to the model being based on historical data that does not take sufficient account of future outcomes or that banks may be incentivised to influence the outcome of the models in order to reduce the capital requirements rather than measuring the risk in the best way. By extension, this can result in the capital requirements not completely covering the risk. In view of this, FI has in some cases introduced limitations within the scope of Pillar 2, including in the form of risk weight floors that limit how low the aggregate outcomes of the internal models may be.<sup>41</sup>

The ongoing review of the internal models (see 1.3.2) aims to make the capital requirements more comparable and to reduce undesirable variation and may, depending on how it is introduced in regulation and supervision, result in a reduced need for corresponding Pillar 2 requirements. The forthcoming output floor (see section 1.3.3) is also intended to limit the effect of internal models on the risk-weighted assets.

#### **2.4 FI's long-range view of capital requirements taking into account the positions in this memorandum**

FI has previously communicated the basic premise that the capital requirements are not to be increased mechanically as a result of changes to the regulatory framework, at the same time as it is not possible to exclude the possibility that the effect of the capital requirement may still, in some cases, be an increase due to the need to ensure there is adequate usable capital.<sup>42</sup> FI is still of the opinion that a large buffer function element in banks' capital requirements is important for maintaining financial stability. When the minimum capital requirements increase as a result of the changes to the regulatory framework, this may therefore mean that the total capital requirements may also need to increase in order for the usable capital to remain adequate.

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<sup>41</sup> The floor results in a capital add-on within the scope of Pillar 2.

<sup>42</sup> 'Changes to the regulatory framework' means here the banking package, the introduction of Basel III in the EU and the review of internal models.

When capital is utilised, it is primarily the combined loss-bearing capacity measured in Swedish kronor that is relevant, not how the capacity is expressed in relation to the risk-weighted exposures. This means that the percentage risk-based capital requirements can be allowed to fall in the long term if the risk-weighted assets increase as a result of changes to the regulatory framework.

The fact that further changes to the regulatory framework will be implemented in the years ahead means that there may need to be future adjustments to how the capital requirements are applied on the basis of how these forthcoming changes are introduced. The description in this memorandum of how FI applied the capital rules is based solely on the format of the regulatory framework once the banking package has been introduced in Sweden.

### **3 The supervisory capital assessment in Pillar 2**

#### **3.1 Introduction and background**

##### ***3.1.1 Introduction***

FI's positions on a number of questions concerning the implementation of the rules that govern the authority's overall assessment of individual banks' risks and capital needs.

##### ***3.1.2 General information about Pillar 2***

Pillar 2 is the collective term for the rules that govern banks' internal capital adequacy assessments and FI's supervisory review and evaluation processes.<sup>43</sup>

Banks that are subject to the capital adequacy rules have to conduct what is known as an internal capital adequacy assessment process and regularly revise this in order to keep it up to date. Under the new rules that apply pursuant to the banking package, the bank, as part of this ongoing assessment process, has to establish an internally assessed own funds need that involves the size of the own funds being satisfactory in relation to both the risk-based requirement and the leverage ratio requirement.<sup>44</sup> The own funds shall be of a sufficient size to cover the risk to which the bank is or might be exposed. It shall be possible for the own funds to absorb potential losses as a result of stress. In this way, the bank shall ensure that the combined risks do not jeopardise its ability to fulfil its obligations.

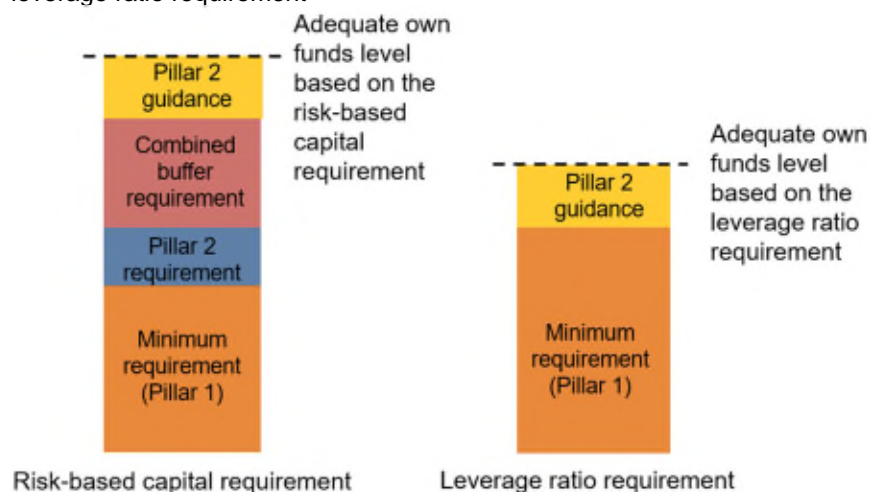
Within the scope of Pillar 2, FI shall, as part of the supervisory review it conducts, conduct an assessment of what is an adequate level of total own funds for the bank. Because there are two parallel requirements, in the form of the risk-based requirement and the leverage ratio requirement, FI will conduct an assessment of an adequate level of own funds on the basis of both the risk-based requirement and the leverage ratio requirement.

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<sup>43</sup> Pillar 2 is not used as a formal term in the EU regulatory framework. It is a term that has been introduced and used by the Basel Committee.

<sup>44</sup> Banking and Financing Business Act (2004:297), Chapter 6, Section 2.

Graph 3.1. Adequate level of total own funds based on the risk-based requirement and the leverage ratio requirement



Source: FI

Note: The image is a simplification. The adequate level of total own funds corresponds to the total capital requirements. The size of the various parts of the graph, and the bars relationship to one another are not to be seen as an indication of how the provisions will actually be implemented.

FI determines on the basis of its assessment how much capital the bank needs to hold in excess of the capital that is required to cover the minimum requirements and the buffer requirements in Pillar 1 on the basis of both the risk-based requirement and the leverage ratio requirement. This will take place in part through additional own funds requirements and leverage ratio requirements in Pillar 2, and in part through Pillar 2 guidance.

FI shall decide on an additional own funds requirement or leverage ratio requirement if FI establishes that certain conditions set out in law are fulfilled. This is known as a Pillar 2 requirement and a decision concerning such a requirement will therefore be made on the basis of a supervisory review and evaluation.<sup>45</sup>

Based on the supervisory review and evaluation, FI is also able to communicate to the bank a risk-based guidance or a leverage ratio guidance. This involves FI notifying the bank of how much capital the authority believes the banks needs to hold in excess of the minimum requirements, Pillar 2 requirements and the buffer requirements. Accordingly, the Pillar 2 guidance constitutes the difference between the total own funds level that FI believes is appropriate and the relevant minimum requirements, specific own funds requirements and buffer requirements in Pillar 1.

<sup>45</sup> Under the Special Supervision Act, FI may refrain from deciding on a Pillar 2 requirement if the breach is negligible or excusable, if the firm rectifies the matter or if any other authority has taken action against the firm and this action is deemed sufficient.

### **3.1.3 Scope of the regulatory framework**

The rules apply to all firms that are subject to the Special Supervision Act and the Capital Buffers Act. They apply at both the solo level and the group level.<sup>46</sup>

The positions presented in this section regarding individual banks therefore also apply at a consolidated level for the relevant groups of firms, unless stated otherwise.

## **3.2 Legal basis**

The provisions concerning Pillar 2 are regulated mainly through Chapter 6, Sections 1–2, 3, 4a, 4b and 5 of the Banking and Financing Business Act (2004:297), Chapter 8, Sections 3–4 and 5–8 of the Securities Market Act (2007:528), Chapter 2 of the Special Supervision Act and certain provisions of the Special Supervision and Capital Buffers Ordinance (2014:993).

### **3.2.1 The additional own funds requirement and the additional leverage ratio requirement in Pillar 2**

Under Chapter 2, Section 1 of the Special Supervision Act, FI shall, under certain circumstances, decide that a bank, in addition to the own funds that are required under the Special Supervision Act, also comply with a specific own funds requirement for the risk of excessive leverage and a specific own funds requirement for other risks. This decision shall be in writing and shall be made on the basis of a supervisory review and evaluation of the bank in accordance with Articles 97 and 101 of the Capital Requirements Directive.

FI shall decide on a Pillar 2 requirement if this is necessary in order to cover risk to which the bank is or might be exposed. This paragraph states that FI shall also decide on such a requirement if

- any of the requirements under Chapter 6, Sections 1–3, 4a, 4b and 5 of the Banking and Financing Business Act concerning, inter alia, solvency, liquidity, risk management and transparency, or corresponding provisions of the Securities Market Act are not fulfilled, and
- it is unlikely that any other measure is sufficient to rectify the deficiency within a reasonable time.

The law states that FI shall decide on a Pillar 2 requirement if the bank has repeatedly failed to hold sufficient additional own funds to cover the guidance about which the bank has been notified by FI. This may involve both a situation in which the bank's own funds have repeatedly fallen below its capital need and a situation in which the bank has failed for some time to build up adequate capital.

Under these rules, FI shall also decide on a specific own funds requirement if other circumstances have emerged that inspire doubt from a supervisory perspective.

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<sup>46</sup> In other words, for the legal entity or for the consolidated situation.



The current right that FI has pursuant to Chapter 2, Section 2 of the Special Supervision Act to decide on a specific own funds requirement for risks to which the institution is exposing the financial system is being removed.

The proposed amendment to Chapter 2, Section 1b of the Special Supervision Act states that at least three quarters of the additional risk-based own funds requirement shall be met with Tier 1 capital, at least three quarters of which shall consist of Common Equity Tier 1 capital. Chapter 2, Section 1a of the Special Supervision Act states that the additional leverage ratio requirement shall be met with Tier 1 capital.<sup>47</sup> If FI believes it is necessary, FI may, pursuant to Chapter 2, Section 1b of the Special Supervision Act, decide in an individual case that the additional own funds requirement shall be met with a larger proportion of Tier 1 capital or Common Equity Tier 1 capital. Correspondingly, FI may, pursuant to Chapter 2, Section 1a, decide that the bank shall fulfil the additional leverage ratio requirement with a larger proportion of Common Equity Tier 1 capital.

### *3.2.1.1 Clarification of risks to which the bank is or might be exposed*

Article 104(1)(a) of the Capital Requirements Directive is implemented through Chapter 2, Section 1, second paragraph, point 2 of the Special Supervision Act. This article deals with situations in which a bank is exposed to risks or elements of risks that are not covered, or not sufficiently covered, by the own funds requirements specified in the parts concerning capital requirements, large exposures and leverage ratio in the Capital Requirements Regulation.<sup>48</sup> The article also covers risks or elements of risks that FI deems not to be sufficiently covered by the own funds requirements in Chapter 2 of the Securitisation Regulation.<sup>49</sup> A situation such as that indicated in Chapter 2, Section 1, second paragraph, point 2 of the Special Supervision Act may encompass, for example, a bank's risk profile that arises as a result of a certain economic trend and market trend.

The Government, or the authority determined by the Government, may, pursuant to Chapter 10, Section 2 of the Special Supervision Act, issue regulations concerning when the own funds requirements in the Capital Requirements Regulation and the Securitisation Regulation shall be deemed not to cover a risk and how the level of an additional own funds requirement in order to cover such a risk shall be established. According to the author's commentary, this authorisation partly implements Article 104(2) of the Capital Requirements Directive.

Article 104(2) indicates, inter alia, that a risk or an element of a risk is not covered or only partly covered when the risk or element of a risk is identified as material by FI and the authority considers the capital that is adequate in

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<sup>47</sup> A corrigendum to the Capital Requirements Directive states that the special leverage ratio requirement shall be met with Tier 1 capital. The corrigendum was published following completion of the report [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0878R\(03\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019L0878R(03)&from=EN).

<sup>48</sup> Parts Three, Four and Seven of the Capital Requirements Regulation.

<sup>49</sup> Regulation (EU) 2017/2402 of the European Parliament and of the Council.

terms of its adequate amount, type and distribution to be greater than that set out in the relevant own funds requirements in the Capital Requirements Regulation, i.e. the minimum requirements. FI shall take into account the individual bank's risk profile when assessing the risks to which the bank is exposed.

### **3.2.2 Guidance within Pillar 2**

Chapter 6, Section 2 of the Banking and Financing Business Act and Chapter 8, Section 4 of the Securities Market Act state that banks shall set their internal capital at adequate levels of own funds. The assessment shall take into account the stress tests that are to be carried out in accordance with Article 100 of the Capital Requirements Directive. The internally assessed capital need is reviewed and assessed in FI's supervisory review and evaluation of the bank.

Under Chapter 2, Section 1c of the Special Supervision Act, FI shall determine appropriate levels of own funds for the bank in conjunction with its supervisory review and evaluation. FI shall communicate to the bank the difference between these levels and the minimum requirements, the additional own funds requirements and the combined buffer requirement. In this way, FI communicates to the bank a relevant guidance concerning additional own funds, i.e. a guidance within the risk-based requirement or a guidance for leverage ratio.

Under Chapter 2, Section 1c of the Special Supervision Act, the guidance shall be institution specific. In addition, the reasons for this legislative proposal indicate that the capital specified in the guidance shall, for example, be able to cover risks and deal with future financial stress. The author's commentary to Chapter 2, Section 1c of the Special Supervision Act clarify that the guidance is permitted to cover risks that are subject to the additional own funds requirement only to the extent that this covers aspects of these risks that are not already covered by the additional own funds requirements.

### **3.2.3 EBA guidelines**

In accordance with Article 107(3) of the Capital Requirements Directive, the EBA has issued guidelines to the national supervisory authorities in order to specify the common procedures and methodologies for the supervisory review and evaluation process.<sup>50</sup> These guidelines were issued on 19 December 2014 and last updated on 19 July 2018. The EBA intends to update the guidelines further in 2020 and 2021, including to take into account changes as a consequence of the banking package.<sup>51</sup> This means that FI may end up changing the application that is described in this memorandum at a later date.

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<sup>50</sup> For more information, please refer to <https://eba.europa.eu/sites/default/documents/files/documents/10180/2282666/6c2e3962-6b95-4753-a7dc-68070a5ba662/Revised%20Guidelines%20on%20SREP%20%28EBA-GL-2018-03%29.pdf>.

<sup>51</sup> For more information, please refer to [https://eba.europa.eu/sites/default/documents/files/document\\_library/EBA%20Risk%20Reduction%20Package%20Roadmaps.docx.pdf](https://eba.europa.eu/sites/default/documents/files/document_library/EBA%20Risk%20Reduction%20Package%20Roadmaps.docx.pdf).

The EBA's ongoing review encompasses updates related to the Pillar 2 requirements and the guidance that are based on the changes in the banking package. In addition, the review encompasses areas such as proportionality, the role played by sustainability-related matters in the process and updates in view of the introduction of the leverage ratio requirement.

### 3.3 Major changes in application pursuant to law

The proposed changes to Swedish law mean that some of FI's previous positions are no longer consistent with the regulations. Among the major changes that ensue from the legislative proposals are:

- The Pillar 2 add-on for systemic risk of 2 per cent is being abolished.<sup>52</sup> This is because the right to decide on an additional own funds requirement for risks to which the institution is exposing the financial system is being removed from Chapter 2, Section 1 of the Special Supervision Act.<sup>53</sup>
- The additional own funds requirement will be decided on in accordance with Chapter 2, Section 1 of the Special Supervision Act. Consequently, the requirement, in contrast to FI's current application, will affect the level at which the automatic restrictions on value transfers occur. The effect of this is that the level of capital at which automatic restrictions on value transfers occur becomes higher, all else being equal.
- By law, three quarters of the risk-based additional own funds requirement shall be met with Tier 1 capital, three quarters of which is Common Equity Tier 1 capital, unless FI determines otherwise for the bank by virtue of Chapter 2, Section 1b of the Special Supervision Act.
- The capital planning buffer is being abolished as its purpose is now being achieved through the Pillar 2 guidance. However, the guidance may end up covering more risks than are currently being managed by the capital planning buffer.

FI continually reviews and updates the methodologies for risk assessment in Pillar 2. For example, this includes the ongoing consultation concerning non-trading book market risks.<sup>54</sup>

### 3.4 General information about Pillar 2 and FI's position

The legal acts that govern Pillar 2 provide some scope for FI and other national supervisory authorities to design the supervisory review and evaluation process and thus also Pillar 2 requirements and guidance.

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<sup>52</sup> This add-on for systemic risk is in place at the group level for the three major banks.

<sup>53</sup> The effect of removing this on the total level for the major banks is counteracted by the O-SII buffer and the systemic risk buffers being added together and the addition of the Pillar 2 guidance.

<sup>54</sup> For more information, please refer to: <https://www.fi.se/sv/publicerat/nyheter/2020/fi-foreslar-ny-pelare-2-metod-for-marknadsrisker-utanfor-handelslagret/>.

FI makes the assessment that there are grounds to adopt a position or provide clarification in the areas below concerning certain key areas that will be affected by the supervisory capital assessment in Pillar 2:

- FI's methodologies for assessing risks within the scope of Pillar 2
- the format and scope of Pillar 2 guidance
- type of capital for compliance with Pillar 2 guidance
- unit for Pillar 2 requirements and Pillar 2 guidance
- disclosure of Pillar 2 guidance.

FI's positions within each area are described in the next section, together with the comments received and the reasoning for each position. Some sections also contain clarifications concerning the practical implementation. The consultative bodies have also made some comments of a general nature that do not relate to any of FI's positions. These comments are also reported below, together with FI's commentary.

#### **3.4.1 Comments received**

*The Swedish Bankers' Association* states that the risks that are material in the assessment of whether an additional own funds requirement shall be decided in accordance with Chapter 2, Section 1, second paragraph, point 2 needs to be clarified and that the materiality assessment must be based on whether the individual bank is exposed to a certain risk in relation to a typical internationally active bank. This is because the global calibration of capital requirements that was performed by the Basel Committee is based on what banks typically look like. Consequently, it is only material 'outliers' in relation to what is typical that may be pertinent for any additional requirements. The association also states that clarification is required as to what is meant by special grounds for FI to impose an additional leverage ratio requirement.

*The Association of Swedish Finance Houses* states that there is no detailed explanation or example of what is meant by special grounds for an additional leverage ratio requirement. The association contends that because the global calibration that was performed by the Basel Committee is based on what major internationally active banks typically look like, the materiality assessment must very well also take this into account.

*AB Svensk Exportkredit* believes that FI should clarify the criteria and methodology for assessing whether a risk or element of a risk is to be considered 'material' in the assessment of whether an additional own funds requirement shall be decided on in accordance with Chapter 2, Section 1, second paragraph, point 2. This is so as to ensure that the scope and focus of the institution's internally assessed capital need does not deviate from FI's basis premise for analysis and assessment.

*The Riksbank* states that an adequate level for leverage ratio is in the interval 5–12 per cent and is also of the opinion that the major Swedish banks should increase their capital as a proportion of their total exposures. Consequently, the Riksbank is of the opinion that FI should introduce an additional leverage ratio

requirement of 2 per cent for the three Swedish major banks, in excess of the minimum requirement of 3 per cent.

*Kommuninvest* states that FI should only establish a substantially higher leverage ratio requirement in Pillar 2 when there are compelling reasons to do so.

*Nordnet* states that there is no reasoning concerning what is considered special grounds. Nordnet is also of the opinion that it is of the utmost importance for the assessment concerning an additional leverage ratio requirement to be tailored to the bank's actual level of risk and that consideration is given to which types of assets make up the total exposure measure.

### **3.4.2 FI's reasoning**

As regards a Pillar 2 requirement that is necessary in order to cover risks to which the institution is or might be exposed, FI does not intend to define or describe in advance what is deemed to be material in excess of what is set out in law. The regulatory framework leaves it to FI to determine what is a material risk and as the authority shall therefore decide an additional own funds requirement or leverage ratio requirement on the basis of. There is reason to retain the flexibility provided by the regulatory framework as the risks that FI is to assess may be substantially different, as may the situations that exist within banks. For example, the materiality assessment for the risk of excessive leverage could end up being affected by the leverage ratio's significance relative to the risk-based requirement for an individual bank.

FI makes the assessment that there are currently only a few situations in which an additional leverage ratio requirement may be pertinent. In line with the regulatory framework, such requirements will be institution specific. FI has removed the formulation concerning special grounds related to the additional leverage ratio requirement.

The Riksbank is of the opinion that FI should introduce an additional leverage ratio requirement of 2 per cent in excess of the minimum requirement of 3 per cent for the major banks on the basis that it believes that an adequate level for the leverage ratio is in the interval 5–12 per cent. As indicated by the principles, FI believes risk-based requirements and usable capital are important. If the leverage ratio requirement were to amount to 5 per cent, this would eclipse the risk-based requirements and reduce the level of usable capital. In addition, such a requirement would deviate drastically from how the framework is generally applied in the rest of the EU. Consequently, FI is not changing its position in this respect.

## **3.5 Changes to assessment methodologies for individual risk types within the scope of Pillar 2**

### **3.5.1 Introduction to the question**

Some of the risks and deficiencies FI identifies are unique to a specific bank. For example, this could be a deficiency in a model or specific deficiencies in the bank's risk management. Other risks are present in several banks. This

primarily relates to risks or elements of risks that are underestimated or not covered by the minimum requirements in Pillar 1.

Under the current regulatory framework, FI has continually published methodology documentation concerning individual risks and types or risk that have been identified. These relate primarily to risks that may be present at several banks. It remains FI's ambition to be transparent with the assessment criteria the authority has used for such risks.

FI is amending the methodology documentation because the potential to manage risks to which the bank exposes the financial system is being removed from Pillar 2. This is taking place at the same time as an amendment to Chapter 2, Section 2 of the Capital Buffers Act (see section 4.1.1) is being made that involves the systemic risk buffer and the applicable capital buffer for systemically important institutions, in practice the O-SII buffer, are to be added together.<sup>55</sup>

FI is also providing some clarification in the methodology descriptions in view of changes to the Special Supervision Act and is also removing one method.

### 3.5.2 *FI's position*

FI intends to retain the capital assessment methodologies that are listed below and to adjust the methodology documentation in accordance with the following.

When this is relevant, the O-SII buffer shall be included when calculating the additional own funds requirement. References to the current requirement for Pillar 2 add-ons for systemic risk are being removed.

FI intends to remove information from the methodology documentation about which type of capital shall be used to meet the own funds requirement, where this is relevant.

For the existing methodologies, they pertain to methodologies for assessing risks that are completely or partly not covered by the Capital Requirements Regulation.

The following methodologies are encompassed by this position and the clarifications:<sup>56</sup>

<sup>55</sup> This is different from the present situation in which, in simple terms, it is the higher of them that applies.

<sup>56</sup> The methodologies listed encompass those that are currently being used. On 11 June 2020, FI published the consultation memorandum *Förslag på pelare 2-metod för bedömning av kapitalpåslag för marknadsrisk i övrig verksamhet*, in which there are proposals to replace the methodologies FI Ref. 17-1281 and parts of the methodology documentation in FI Ref. 14-14414 For more information, please refer to <https://www.fi.se/sv/publicerat/nyheter/2020/fi-foreslar-ny-pelare-2-metod-for-marknadsrisk-utanfor-handelslagret/>.

- FI's supervision of banks' calculations of risk weights for exposures to corporates, FI Ref.15-13020.
  - Increased capital requirements on bank loans for commercial real estate, FI Ref. 19-14171.
  - FI's methodologies for assessing individual risk types within Pillar 2 (Interest rate risk in the banking book and pension risk), FI Ref. 14-14414.
  - Changes to the Pillar 2 methodology for assessing the capital requirement: internal credit spread within interest rate risk in the banking book, FI Ref. 17-1281.
  - Capital requirements for Norwegian mortgages. This pertains to reciprocation of a Norwegian measure under FT-NO – Memo 9 April 2014. The requirement will continue to be calculated in accordance with the methodology described in the capital requirements memorandum, FI Ref. 14-6258.
- FI intends to review and update the memorandum *FI's Pillar 2 capital assessment method for systemic risk associated with securitisation* (FI Ref. 16-17820).
- FI intends to remove the assessment methodology that is specified in the memorandum *Pillar 2 capital requirements for maturity assumptions* (FI Ref. 16-2703).

### 3.5.3 Comments received

*The Swedish Savings Banks Association* contends that the methodologies of capital assessment constitute general norms of a type that FI needs authorisation to issue. The association is of the opinion that determining what is institution specific or not is complicated and would need to be analysed in the memorandum.

*The Swedish Bankers' Association* is of the opinion that the changes to the methodologies announced by FI are not sufficient as the methodologies will retain an element of systemic risk. The Swedish Bankers' Association states that calculating Pillar 2 requirements on the basis of the prospective risk-weighted assets multiplied by a capital requirement including capital buffers for systemic risk results in the Pillar 2 requirement being given an element of systemic risk. In addition, the association believes that general risk weight floors in the Pillar 2 requirements, as with commercial real estate, are not institution specific as no assessment is being made of the individual bank's risk.

The Swedish Bankers' Association also believes that FI should abolish the capital assessment methodology for systemic risk associated with securitisation because this methodology is based entirely on reasoning pertaining to systemic risk.

*The Association of Swedish Finance Houses* notes that elements of systemic risk remain in the methodologies and parts of these are not institution specific and are instead more generally applicable. The association contends that the

capital assessment methodologies constitute general norms of a type that FI needs authorisation to issue.

*AB Svensk Exportkredit* states that it is important for FI to become more transparent when it comes to methodologies for calculating the new requirements so that institutions are able, in their capital planning, to anticipate how much capital is required under the new rules. FI should also provide clarification about whether the authority, within the scope of an assessment of the specific capital requirement, will be including both an estimated capital requirement for a risk as if the risk had been included in Pillar 1 and buffer requirements applicable at the time.

*The Riksbank* states that it is important for a large portion of the capital to consist of Common Equity Tier 1 capital in order to ensure there is a good capacity to cover any future losses. The Riksbank notes that FI has the opportunity within the Pillar 2 requirement to demand that banks, under specific circumstances, have a larger proportion of Common Equity Tier 1 capital than the standard proportion of Tier 1 capital specified in the proposal. Consequently, the Riksbank emphasises the importance of FI ensuring as far as is possible that the capital consists of Common Equity Tier 1 capital.

#### ***3.5.4 Clarifications concerning assessment methodologies for individual risk types within the scope of Pillar 2***

The new regulatory framework clarifies that it is the situation for the individual bank that shall form the basis of a Pillar 2 requirement. It is also made clear that it is FI that shall assess whether it is necessary to have such a requirement in order to cover risks to which the bank is or might be exposed. In this assessment, FI will be taking into account the individual bank's risk profile.

By virtue of what is set out in law, FI intends to make decisions concerning a Pillar 2 requirement, the size and structure of which will be based on a supervisory review and evaluation of the bank. FI will be basing this supervisory review and evaluation on the bank's risk profile. This includes examining whether the bank has a type of risk that is specified in the methodologies and how the bank has managed its exposures in accordance with relevant parts of the Capital Requirements Regulation. As part of this review, FI will also, if this is justified for the individual bank, depart from the capital distribution for meeting the additional own funds requirement as set out in law, i.e. whether the requirement needs to be met with a larger proportion of Common Equity Tier 1 capital or Tier 1 capital. Accordingly, FI's assessment of risk and of the size of the additional own funds requirement will take the individual bank's situation and risk profile into account. FI is of the opinion that risk weight floors are institution specific. This is because when such a floor is applied in an individual case, it will be based on an institution's specific exposures.

The published methodology documentation does not in itself govern the banks and does not constitute any norms for which FI needs authorisation. The publication of methodology documentation provides a transparent view of how



FI intends to assess certain specified risks as part of its supervisory review and evaluation process.

Methodology documentation is used to create a predictability and transparency that is beneficial to the banks. Without this documentation, there would have been less transparency, which would have benefited neither the banks nor other actors that need to understand how FI applies the capital rules. Good transparency in terms of how FI will be applying the new capital rules is also achieved through the publication of this memorandum. FI published a similar memorandum in 2014 and the authority judged this to be of major benefit to banks and other actors. Publication of this documentation is well in line with FI's basic premise; to have simple and predictable capital requirements that reduce uncertainty among the banks' stakeholders, especially their financiers, and thus contribute to financial stability.

In accordance with Section 3 of the Special Supervision and Capital Buffers Ordinance, FI shall provide through its website the general criteria and methodologies that the authority applies as part of its supervisory review and evaluation process.

Certain methodologies entail an additional own funds requirement in Pillar 2 that takes into account the capital need that the bank would have if the risk or deficiency was being managed in Pillar 1. Consequently, the size of the specific capital requirement will also take into account what the bank's buffer requirements would have been if the risk had been managed in an adequate way in Pillar 1. This does not mean that the specific capital requirement is intended to cover systemic risk.

### ***3.5.5 Reasons for changes to existing methodologies***

There are reasons to provide clarification about how FI's methodologies need to be changed as a result of the amendments to the Special Supervision Act.<sup>57</sup>

Because the 2 per cent add-on for systemic risk in Pillar 2 is being abolished, FI intends to remove references to this add-on from the methodology descriptions that have such references.

The rules that have applied until now have meant that the requirements for O-SII buffers that FI has determined have no effect in practice. Accordingly, requirements for the O-SII buffer have not reflected the calculation methodology in the methodology descriptions. In light of the amendments to the Capital Buffers Act, it is reasonable to update the methodologies for calculating the size of the requirement with a reference to a requirement for the O-SII buffer where this is relevant.

The basic premise for how the Pillar 2 requirements are to be met ensues from the Special Supervision Act. FI intends to delete corresponding sections for the existing methodologies from the methodology documentation.

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<sup>57</sup>The Pillar 2 requirements that pertain to risks and deficiencies that are only present at one firm may also need to be changed as a result of the changes to the regulatory framework.

FI notes that, in its response to the consultation, the Riksbank emphasises the importance of Common Equity Tier 1 capital in order to ensure a good capacity to cover any future losses. FI shares the Riksbank's view of the importance of a high proportion of Common Equity Tier 1 capital, but makes the assessment that, based on the basic rule as set out in law, general application of a capital distribution that is different from that specified in the basic rule is not justified. Nevertheless, FI does have the opportunity to decide on a higher proportion of Common Equity Tier 1 capital if this may be deemed justified in the individual case. FI is of the opinion that a higher proportion of the additional own funds requirement shall be met with Common Equity Tier 1 capital, at least in those cases that involve coverage of losses already incurred but which, for various reasons, have not affected the accounts and the capital requirements – rather than a risk of losses. A case such as this could also be a temporary add-on in order to cover risks that actually should be covered by the Pillar 1 requirements but are instead being managed in Pillar 2 for a period. One example of such an add-on is increased capital requirements for bank loans for commercial real estate. The fact that Pillar 2 guidance (see section 3.6) is to be covered entirely by Common Equity Tier 1 capital to some extent counteracts the lower proportion of this type of capital in the Pillar 2 requirements.

The existing assessment methodologies manages risks or elements of risks to which the bank is exposed but which are not covered or not adequately covered by the minimum requirements. FI believes that clarification is justified because changes are being made to the legal conditions for the various situations in which additional own funds requirements can be decided.

Because the changes to the methodology documentation concerned are being described in this memorandum, FI does not intend to submit the updated versions of the existing methodology documentation for consultation, to the extent that the changes are only those that apply by virtue of amendments to regulations and acts. However, FI does intend to submit new and amended methodologies for consultation when this is pertinent.

The reason why FI is retaining the Pillar 2 capital assessment methodology for systemic risk associated with securitisation (FI Ref. 16-17820), and is revising this, is that the methodology also currently indirectly manages risks for the individual institution that are not adequately covered by the Pillar 1 minimum requirement. FI is therefore of the opinion that there is reason to keep this methodology but to revise it in order to clarify that it fulfils the conditions set out in law. FI will continue to prescribe capital requirements for institution-specific risk.

FI is removing the assessment methodology set out in the memorandum *Pillar 2 capital requirement for maturity assumptions* primarily in order to simplify application<sup>58</sup> but also as this is justified to some extent with systemic risk.

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<sup>58</sup> For example, this overlaps in part with the assessment methodology in the memorandum *Increased capital requirements on bank loans for commercial real estate* (FI Ref. 19-14171).

However, it is still possible for FI to manage institution specific risk as part of ongoing supervision when this is necessary.

### **3.6 Position on the format and scope of Pillar 2 guidance**

#### **3.6.1 Introduction to the question**

The Capital Requirements Directive largely clarifies how guidance is to be introduced but in several respects hands over application to the supervisory authority.

#### **3.6.2 FI's position**

As a starting point, FI intends to use stress tests in order to assess the size of the capital that will be notified through guidance. In addition, the authority may include other components in guidance. It is FI's intention to use published methodologies to a great extent when assessing the various parts, where this is appropriate.

The capital need that is determined through the risk-based Pillar 2 guidance shall be deducted from the capital conservation buffer. This means that the risk-based Pillar 2 guidance that is communicated to the banks will specify the level that exceeds the capital conservation buffer. No corresponding deduction is made for the leverage ratio guidance because there is no equivalent to the capital conservation buffer in the rules for leverage ratio.

As a starting point, FI will be notifying the bank of both a risk-based guidance and a leverage ratio guidance for the highest organisational level that FI supervises. This means that notification of the guidance will be given at the group level if there is a group subject to Swedish supervision, otherwise it will be given at the solo level. If there are special grounds to do so, FI may also give notification of guidance at the solo level even if the group level is subject to Swedish supervision.

#### **3.6.3 Comments received**

*AB Svensk Exportkredit* is of the opinion that FI should provide clarification about which risks, or types of risk, may be encompassed by Pillar 2 guidance, in addition to the stress tests and should also insure there is clarity about the methodologies for establishing these risks for individual institutions. The company believes it is important that FI publishes its methodologies for stress tests as soon as possible. The company also states that the methodology description for stress tests for Pillar 2 guidance should clearly specify which additional factors and risks linked to the financial system will be included in the scenarios and how the assessment will be implemented for other components. The company is also of the opinion that FI should provide clarification of its reasoning concerning the initially estimated level of Pillar 2 guidance and should illustrate how the authority will be adopting a position on any impact on institutions' competitive conditions when establishing guidance.

*The Association of Swedish Finance Houses* believes that clarification should be provided about which components and methodologies, respectively, FI

intends to use when assessing Pillar 2 guidance. According to the association, it is necessary for the guidance to be combined with a justification, for example one that is equivalent to that provided for a decision concerning an additional own funds requirement, because the guidance may be reviewed in court.

*Kommuninvest* states that it is very important that FI takes full account in its risk assessments of the business being conducted on the basis of the institutions' various business models and that methodologies and stress tests are designed on the basis of this.

*Nordnet* is of the opinion that additional leverage ratio requirements and leverage ratio guidance should be applied restrictively in order to ensure that increased risk-taking that may arise due to incentivisation effects, resulting from the fact that the measure is insensitive to risk, is proportionate to the risk-taking that the leverage ratio measure is intended to result in. Furthermore, such requirements should be based on the individual institution's risk profile and circumstances and should be determined in dialogue with the institution in order to exclude such mechanical stress tests as have been used in the past in order to establish the capital planning buffer, for example. In addition, FI should evaluate an institution's potential to strengthen its leverage ratio when the authority is deciding on increased leverage ratio requirements.

*The Swedish Savings Banks Association* ascertains that the guidance is not directly compulsory but that it contains components of a compulsory nature. The association argues that a notification concerning guidance needs to contain a justification of the same type as provided with a decision concerning an additional own funds requirement. Furthermore, the association believes it would be desirable if FI were able to provide a description of the types of components that may be included in guidance in addition to the stress tests.

*The Swedish Bankers' Association* is of the opinion that, in the near future, FI should disclose how the authority works out the indicative levels for the capital add-on for Pillar 2 guidance specified in the memorandum. The Swedish Bankers' Association understanding is that extremely unlikely stress scenarios would be required in order for a bank to exceed the level of the capital conservation buffer. In addition, the Swedish Bankers' Association would like FI to provide clarification in the memorandum in question about how the authority will be calculating the guidance and whether there will be any difference in the calculation methodology used for risk-based guidance and leverage ratio guidance. The association believes that the forthcoming consultation memorandum should be so detailed that it is possible to calculate the outcome of forthcoming notifications concerning the level of guidance.

#### **3.6.4 Reasons for FI's position**

The law states that FI shall determine adequate levels for own funds. This means that FI has to determine how high the own funds shall be in order to be of an adequate level to cover all risks to which a bank is exposed and also able to absorb potential losses as a result of financial stress. The basic premise is that the communicated guidance shall cover risks or aspects of risks that are not already covered by the minimum requirements, Pillar 2 requirements or

buffer requirements. A supervisory review and evaluation of adequate own funds levels shall take place regularly and take into account the results of the stress tests referred to in Article 100 of the Capital Requirements Directive. At the same time, this means that the communicated guidance is not limited to covering only the results of stress tests. This has also been made clear in the government bill through it being described that guidance shall, for example, be able to cover risks and manage future stress scenarios that are not covered by the minimum requirements, Pillar 2 requirements or buffer requirements.<sup>59</sup> FI clarifies this in Graph 3.2 by describing how part of the guidance pertains to the stress tests and how the guidance may also be affected by more parts ('other parts'). Pillar 2 guidance will therefore be based on the outcome of stress tests and other institution-specific assessments.

It is stated in section 3.6.5 that FI intends to produce a methodology for how the outcome of stress tests is to be taken into account when Pillar 2 guidance is being established. For the other parts, FI also intends, where this is appropriate, to use to a large extent published methodologies when assessing various components of the level of capital that banks are notified of through guidance. This is consistent with FI's overarching ambition to be transparent when it comes to the supervisory capital assessment.

For example, it may be pertinent to issue guidance in excess of that which applies pursuant to the stress tests when the result of a stress test shows risks in the event of financial stress that are not covered by other requirements. It may also be pertinent to manage those risks that are not covered by the stress tests, for example due to the design of the stress tests or institution-specific characteristics. For example, there could also be risks that have properties that make it more appropriate to manage the risk through guidance rather than a requirement.

FI notes that the consultative bodies comments about the importance of both great clarity in advance about how guidance will be calculated and comments that press home the importance of the institution-specific nature of guidance. FI understands both aspects and concludes that these are not always possible to reconcile. Consequently, in order to be as transparent as possible and meet expectations, FI provides in this memorandum an interval with the authority's indicative assessment of how large the stress test-related portion of the guidance may usually be. FI would also like to highlight here the authority's ambition to refer for consultation and publish its framework for the stress tests and how these relate to the Pillar 2 guidance, and also the authority's general ambition to submit for consultation and publish methodologies for assessing the risks present in several banks. FI is doing this in order to increase the predictability of the authority's application.

To make things simple and functional for all banks, it is FI's intention that its basic premise will be to communicate to the banks both risk-based guidance and leverage ratio guidance. For some banks, the total risk-based capital

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<sup>59</sup> Govt Bill 2020/21:36 Page 113.

requirement may exceed the total leverage ratio requirement, and vice versa (see section 6.2). The situation may also change over time.

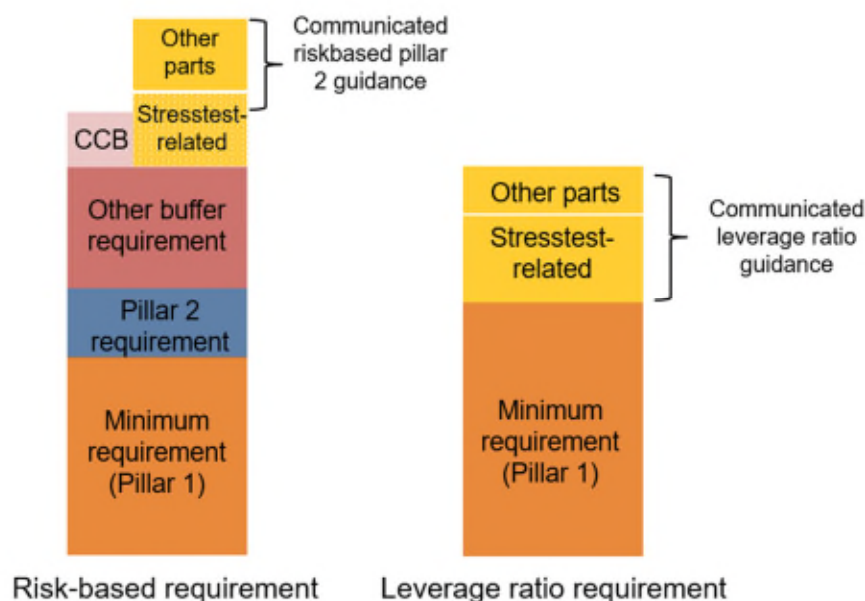
The capital conservation buffer and the risk-based guidance are naturally overlapping. Consequently, in line with the principles that have applied thus far to the management of the capital planning buffer, a bank should be able to comply with the risk-based guidance using the same capital as it uses to comply with the capital conservation buffer. Based on Chapter 2, Section 1d of the Special Supervision Act, the consequence is that the risk-based guidance will be expressed and notified as that part of the guidance that exceeds the capital conservation buffer.

The leverage ratio requirement is being introduced as a minimum requirement in the Capital Requirements Regulation. Unlike the risk-based provisions, the leverage ratio provisions do not contain a buffer that is equivalent to the capital conservation buffer. It is therefore important that banks have adequate guidance in order to enable them to absorb losses without risking breaching the minimum requirement under financial stress.

At the same time, the introduction of guidance above the leverage ratio requirement may result in the total leverage ratio requirement exceeding the total risk-based requirement. In this way, the leverage ratio requirement can transition from acting as a safety barrier to exceeding the risk-based requirement and thus constitute the bank's highest requirement. Consequently, a difficult trade-off arises between two of the principles that form the basis of this memorandum, namely the principle of adequate usable capital and the principle of risk-based requirements. The farther above the leverage ratio requirement the buffer is, the greater the probability that the leverage ratio requirement is the bank's most restrictive requirement.

The lack of overlapping requirements also means that it cannot become a question of any net calculation when setting the size of the leverage ratio guidance.

Graph 3.2. General design of guidance



Source: FI

Note: The capital conservation buffer has been abbreviated to CCB. The size of the various parts of the graph, and the bars relationship to one another are not to be seen as an indication of how the provisions will actually be implemented.

In order to make this simpler, FI intends, as a basic premise, to communicate to the bank guidance for the highest level that is subject to the authority's supervision. This means that guidance is communicated at the group level if there is a group that is subject to Swedish supervision. This position also means that FI intends to communicate guidance for Swedish subsidiaries that are part of a group that is subject to supervision in another country. This position does not rule out the possibility of FI also giving notification of guidance at the solo level for companies in a group that is subject to Swedish supervision if there are specific grounds to do so.

### 3.6.5 Ongoing review of stress tests

FI is currently undertaking a project to revise the methodology for taking into account the outcome of stress tests when Pillar 2 guidance is being established, and is planning to publish a consultation memorandum at the beginning of 2021. Stress tests are being given a more explicit role in Sweden than was previously the case as a result of the banking package. The reasons for this are two-fold, both because of how the rules concerning guidance are being introduced into the law and due to the more extensive changes to the regulatory framework. Consequently, FI is of the opinion that it is appropriate to produce a methodology that clarifies the link between the stress tests and the guidance. This includes how FI takes into account the banks' own stress tests, the EBA's stress tests and FI's stress tests and assessments. FI notes the consultative bodies' comments on the scope, importance of clarity, institution-specific adaptations and clear communication, and cites the forthcoming consultation memorandum.

FI intends to place greater importance on the stress tests and the risks and sensitivities these encompass. The authority also intends to stress test more banks than it does currently. Even though the purpose of the stress tests is to assess institution-specific risks, the scenario should take into account factors and risks present in the financial system and that therefore impact the bank's risk profile and its ability to manage stress.

FI's indicative assessment is that the stress test-related capital need may exceed the current size of the capital conservation buffer and therefore result in a communicated risk-based guidance, usually of approximately 1 to 1.5 per cent of risk-weighted assets. The level may be higher or lower for the individual bank, depending on the specific outcome of the stress test and FI's assessment. In a corresponding manner, FI's indicative assessment is that the stress test-related capital need for leverage ratio can usually amount to approximately 0.2 to 0.5 per cent of the exposure amount for leverage ratio. This level may also be higher or lower for the individual bank, depending on the specific outcome of the stress test and FI's assessment. The levels of the guidance, like risks they encompass, may change over time in line with the format of the regulatory framework, changes in the external environment and the banks' risk profile, and FI's risk assessment.

### **3.7 Position on type of capital for coverage of Pillar 2 guidance**

#### ***3.7.1 Introduction to the question***

The act leaves it up to the supervisory authority to determine which type of capital shall be used to meet the guidance.

#### ***3.7.2 FI's position***

The risk-based Pillar 2 guidance and Pillar 2 guidance for leverage ratio shall be met with Common Equity Tier 1 capital.

#### ***3.7.3 Comments received***

*The Swedish Bankers' Association* believes that the leverage ratio guidance, as is the case for the minimum requirement for leverage ratio, should be covered with Tier 1 capital. The purpose of the leverage ratio requirement is to have a safety barrier to the existing risk-sensitive capital requirements and to limit banks' borrowing as a proportion of their Tier 1 capital. A stress test-related capital need is not at the core of any of these purposes, and does not constitute a good reason for parts of the requirement to be met with Common Equity Tier 1 capital.

*Nordnet* contends that the requirement that the leverage ratio guidance be covered using Common Equity Tier 1 capital lacks practical significance and should not be introduced for reasons of simplicity. This is because institutions can still be expected to hold more Common Equity Tier 1 capital in the risk-based requirement.



### **3.7.4 Reasons for FI's position**

If it is to act as a buffer, it needs to be possible for the capital to be used in a simple way to cover losses. FI argues that it is natural that a buffer, the purpose of which is to be used first when a bank suffers losses, shall consist of Common Equity Tier 1 capital. This is because this type of capital, without specific decisions or measures, decreases in the event of losses. It is also simple to manage in practice. Allowing Pillar 2 guidance to be met with another type of capital would entail difficulties relating to how the overlap with the capital conservation buffer should be managed. This is because the capital conservation buffer is to be met with Common Equity Tier 1 capital. The previous capital planning buffer was also to be met with Common Equity Tier 1 capital.

Although the purpose of the leverage ratio requirement is to act as a safety barrier, its introduction into the Capital Requirements Regulation in the form of a minimum requirement makes this requirement the most restrictive requirement for some banks. FI has strong possibilities to intervene if the requirement is not met. Consequently, FI believes there are reasons why the leverage ratio guidance should also be met with Common Equity Tier 1 capital, which is the capital that is most easily usable for absorbing losses.

It is likely that the position that the leverage ratio guidance shall be met with Common Equity Tier 1 capital does not necessarily entail that the bank needs to take in further Common Equity Tier 1 capital.<sup>60</sup> However, there may be cases where this might be pertinent because the relationship between the risk-weighted requirement and the leverage ratio requirement differs from bank to bank and as the actual level of certain guidance may exceed the indicative level specified in section 3.6.5.

All in all, FI is of the opinion that guidance shall be met with Common Equity Tier 1 capital.

## **3.8 Position on unit for Pillar 2 requirements and Pillar 2 guidance**

### **3.8.1 Introduction to the question**

The act leaves room for FI to determine which unit the Pillar 2 requirement decided on shall be expressed in and thus met in. In other words, FI is able to decide that the bank shall comply with a Pillar 2 requirement expressed in nominal terms or as a percentage of risk-weighted assets or of the exposure amount for leverage ratio. Correspondingly, the act leaves room for FI to decide the unit in which guidance shall be communicated.

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<sup>60</sup> If the bank has adequate Common Equity Tier 1 capital to meet the guidance, the bank can take in Additional Tier 1 capital when needed in order to meet the minimum requirement for leverage ratio.

### 3.8.2 *FI's position*

Pillar 2 requirements will be decided and expressed as a percentage of total risk-weighted assets or of the exposure amount for leverage ratio.

Correspondingly, guidance will be determined and communicated as a percentage of total risk-weighted assets or of the exposure amount for leverage ratio.

### 3.8.3 *Comments received*

*The Swedish Bankers' Association's* view is that the Pillar 2 requirements should be expressed as a nominal amount. The association is of the opinion that the directive does not provide the opportunity to choose to decide and express the own funds requirements as a percentage of total risk-weighted assets or of the exposure amount for leverage ratio. The Swedish Bankers' Association also cites the text of the act, which states that 'in conjunction with a supervisory review and evaluation of an institution, Finansinspektionen shall determine adequate levels of own funds for the institution. Finansinspektionen shall communicate to the institution the difference between these levels and the own funds requirements.'

Furthermore, the Swedish Bankers' Association states that by expressing the Pillar 2 requirements as a nominal amount, the authority is able to make decisions that are not at risk of being altered due to external factors. This provides more predictability for banks. According to the Swedish Bankers' Association, this also avoids a situation in which changes in the market that affect risk-weighted assets in either direction result in a direct change to the Pillar 2 add-on for a specific risk, despite the risk not varying in correlation with the change in risk-weighted assets. The Swedish Bankers' Association also believes that a nominal amount does not appreciably complicate the banks' practical and administrative management of the capital requirements.

### 3.8.4 *Reasons for FI's position*

FI does not agree with the Swedish Bankers' Association that the directive or the government bill entail that requirements and guidance shall be expressed in nominal terms, especially not given that other requirements are determined in percentage terms. FI makes the assessment that the regulatory framework allows for FI's application.

FI believes that the option of expressing the requirements and guidance in percentage terms is simple to understand and use. The minimum requirements and buffer requirements are also expressed in percentage terms. In addition, the risk-based additional own funds requirement is a basis for the MREL requirement that the National Debt Office determines pursuant to the Resolution Act. According to the directive, this requirement shall also be expressed in percentage terms. Accordingly, FI's position means that a clear relationship emerges between the capital requirements and MREL.

A decision concerning a Pillar 2 requirement for a bank applies indefinitely. Correspondingly, the level of the communicated guidance remains unchanged until such time as the bank is notified of a new level. Pillar 2 requirements and guidance are based on FI's recurrent supervisory review and evaluation processes. The frequency of the supervisory review and evaluation processes vary between the banks that are subject to FI's supervision (see section 5). Expressing the levels as a percentage reduces the risk of a bank's Pillar 2 requirement or guidance decreasing in relative terms, for example in the event of strong growth in the bank's assets, and vice versa if its assets were to shrink.

At the same time, using percentage terms means, exactly as expressed by the Swedish Bankers' Association, that the size of a bank's Pillar 2 requirements can be influenced by external factors. In addition, some banks are subject to Pillar 2 requirements that do not vary in correlation with risk-weighted assets. However, the banks that have such requirements are, generally speaking, more frequently subject to supervisory reviews and evaluations, and the level of their capital requirements will therefore be subject to more frequent revision.

FI can see that both methodologies have their advantages and disadvantages, which means that this is not an entirely simple question. FI understands that the choice of methodology may cause difficulty in certain cases, at the same time as use of nominal terms may create difficulty in others.

All in all, FI believes that the option of using percentage terms is both simpler and functionally better than using nominal terms. It is also more consistent with the application in other countries.

### **3.9 Position on the disclosure of Pillar 2 guidance**

#### ***3.9.1 Introduction to the question***

This section describes FI application when it comes to disclosure of guidance.

#### ***3.9.2 FI's position***

FI will be publishing notified guidance.

#### ***3.9.3 Comments received***

*The Swedish Bankers' Association* is of the opinion that there should be clarification as to whether guidance will be published only at the group level or allocated to the solo level. Furthermore, the Swedish Bankers' Association stresses that FI must, in its communication of Pillar 2 guidance, clarify that guidance is a recommendation and not a binding requirement.

*AB Svensk Exportkredit* is of the opinion that, when FI published the communicated Pillar 2 guidance, it should make it clear that Pillar 2 guidance does not constitute a binding requirement for the institution.

#### ***3.9.4 Reasons for FI's position***

FI publishes the quarterly memorandum *Capital requirements for Swedish banks* for banks in Supervision Categories 1 and 2 at the group level where

there are such, otherwise at the solo level. The banks' capital requirements and own funds as at the end of the respective quarter are reported in this document.

FI believes that, as with the minimum requirements, Pillar 2 requirements and buffer requirements are published for the larger banks, the levels that apply by virtue of Pillar 2 guidance should also be published in order to provide a complete and transparent view of the total capital requirements. This will allow external observers to determine whether a bank is operating with capital that exceeds or falls below the level of capital that has been communicated through guidance. Disclosure also makes it clear how much capital the bank is choosing to hold in excess of the total capital requirements. Such clarity is important in order to reduce uncertainty during financial stress. Consequently, FI intends to publish communicated guidance, in addition to other requirements, primarily for the larger banks that are already covered by FI's quarterly publication.<sup>61</sup>

Guidance is not a formally decided requirement. However, if it is to act as a buffer during financial stress, it is important that the guidance is also met during more normal times (see section 2.2). As stated in section 1.6, FI has the opportunity to take action if a bank fails to hold sufficient own funds in order to meet the guidance of which FI has notified the bank. Breaching the guidance has no automatic repercussions but FI does have the possibility to take action when this is justified given the situation in question.

The requirements and general guidelines on disclosure that the banks are to apply are described in the consultation memorandum *Förslag till regeländringar på grund av EU:s bankpaket*.

## **4 Management of systemic risk within the buffer framework**

### **4.1 Introduction and background**

#### **4.1.1 Introduction**

The EU regulatory framework contains several supplementary rules on tools for managing systemic risk. In addition to the countercyclical capital buffer (see section 4.5), the Capital Requirements Directive also contains rules on buffers for systemic risk and for systemically important institutions.<sup>62</sup> The latter consists of a buffer for global systemically important institutions (G-SII buffer) and a buffer for other systemically important institutions (O-SII buffer). The buffer requirements shall be met with Common Equity Tier 1 capital.

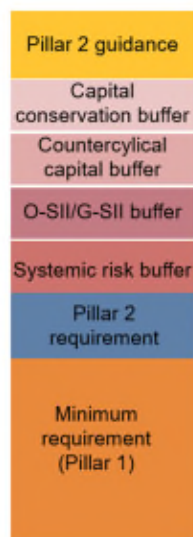
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<sup>61</sup> For more information, please refer to <https://www.fi.se/contentassets/8f311c7b2d6d49918562ec99fba26a4b/kapitalkrav-sv-banker-2020-kv2-eng.pdf>.

<sup>62</sup> There are also tools for managing systemic risk in the Capital Requirements Regulation. These are not covered primarily in this memorandum. Based on Article 124 and Article 164, respectively, of the Capital Requirements Regulation, FI is able to introduce higher risk weights for exposures within the jurisdiction that are secured against real estate. FI is also the authority responsible for measures pursuant to Article 458 of the Capital Requirements Regulation (see section 4.4.3.1).

Through the banking package, it becomes clearer that these buffers, as with other tools in the Capital Requirements Regulation, shall cover different risks and shall therefore not overlap one another. This is consistent with the fact that the banking package also specifies that the requirements are to be added together.<sup>63</sup>

Graph 4.1 The internal relationship between the risk-based capital buffers



#### Risk-based capital requirement

Source: FI

Note: The graph is only illustrative. The size of the various parts of the graph are not to be seen as an indication of how the provisions will actually be implemented.

This section describes in general terms the buffers that are included in the total risk-based requirement and how these relate to one another and to the tools in the Capital Requirements Regulation.<sup>64</sup> This section does not describe the buffers that only relate to a global systemically important institution as Sweden does not have any of these banks. Nor does it describe the requirements that have been introduced in other member states and that FI has reciprocated.

#### **4.1.2 Buffers for systemically important institutions**

A systemically important institution is a bank that is deemed to give rise to risk to the financial system if it were to fall or stop functioning entirely or partially. In the Capital Buffers Act, FI is designated as an authority with the power to both identify what are termed ‘other systemically important institutions’ (O-SII) and to determine requirements concerning a buffer that these banks shall meet in order to mitigate the risk of potential negative effects that they may have on the financial system if they were to run into financial difficulties.

The banking package removes the previous ceiling for the O-SII buffer of 2 per cent. FI is able to independently decide on an O-SII buffer of up to three per

<sup>63</sup> For groups that are subject to both an O-SII and a G-SII buffer, the higher of the two buffers is applied.

<sup>64</sup> The capital conservation buffer is not described because this is set out in law.

cent. Authorisation from the European Commission is required for higher levels.

#### ***4.1.3 The systemic risk buffer***

The purpose of the systemic risk buffer is to mitigate and manage the risk of shocks that may have serious negative effects on the financial system and the real economy of a member state. For example, there may be risks that are grounded in the structure of the financial system. In the banking package, several restrictions on the extent of this buffer requirement have been removed. At the same time, however, it has been made clear that the requirement for a systemic risk buffer is not permitted to cover risks that are covered by other tools.

As a result of the banking package, it is no longer a requirement that the systemic risk be of a structural nature in order for it to warrant a buffer. FI is able to determine the systemic risk buffer rates in several different ways and for all or a group of banks. The banking package gives FI the option to set a systemic risk buffer rate for a subset of exposures, what is known as a 'sectoral systemic risk buffer'. If an exposure is encompassed by more than one systemic risk buffer rate, the total rate is called a 'combined buffer rate'.

There are also provisions on what applies in the event of reciprocation of systemic risk buffers between different member states.

In simple terms, FI is able to decide on a systemic risk buffer of up to three per cent. If FI makes the assessment that the total systemic risk buffer should exceed three per cent, but not five per cent, FI shall request an opinion from the European Commission. If the European Commission does not agree with FI's proposal, FI may then choose to comply with the opinion or to diverge from it by setting the buffer at over three but no more than five per cent and provide an explanation (according to the principle of 'comply or explain'). FI is able to establish a systemic risk buffer of over five per cent only after authorisation from the European Commission.<sup>65</sup>

#### ***4.1.4 Limitations on the total buffer for systemically important institutions and the systemic risk buffer***

The bank's O-SII buffer is added to the systemic risk buffer. If the sum of these two buffer requirements exceeds five per cent, FI may only adopt them if the measure has been authorised by the European Commission.<sup>66</sup>

## **4.2 Legal basis**

The provisions of the Capital Requirements Directive concerning a buffer for O-SII and the systemic risk buffer have been inserted into the Capital Buffers Act.

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<sup>65</sup> There are specific provisions concerning how reciprocated buffer rates shall be taken into account.

<sup>66</sup> There are specific provisions concerning how reciprocated buffer rates shall be taken into account.

According to Chapter 1, Section 3 of the Capital Buffers Act, FI supervises compliance with the provisions of the Capital Buffers Act and under other provisions of the same act, FI has the right to decide on these buffers.

According to Chapter 1, Section 6 of the Special Supervision Act, FI is the competent authority under the Capital Requirements Regulation to supervise compliance with the regulation.

#### **4.2.1 Capital buffer for other systemically important institutions – O-SII buffer**

The provisions concerning the buffer for O-SII have been inserted into Chapter 5 of the Capital Buffers Act. According to Chapter 5, Section 3, FI has the right to decide that a bank shall have a capital buffer for O-SII at the individual level, sub-group level or group level. Chapter 5, Section 4 makes it clear that FI is able to set a buffer for O-SII at maximum of three per cent of the bank's risk-weighted assets. FI is only permitted to set the buffer at more than three per cent if the authority has first complied with the notification requirement set out in Article 131(7) of the Capital Requirements Directive and this measure has been authorised by the European Commission in accordance with Article 131(5)(a) of the Capital Requirements Directive.

#### **4.2.2 Systemic risk buffer**

The provisions concerning a systemic risk buffer are in Chapter 4 of the Capital Buffers Act. According to Chapter 4, Section 1, FI has the right to decide that a bank shall have a systemic risk buffer at the individual level, sub-group level or group level. The systemic risk buffer may not be used to cover risk that are already covered by a capital requirement pursuant to the Capital Requirements Regulation or by a countercyclical capital buffer or a capital buffer for systemically important institutions.<sup>67</sup>

Chapter 4, Section 3 of the Capital Buffers Act indicates that FI is able to decide on a systemic risk buffer rate that does not result in a combined buffer rate of more than three per cent of an exposure.<sup>68</sup> FI may decide on a systemic risk buffer rate that results in a total buffer rate for an exposure of more than three per cent, but no more than five per cent. However, this requires FI to request an opinion from the European Commission and that FI alters course based on the opinion or explains why it is not doing so.<sup>69</sup> FI is able to set a systemic risk buffer rate for an exposure that results in a combined buffer rate<sup>70</sup> of over five per cent, but this requires the measure to be authorised by the

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<sup>67</sup> Chapter 4, Section 6 indicates that if FI decides on a systemic risk buffer pertaining to exposures in other member states, the same buffer level shall apply to all of the bank's exposures within the EEA outside of Sweden. However, buffer rates that are introduced in other countries and FI has reciprocated are not applicable.

<sup>68</sup> FI is able to make the decision one month after it has complied with the notification requirement pursuant to Article 133(9) of the Capital Requirements Directive.

<sup>69</sup> In other words, according to the principle of 'comply or explain' that is set out in Article 133(11).

<sup>70</sup> According to Chapter 4, point 2 of the Capital Buffers Act, the combined buffer rate is the sum of the various systemic risk buffer rates that an exposure is encompassed by. This is not to be confused with the combined buffer requirement.

European Commission in accordance with Article 133(12) of the Capital Requirements Directive. Chapter 4, Section 4 of the Capital Buffers Act states that FI has the right to maintain or reduce a buffer rate without requesting an opinion or authorisation from the European Commission.<sup>71</sup>

### **4.3 Position on the question of a buffer for other systemically important institutions**

#### **4.3.1 Introduction to the question**

In this section, FI sets out its position on the level and scope of the O-SII buffer for the banks that are designated as other systemically important institutions.

#### **4.3.2 FI's position**

Swedbank AB, Svenska Handelsbanken AB and Skandinaviska Enskilda Banken AB shall, at the group level, hold a capital buffer for other systemically important institutions of 1 per cent as of the date on which the amendments to the Capital Buffers Act enter into force, but no later than 1 January 2021.

Nordea Hypotek AB shall continue to be subject to an O-SII buffer of 0 per cent.

#### **4.3.3 Comments received**

*The Riksbank* is of the opinion that FI should decide that systemically important banks shall continue to hold an O-SII buffer that is at least as large as it has been historically. The Riksbank notes that FI's justification for the reduction of the O-SII buffer is that this is partly due to the introduction of Pillar 2 guidance. The Riksbank's position is based on the fact that Pillar 2 guidance does not constitute a formally decided requirement and that the capital in the guidance is thus not as usable for absorbing losses.

#### **4.3.4 Reasons for FI's position**

The reason why the three major banks will be subject to an O-SII buffer of 1 per cent is that they each, through their operations, create risks that have the potential to affect not just their own survival but also threaten the stability of the entire financial system.

The rules for how systemically important institutions are to be designated remain largely unchanged when compared with the current rules. The assessment of what constitutes other systemically important institutions is based on the guidelines issued by the EBA.<sup>72</sup> The basic criteria consist of the bank's size and significance to the economy, its complexity (including cross-border operations) and interconnectedness with the financial system. When FI is assessing a bank, it is allocated what is known as an 'O-SII score', which

<sup>71</sup> The measure needs to be reported to the ESRB.

<sup>72</sup> For more information, please refer to

<https://eba.europa.eu/sites/default/documents/files/documents/10180/930752/964fa8c7-6f7c-431a-8c34-82d42d112d91/EBA-GL-2014-10%20%28Guidelines%20on%20O-SIIs%20Assessment%29.pdf>.



quantifies the importance it is deemed to have for the stability of the financial system. On top of this, it is possible for FI to conduct a qualitative assessment. The focus is on the significance of the individual bank to the stability of the entire system through the risk of problems for the bank spreading to other financial firms. The more important a bank is deemed to be to the system, the larger the O-SII buffer that FI is justified in requiring that it holds.

Which banks are designated O-SII and what capital buffer shall be imposed on them shall, in future, as is currently the case, be evaluated annually.<sup>73</sup>

According to the review that was conducted in June 2020, groups that were led by Swedbank AB, Skandinaviska Enskilda Banken AB and Svenska Handelsbanken AB remained as O-SII with a buffer requirement of two per cent. Nordea Hypotek AB was also identified as an O-SII, but with a buffer requirement of 0 per cent.

The review indicates that systemic importance is dominated by the three major banks that each account for approximately 15, 25 and 20 per cent, respectively, of the total number of O-SII points. The EBA recommends a threshold for O-SII identification of 3.5 per cent of the total number of points. Accordingly, the three major banks are well above this threshold.

FI makes the assessment that, through their operations, the three major banks each create risks that may affect not just the survival of the individual bank but also entail a threat to the stability of the entire financial system. They should therefore be subject to a requirement to hold an O-SII buffer. However, FI believes, in view of the changes resulting from the banking package, including the clearer justification of the buffer and the introduction of Pillar 2 guidance that is expected to strengthen the banks' resilience, that there is reason to reduce the O-SII buffer for the major banks from 2 to 1 per cent. The Riksbank argues that capital which is covering Pillar 2 guidance is not as usable for absorbing losses because guidance is not a formally decided requirement. FI makes the assessment that capital which is covering Pillar 2 guidance is at least just as usable, if not more so, as capital that is covering the O-SII buffer. Both the O-SII buffer and the guidance shall be met with Common Equity Tier 1 capital. However, unlike the O-SII buffer, the guidance does have greater flexibility in terms of its structure. This means that FI has more potential to act on the basis of the specific situation. The high degree of transparency that FI intends to apply to the Pillar 2 guidance also ensures that outsiders also gain an insight into whether a bank is permitted in a certain situation to fall below the Pillar 2 guidance without FI intervening. As indicated in section 2.2, FI believes it is important that the guidance is met under more normal times in order to enable it to act as a buffer during periods of financial stress. This section also states that the level of the capital requirement, when it comes to

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<sup>73</sup> FI's published list for 2020, with calculations for the systemic importance of groups, <https://www.fi.se/contentassets/2e982061e8574f79ba3d59b547751829/identifying-kapitalbuffertpaslag-o-sii-2020.pdf>.

the buffers, the Pillar 2 requirements and the guidance, needs to be evaluated in the specific situation.

In view of this, FI does not share the Riksbank's opinion that the O-SII buffer should be kept as low as the previous level. Despite the reduction, the combined buffer requirement is becoming higher than it is today as a result of the O-SII buffer and the systemic risk buffer being added together. In this context, it should be noted, however, that the add-on for systemic risk in Pillar 2 of 2 per cent is being abolished and thus counteracts an increase in the total level of the capital requirements.

Nordea Hypotek AB has approximately 3.3 per cent of the total number of O-SII points. The bank is subject to an O-SII buffer of 2 per cent that the Finnish supervisory authority imposes on Nordea Bank Abp at the group level. Consequently, FI believes that a buffer requirement of 0 per cent for Nordea Hypotek AB remains justified. The assessment of which banks are classified as O-SII and the size of the buffer are subject to annual review.

#### **4.4 Position related to the systemic risk buffer**

##### ***4.4.1 Introduction to the question***

In this section, FI describes its position on the level and scope of the systemic risk buffer. The major Swedish banks have been subject at the group level to a systemic risk buffer of 3 per cent in Pillar 1 since 1 January 2015.

##### ***4.4.2 FI's position***

Swedbank AB, Svenska Handelsbanken AB and Skandinaviska Enskilda Banken AB shall continue to hold at the group level a systemic risk buffer of 3 per cent for the total exposures of the group.

FI intends to send out new decisions concerning the systemic risk buffer that apply from the date on which the Capital Buffers Act enters into force, but not later than 1 January 2021.

##### ***4.4.3 Comments received***

*The Swedish Bankers' Association* is of the opinion that any divergences in the structure of the Swedish capital requirements compared with the capital requirements applied in the rest of the EU need to be justified and that there is a cost associated with unjustified divergences from how the requirements are generally applied in these countries. The Swedish Bankers' Association believes it is of particular importance that the capital requirements which affect the level of the MDA<sup>74</sup> are applied in a consistent and well-founded manner in all member states. Unjustifiably high levels of the MDA for Swedish banks result in them needing to hold more capital than banks in other member states in order to enable them to issue Additional Tier 1 capital instruments on competitive terms. The Swedish Bankers' Association concludes that the

<sup>74</sup> The level of the capital requirement at which the automatic restrictions on value transfers kick in.

banking package specifies that relevant competent or appointed authorities should endeavour to avoid overlapping or inconsistent application of the regulatory framework's macroprudential measures.

The Swedish Bankers' Association is under the impression that the argument in favour of retaining a systemic risk buffer of 3 per cent for the three largest banks is not sufficiently substantiated and provides a number of arguments to support this view. The Swedish Bankers' Association believes that the systemic risk buffer for the three major Swedish banks at the group level should be reduced to 1 per cent so that the total capital requirement for systemic risk within the scope of the combined buffer requirement amounts to 2 per cent. The Swedish Bankers' Association states that this would entail a more justified and consistent application of the capital requirements in accordance with the banking package and would also result in the important level of the MDA for Swedish banks ending up more in line with the level that applies to banks in other EU countries. The Swedish Bankers' Association generally believes that, instead of imposing capital requirements that affect the level of the MDA, FI should work with 'usable buffers' such as Pillar 2 guidance. In order to ensure consistent and uniform application of the regulatory framework among member states, FI needs to be able to demonstrate that the Swedish banking system is large, more concentrated and more interconnected than the banking systems of comparable EU countries and that the repercussions of a banking crisis would therefore risk being greater in Sweden.

The Swedish Bankers' Association also believes that the application of macroprudential measures overlaps as Swedish mortgages have to have both a systemic risk buffer and are subject to a risk weight floor in accordance with Article 458 of the Capital Requirements Regulation, which includes systemic risks. FI needs to ensure that there is no overlapping application. The Swedish Bankers' Association contends that the EBA addresses the fact that these measures overlap as a comment in its latest opinion on the continued application of Article 458 (EBA/Op/2020/16). Furthermore, the Swedish Bankers' Association argues that, in its opinion, the EBA orders FI to review how it intends to apply these measures in relation to one another after 2021.

#### ***4.4.4 Reasons for FI's position***

All in all, FI is of the opinion that the three major banks shall continue to have a systemic risk buffer at the group level of 3 per cent.<sup>75</sup> The reason for this is primarily to mitigate the structural systemic risk that arises due to these three groups having large similarities. Consequently, the risk of a problem in one major bank coinciding with problems in the other two is appreciably greater than for the other banks in the marketplace. Because these three banks also constitute a large share of the market, the repercussions are much more serious were problems to arise.

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<sup>75</sup> On top of this, there may be additional requirements that have been introduced in other countries if FI reciprocate their requirements.

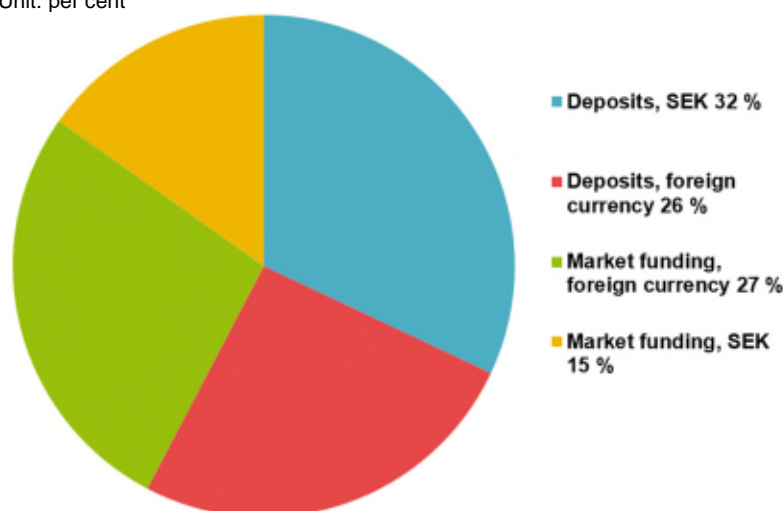
The Swedish banking system is large in relation to the size of the economy. It is also concentrated and interconnected. On top of this, the banking system is characterised by a high degree of market financing, including a substantial element of financing in foreign currencies (Graph 4.2).

The banking system is characterised by a high degree of market concentration. There are three major Swedish banks, which are also O-SII, that operate in the bulk of Sweden. Together with the two foreign banks Nordea and Danske Bank's Swedish operations, they account for approximately 71 per cent of the banking system's total lending to the general public in Sweden (Graph 4.3) and 78 per cent of its assets (Graph 4.4).

Unlike the smaller Swedish banks, the three major banks are similar to one another in that they have substantial operations outside of Sweden, primarily in northern Europe, and are active to a greater extent on the international financial markets. These international operations make the major banks more vulnerable to international economic problems and international financial stress.

In addition to this, the three major banks' respective groups have similar business models, a broad asset structure and similar levels of risk. All three banks are exposed to many market segments. Consequently, they are interconnected through their exposures and business models. These banks' combined market share, in combination with their similarities, means that there is a structural systemic risk that increases the vulnerability of the Swedish banking system. The risk of a problem with one major bank coinciding with problems that also arise in the other two is thus appreciably greater than for the other banks in the marketplace.

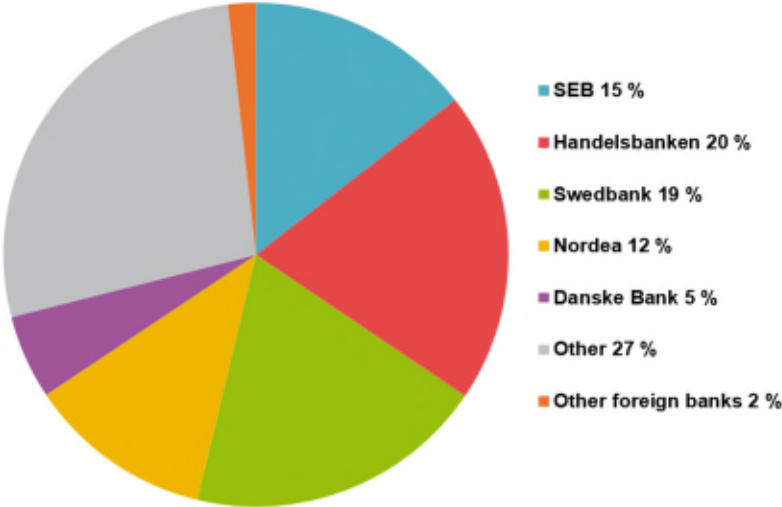
Graph 4.2. Half of the major banks' funding comes from the securities market  
Unit: per cent



Source: FI

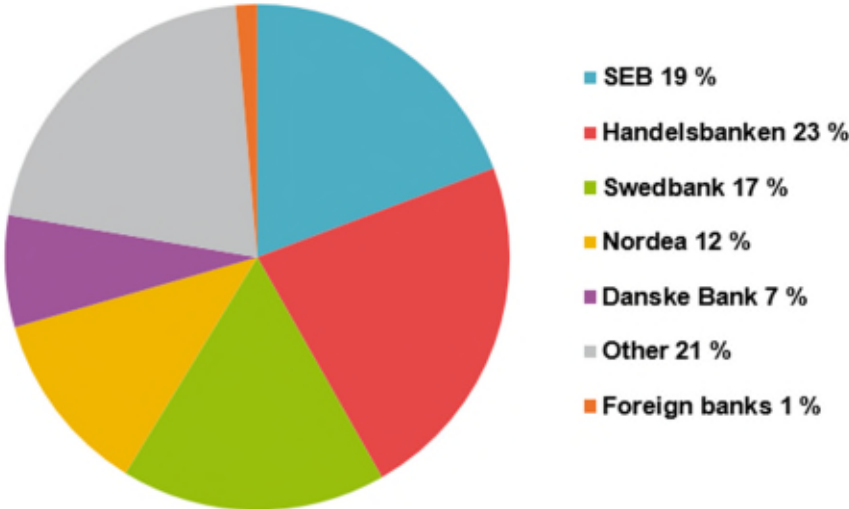
Note: Data for Q2 2020. Equity and liabilities are not included in the calculation of the banks' liabilities.

Graph 4.3. Lending to the public in Sweden  
Unit: per cent



Source: FI and Statistics Sweden.  
Note: Data for Q2 2020. Also includes foreign bank's branches and subsidiaries.

Graph 4.4. Distribution of the banks' assets  
Unit: per cent



Source: FI  
Note: Data for Q2 2020. Also includes foreign bank's branches and subsidiaries.

The similarities between the major banks also means that the market may, to a greater extent, presuppose that a problem in one major bank is also present in the other two, further exacerbating the structural risk. Consequently, there is a dependency of confidence between the three of them.

Major shocks in the financial system risk leading to serious and negative repercussions for the real economy, and it may be difficult to alleviate a crisis without substantial cost to society. The Swedish structure means that there is a

concentration of risk and clear links between the major banks. There is thus a risk that a crisis will affect the system as a whole. The risk of a financial crisis is not necessarily greater in Sweden than in other countries, but there is a risk that the consequences of a banking crisis would be substantial if it were to happen here. One contributory factor in this respect is the central role played by the major banks in the supply of credit to the real economy. The banks' ability to continue lending is especially important during periods of crisis.

The level of the systemic risk buffer tracks the degree of risk. However, it is necessary in large parts to conduct a qualitative assessment when setting the size of the systemic risk buffer. The regulatory framework gives FI a mandate to set a systemic risk buffer of up to 3 per cent without requesting an opinion or authorisation from the European Commission. FI makes the assessment that there are reasons to keep the systemic risk buffer at its existing level and has taken into account the various aspects and principles in its assessment. In this case, the principle of usable capital has been given more weight than the aspect concerning any deviations from the capital requirements that are applied in the rest of the EU. As set out in section 2.2, FI believes it is important for banks that are of systemic importance to have more usable capital in order to make them better equipped to manage any problems and able to continue lending during periods of financial stress. Usable capital has proved to be an important component and the current buffers have contributed to the Swedish banking system having remained functional during the coronavirus pandemic.

Section 2.2 also describes how FI has the opportunity to reduce or remove certain parts of the capital requirement, for example if risks that have been included in the assessment have materialised. This description also covers the systemic risk buffer. In the same way as systemic risk may vary over time, the capital requirements for systemic risk can also be changed before, during and after a systemic crisis.

#### *4.4.4.1 Measures that complement one another*

The O-SII buffer manages the risk that each individual O-SII constitutes for the system. However, the fact that there are three banks with similar risk profiles that together account for a large portion of the operations in the banking market creates structural systemic risks that are covered not by the O-SII buffer but by the systemic risk buffer.

The systemic risk buffer also complements the countercyclical buffer, the purpose of which is to manage not structural systemic risks but systemic risks that vary over time, and is thus intended to ensure that banks have sufficient capital to continue lending in the event of shocks in the financial system (see section 4.5).

Through Article 458 of the Capital Requirements Regulation, FI applies a risk weight floor of 25 per cent for Swedish mortgages. The risk weight floor for Swedish mortgages is justified with respect to financial systemic risks. The measure applies until 30 December 2020, inclusive. FI is working on an

extension to the measure.<sup>76</sup> On 12 November, the European Commission decided not to propose that the Council of the European Union reject the extension.<sup>77</sup>

As mentioned by the Swedish Bankers' Association, the EBA has issued an opinion concerning the extension of the measure.<sup>78</sup> The opinion also states that the EBA does not object to FI's intention to extend the risk weight floor. FI's assessment is that the application of Article 458 of the Capital Requirements Regulation and the systemic risk buffer do not overlap. Nor does the ESRB object to FI's intention to extend the risk weight floor.<sup>79</sup>

#### **4.5 Countercyclical capital buffers**

The level of the Swedish countercyclical capital buffer rate is currently managed through the regulations that FI issues pursuant to Chapter 7, Section 1 of the Capital Buffers Act. The set buffer rate is based on the authority's assessment of cyclical systemic risks that are caused by excessive credit growth. FI focusses its assessment on the current circumstances in the credit market such as the rate of growth in banks' lending to corporates and households and the level of indebtedness. The banking package does not result in any major changes to how the buffer is applied. However, it does appear that FI has to calculate a countercyclical buffer rate on a quarterly basis, but that FI does not need to set the countercyclical buffer rate each quarter and is instead able to set or change it when necessary.

## **5 Different times for the introduction of the changes**

### **5.1 Introduction to this area**

The banking package and changes to the Swedish regulatory framework entail changes to how FI applies the capital requirements. In this section, FI clarifies when these changes will be introduced.

### **5.2 Comments received**

*AB Svensk Exportkredit* is of the opinion that, when disclosing indicative capital requirements, FI should state clearly that this is not a formally communicated assessment of an adequate level for own funds. The company

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<sup>76</sup> For more information, please refer to <https://www.fi.se/contentassets/9f5fa47c2214445389dc1a53a52ea331/notifikation-artikel-458-crr-2020-09-16n.pdf>.

<sup>77</sup> For more information, please refer to <https://www.fi.se/en/published/news/2020/european-commission-approves-extension-of-the-risk-weight-floor-for-swedish-mortgages/>.

<sup>78</sup> For more information, [https://eba.europa.eu/sites/default/documents/files/document\\_library/Publications/Opinions/2020/934115/EBA-Op-2020-16%20-%20EBA%20Opinion%20on%20measures%20in%20accordance%20with%20Art%20458%20%28SE%29.pdf](https://eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2020/934115/EBA-Op-2020-16%20-%20EBA%20Opinion%20on%20measures%20in%20accordance%20with%20Art%20458%20%28SE%29.pdf).

<sup>79</sup> For more information, please refer to <https://www.esrb.europa.eu/mppa/opinions/html/index.en.html>

also believes that in 2021, there is a risk of unfavourable treatment and competitive advantages/disadvantages proportionate to how some institutions in Supervision Categories 2–4 will be subject to Pillar 2 guidance in 2021, while supervisory review and evaluation for other institutions will only take place in 2022 or later. FI should state clearly in the memorandum that compliance with new Pillar 2 guidance is not expected in 2021 (or the first current year after amendments to the Special Supervision Act have entered into force).

*The Swedish Bankers' Association* is of the opinion that the memorandum needs to describe more clearly how the transition period, from the point at which the new provisions enter into force until the first supervisory review and evaluation is conducted, is being handled for different supervision categories. It should be made clear how the disclosure of guidance will take place during this period.

*The Swedish National Debt Office* welcomes clarification of the fact that the indicative levels published by FI constitute in practice applicable Pillar 2 requirements, until such time as an institution is subject to decided Pillar 2 requirements. This would facilitate the application of future MREL requirements.

*The Association of Swedish Finance Houses* contends that it should be stated more clearly how the introduction is being implemented for different supervision categories.

### 5.3 Clarification about introduction times

The changes that apply by virtue of the banking package will begin being applied at different times. This summary describes some of the areas that have the greatest impact on the banks. The bulk of them apply by virtue of law.

Table 5.1 Summary of times for the introduction of various changes

Area	Time
Decisions that relate to the scope and level of the O-SII buffer (section 4.3) and the systemic risk buffer (section 4.4)	FI intends to decide on changes to the O-SII buffer and the systemic risk buffer at the same time as the amendments to the Capital Buffers Act enter into force, but no later than 1 January 2021.
Setting the size of the combined buffer requirement (section 4.1)	Requirements for the O-SII buffer and the systemic risk buffer are added together in the combined buffer requirement when the amended Capital Buffers Act enters into force.
Add-ons for systemic risk of 2 per cent in Pillar 2 (section 3.3) and capital requirements in Pillar 2 that pertain to maturity assumptions (section 3.5)	Are removed when the amended Special Supervision Act enters into force.



Decision concerning Pillar 2 requirements and notifications concerning Pillar 2 guidance (section 3)	After the first supervisory review and evaluation that is implemented following the entry into force of the amended Special Supervision Act. The time may therefore differ from bank to bank.
Leverage ratio requirements (section 1.4.2.1)	According to the Capital Requirements Regulation, the minimum requirement for leverage ratio shall be applied from 28 June 2021.

Rules on the calculation of the combined buffer requirement and provisions on the various buffers are set out in Chapter 2, Section 2 of the Capital Buffers Act. Consequently, amendments to these components only gain effect once the Capital Buffers Act enters into force. Section 4.3.2 indicates that FI intends to decide on changes to the O-SII buffer and the systemic risk buffer so that these changes begin to apply at the same time as the amendments to the Capital Buffers Act enter into force, but no later than 1 January 2021.<sup>80</sup>

The potential for FI to manage systemic risk through Pillar 2 ceases to apply when the amendments to the Special Supervision Act enter into force. This means that add-ons for systemic risk in Pillar 2 and the memorandum *Pillar 2 capital requirements for maturity assumptions* (FI Ref. 16-2703), which have been justified in part by the risks to the financial system, are removed when the amendments to the Special Supervision Act enter into force. Consequently, this does not require any specific procedure.

FI conducts an annual supervisory review and evaluation of systemically important banks in Supervision Category 1.<sup>81</sup> Banks included in Supervision Category 2 are normally subject to this assessment every other year. FI conducts the supervisory review and evaluation more infrequently for the majority of smaller banks and groups as long as there is no indication of significant risks to their financial health or non-compliance with regulatory frameworks.

In accordance with Chapter 2, Section 1 and Section 1c of the Special Supervision Act, FI is able to decide on a Pillar 2 requirement and notify the bank of Pillar 2 guidance that is based on a supervisory review and evaluation. FI will decide on Pillar 2 requirements and notify the banks of guidance after the first supervisory review and evaluation to which the bank is subject after the amendments to the Special Supervision Act have entered into force. Because the provisions concerning leverage ratio start applying on 28 June

<sup>80</sup> The law as it currently stands allows FI to decide on the proposed O-SII buffer and the systemic risk buffer. However, they are not being added together in the combined buffer requirement until the amended act enters into force.

<sup>81</sup> For more information about the supervision categories, please refer to <https://www.fi.se/contentassets/0ba815d50b964a128b20e961f86da9ce/tillsynskategorisering-kreditinstitut-filialer-2021.pdf>.

2021, a supervisory review and evaluation that is decided after this date will also encompass the leverage ratio provisions. However, this does not exclude the possibility of FI deciding applicable Pillar 2 requirements at an earlier stage when this is justified, for example on the basis of the bank's capital position.

FI understands the need for further clarity, which several consultative bodies have called for, about what applies during the transition period between the introduction of the act until such time as the bank is subject to a supervisory review and evaluation. FI intends to provide more information about the practical introduction process during the transition period.

#### **5.4 Transparency**

Because the changes to the various parts of the capital requirements start to apply at different times, it may be difficult for external stakeholders to gain an understanding of which requirements a bank is subject to and how well it is complying with applicable requirements at a certain time. FI will therefore continue publishing the capital requirements for banks in Supervision Categories 1 and 2 on a quarterly basis. FI's previous assessment of the risks remains in force until such time as the authority has conducted a new assessment.

FI's published levels will be indicative once the amendments to the Special Supervision Act have entered into force and until such time as a bank is subject to Pillar 2 requirements that have been decided in respect of the bank and the bank has been able to receive a notification concerning Pillar 2 guidance. The published capital requirement will reflect the capital need from the supervisory review and evaluation that has been conducted in 2020, adjusted for the new rules that have become applicable. These indicative data on Pillar 2 requirements do not affect the level at which the bank is in breach of the combined buffer requirement. Consequently, breaches of the combined buffer requirement do not necessarily result in automatic restrictions on value transfers until such time as the bank is subject to decided Pillar 2 requirements.

## **6 Impact assessment**

### **6.1 Introduction**

FI is basing its positions on how they affect the total capital requirement. Consequently, the impact assessment describes the combined effect of the changes to the regulatory framework, with some minor simplifications. For example, the description does not take into account the fact that different parts of the capital requirements start applying at different times. It should be noted in this context that a substantial portion of the effects result from changes that apply directly by virtue of law and are thus not affected by FI's position. These effects are described in the report *EU:s bankpaket om riskreducerande åtgärder* and in Govt Bill 2020/21:36, but they do not affect the outcome of this impact assessment.

All in all, FI is of the opinion that the impact assessment shows that the positions have appropriate and reasonable effects, and that they strike a reasonable balance between the principles described in section 2.1.

FI notes that the parallel requirements (risk-based and leverage ratio-based) entail increased complexity for banks, authorities and other stakeholders that monitor and assess banks' capital position. The outcome may be very different for different banks and the relationship between the risk-based requirements and the leverage ratio requirement may also vary over time. Because the parallel provisions apply by virtue of the Capital Requirements Regulation and law, FI is not able to remove this complexity. Consequently, FI's strive for simplicity and predictability largely relates to not making the overall picture even more complex.

### **6.1.1 Comments received**

*AB Svensk Exportkredit* is of the opinion that it is worrying that the proposal involves smaller institutions' total capital requirements increasing more than those of the major banks, which, in some cases, even have their requirements reduced. The company states that this may have a serious impact on competition, with the major banks being favoured in relation to smaller institutions and the threshold for new institutions establishing themselves in the Swedish market increasing.

## **6.2 Impact on undertakings**

### **6.2.1 Undertakings affected**

The positions in this memorandum affect all of the firms that are subject to the Special Supervision Act and the Capital Buffers Act to at least some extent. This includes credit institutions, including banks, and some investment firms, at both the solo level and the group level. However, as set out in section 1.2, the term 'bank' is used in this memorandum as a collective term for all of these types of firm.

The proposed changes encompass approximately 168 institutions, of which 116 are credit institutions and 52 are investment firms. On top of this, approximately 52 institutions are affected on a consolidated basis. Beginning in June 2021, the vast majority of investment firms will no longer be subject to the Capital Requirements Regulation and the Capital Requirements Directive, and associated national provisions, and will instead be subject to the new capital adequacy framework for investment firms.<sup>82</sup> This means that the practical repercussions of the proposed positions in this memorandum should be extremely limited for these companies.

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<sup>82</sup> The new capital adequacy framework for investment firms consists of Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No 1093/2010, (EU) No 575/2013, (EU) No 600/2014 and (EU) No 806/2014, and the national provisions implementing Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU.

### **6.2.2 General information about the impact on major banks**

The three systemically important major banks are currently subject to a Common Equity Tier 1 capital requirement relating to systemic risks of a total of 5 per cent. The requirement consists of an add-on for systemic risk in Pillar 2 of 2 per cent, a systemic risk buffer in Pillar 1 of 3 per cent and an O-SII buffer of 2 per cent. The O-SII buffer has no practical effect under the current law as it is only the higher of the systemic risk buffer and the O-SII buffer that applies.

This memorandum describes how the add-on for systemic risk of 2 per cent in Pillar 2 is being removed. At the same time, the systemic risk buffer and the proposed O-SII buffer of 1 per cent are being added together. On top of this, the Pillar 2 guidance is deemed to also apply to the major banks and amount to an estimated 1 to 1.5 per cent of risk-weighted assets.

The proposed structure, with a systemic risk buffer of 3 per cent, an O-SII buffer of 1 per cent and a Pillar 2 guidance of an estimated 1–1.5 per cent (i.e. a total of 5–5.5 per cent), therefore means that the major banks are expected to be given an unchanged or slightly higher capital requirement as a result of FI's application.

However, the impact of the changes described here is that the level at which automatic restrictions on value transfers begin to apply rises by one percentage point.<sup>83</sup> This is because the O-SII buffer and the systemic risk buffer are being added together and, as a result, a larger portion of these buffers is encompassed by the combined buffer requirement than under the current regulations (see section 6.2.3.4).

### **6.2.3 The total capital requirements and their components**

This section contains descriptions of calculations and their outcome.

#### *6.2.3.1 Description of the calculations*

The following section contains a description of the estimated effects for banks in Supervision Categories 1 and 2 that are covered by FI's quarterly publication for the second quarter of 2020.<sup>84</sup> The reason why the smaller banks are not covered is that the impact on these is primarily attributable to amendments to regulations, directives and acts rather than the positions presented in this memorandum.

The data are based on what the outcome would have been if the proposed application and certain other changes were based on data that the banks have

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<sup>83</sup> In addition, the level is affected by the fact that the Pillar 2 requirements will be formally decided.

<sup>84</sup> Kommuninvest has been excluded from the institution-specific data because of its specific business model, which means that it currently has Pillar 2 add-ons attributable to the leverage ratio requirement. The data pertain to the group level where applicable. Subsidiaries included in a consolidated position that is subject to another country's supervision are not included in the compilation.

reported to FI for the second quarter of 2020, with some exceptions and additions.<sup>85</sup>

The graph and the calculations contain simplifications and assumptions. For example, only the most material changes that apply by virtue of acts and regulations have been taken into account. Proposed changes in the consultation memorandum *Förslag till regeländringar på grund av EU:s bankpaket* have not been taken into account.

The calculations concern the group level, where applicable. The size of the various components of the capital requirement is estimated as per the following.

#### *The risk-based capital requirement*

*Minimum requirement:* 4.5 per cent Common Equity Tier 1 capital, 6 per cent Tier 1 capital and 8 per cent total capital requirement.

*Capital requirement in Pillar 2:* The information is based on Pillar 2 add-ons as per the second quarter of 2020. In addition, the Pillar 2 add-on for commercial real estate exposures is included as FI has clarified in a previous communication that it intends to calculate a capital add-on for credit exposures to the commercial real estate sector when assessing banks' Pillar 2 capital requirements as of 2020.<sup>86</sup> The Pillar 2 requirements whose levels are affected by the size of the buffers have been recalculated in line with the positions. The add-on for systemic risk of 2 per cent in Pillar 2 and the Pillar 2 add-on for maturity assumptions are excluded in accordance with section 3. The calculations are based on the distributions of type of capital as specified in law.<sup>87</sup>

In the data, the Pillar 2 requirements are reported as having been decided for the banks on the basis of the assumptions above. FI would like to clarify that this has only been done for illustrative purposes in order to indicate the outcome given the reported assumptions.

*Systemic risk buffer:* 3 per cent of risk-weighted assets for the three major banks. Covered entirely by Common Equity Tier 1 capital.

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<sup>85</sup> The data have been taken primarily from:

<https://www.fi.se/contentassets/8f311c7b2d6d49918562ec99fba26a4b/kapitalkrav-sv-banker-2020-kv2-eng.pdf> and what was received by FI on 11 August 2020. The impact assessment is therefore based on a statistical balance sheet and does not capture any changes in exposures that may be the result of altered incentives as a consequence of the banking package.

<sup>86</sup> This add-on is based on the nominal level that was communicated in:

<https://www.fi.se/contentassets/039759adf2374926b3304e1883abde93/pm-kapitalkrav-banklan-komm-fastigh-19-14171.pdf>.

<sup>87</sup> It is possible for FI to deviate from the capital distribution specified as a basis in law. For example, in the impact assessment, FI has not taken into account the fact that the add-on for increased capital requirements on bank loans for commercial real estate is given a different capital distribution than that which the law specifies as a basis.

*Buffer for O-SII:* 1 per cent of risk-weighted assets for the three major banks. Covered entirely by Common Equity Tier 1 capital.

*Capital conservation buffer:* 2.5 per cent of risk-weighted assets according to law. Covered entirely by Common Equity Tier 1 capital.

*Pillar 2 guidance:* An indicative level of 1 per cent for all banks, except for the bank that, as per the second quarter, was subject to a capital planning buffer in excess of 1 per cent. Covered entirely by Common Equity Tier 1 capital.

*Countercyclical capital buffer:* The countercyclical buffer that appears in *Capital requirements for the Swedish banks, second quarter 2020*.

*Risk-weighted assets:* The risk-weighted assets that are reported for the second quarter of 2020. This means that some of the changes, primarily concessions, that apply by virtue of the banking package can already be included in the banks' reported data. One example is the expanded concession on risk-weighted assets for lending to small and medium-sized enterprises.<sup>88</sup> The introduction of this concession has been brought forward in the Capital Requirements Regulation as a support measure due to the coronavirus pandemic. As per the second quarter, the concession has been taken into account to a varying extent by the banks. This means that a comparison of the banks may be somewhat misleading in this respect.

#### *Leverage ratio requirement*

*Minimum requirement:* Three per cent of the total exposure amount for leverage ratio. This information is based on the banks' reported data for the second quarter of 2020 and therefore does not take into account certain amendments to the Capital Requirements Regulation resulting from the banking package and that start to apply on 28 June 2021.

*Pillar 2 requirements:* Assumed level of 0 per cent. This information is based on outcome as per the second quarter of 2020 where the banks that are covered by the compilation do not have Pillar 2 requirements for excessive indebtedness.

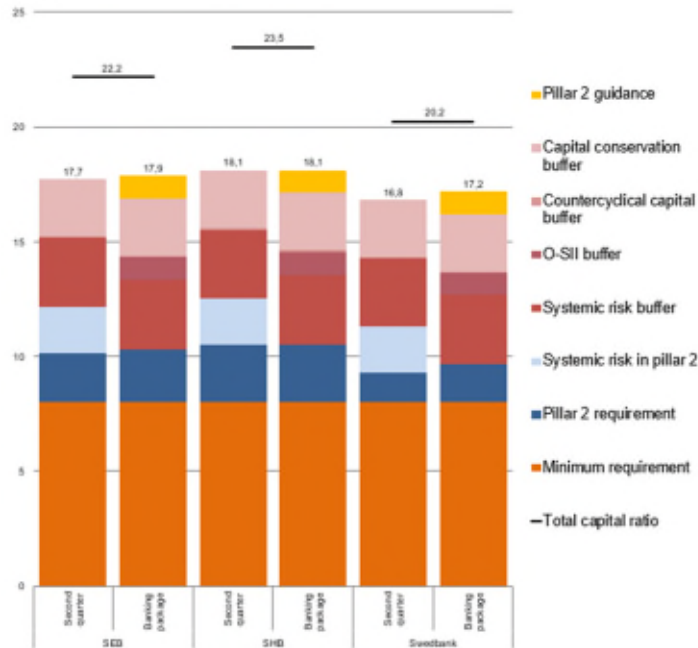
*Pillar 2 guidance:* An indicative level of 0.35 per cent of the total exposure amount for leverage ratio for all banks. Covered entirely by Common Equity Tier 1 capital.

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<sup>88</sup> When risk-weighted assets decrease, the capital requirements that are calculated as a percentage of risk-weighted assets also decrease. The level of the concession varies between the firms. FI's calculations indicate reductions of an estimated 1.5–2 per cent of risk-weighted assets. The discrepancies may be substantial both upwards and downwards, depending primarily on the bank's business model. The banks' reported capital ratios are also strengthened by these concessions.

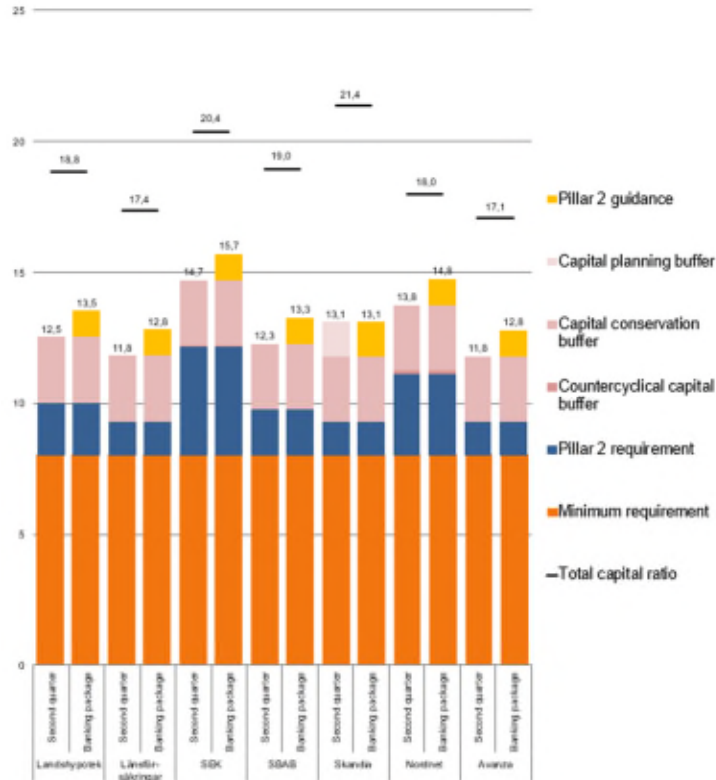
6.2.3.2 Outcome of the application of the changes to the regulatory framework

Graph 6.1. Total risk-based capital requirement for the three major banks.  
Unit: per cent



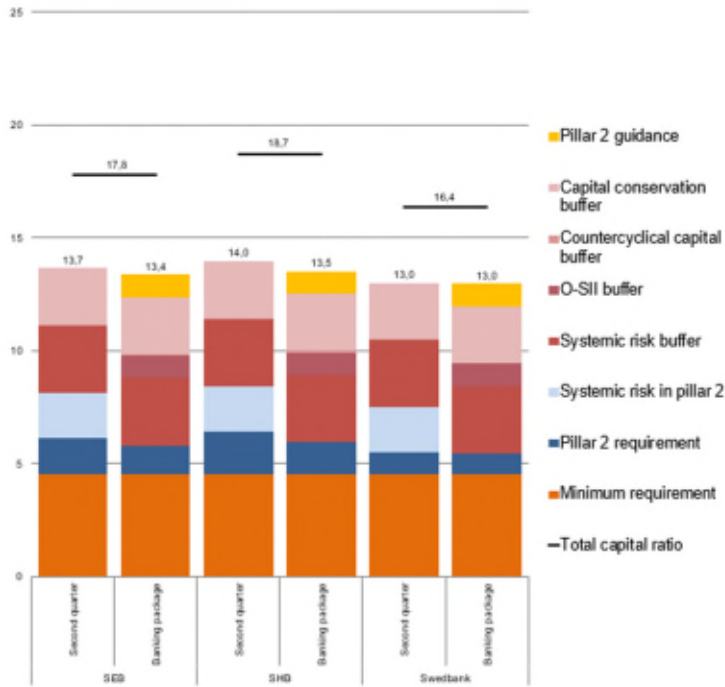
Source: FI

Graph 6.2. Total risk-based capital requirement for 7 banks in Supervision Category 2  
Unit: per cent



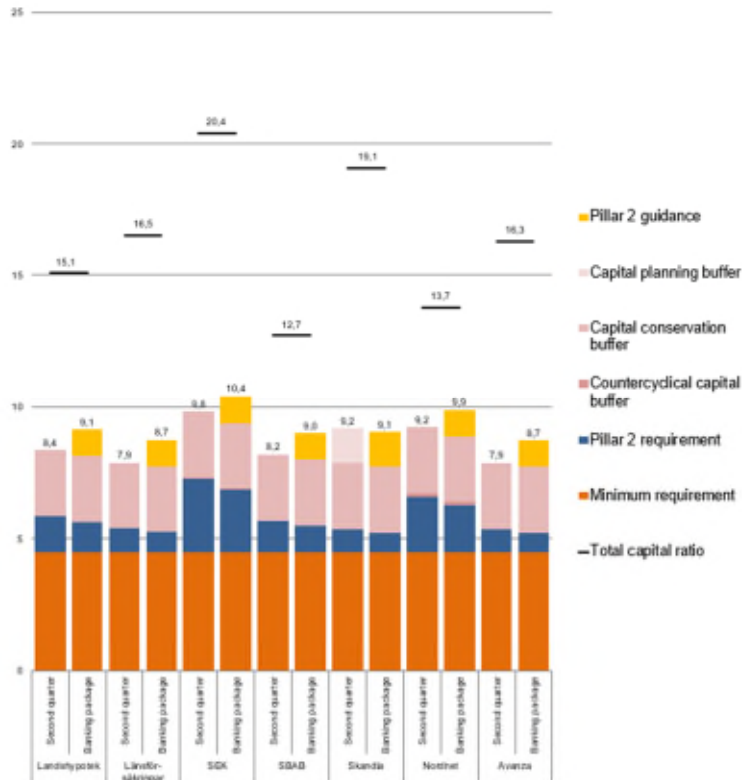
Source: FI

Graph 6.3 Total risk-based Common Equity Tier 1 capital requirement for the major banks  
Unit: per cent



Source: FI

Graph 6.4. Total risk-based Common Equity Tier 1 capital requirement for 7 banks in Supervision Category 2  
Unit: per cent

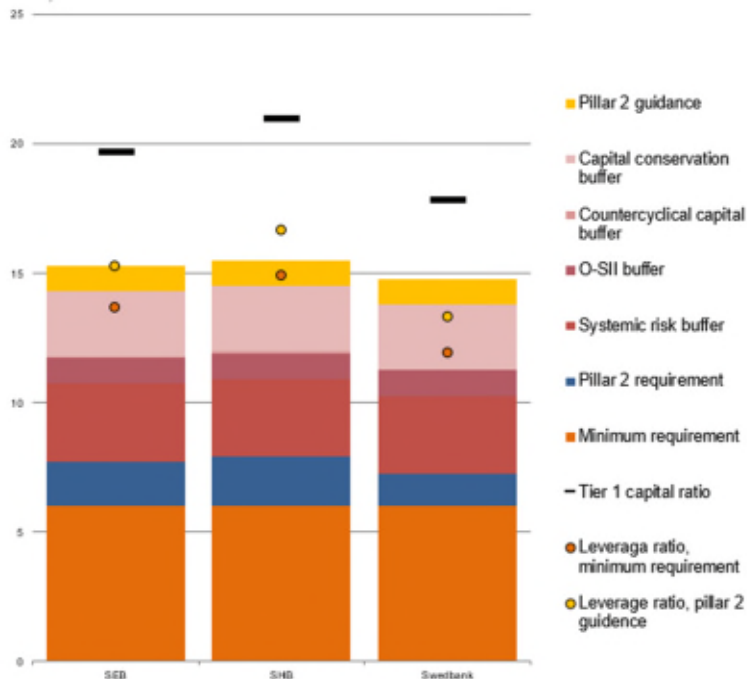


Source: FI



Graph 6.5. Total Tier 1 capital requirement with the banking package for the three major banks.

Unit: per cent

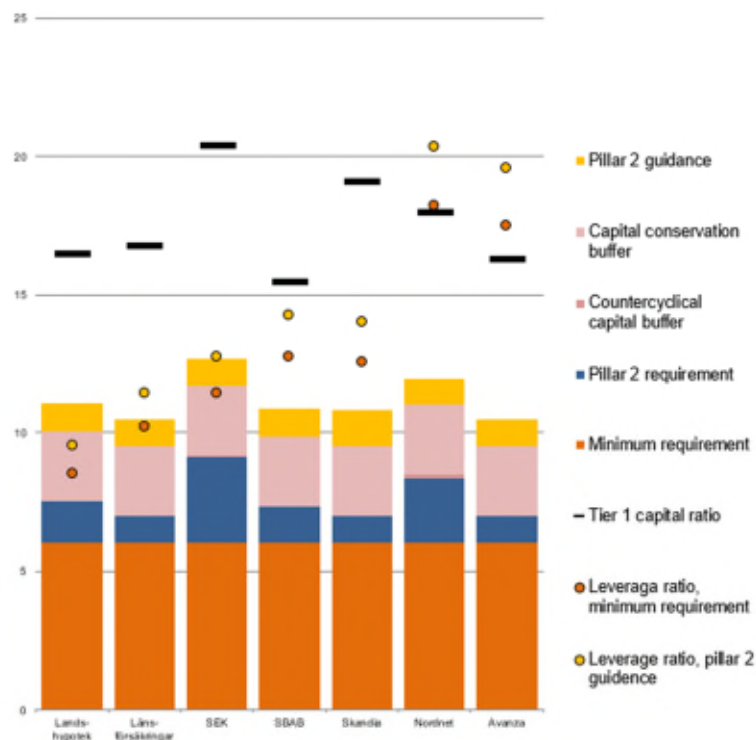


Source: FI

Note: The leverage ratio requirement has been recalculated in the graph to terms of risk-weighted assets.

Graph 6.6. Total Tier 1 capital requirement with the banking package for 7 banks in Supervision Category 2

Unit: per cent



Source: FI

Note: The leverage ratio requirement has been recalculated in the graph to terms of risk-weighted assets.

In Table 6.1 the various components of the capital requirement are expressed in SEK. The prerequisites for the calculations are the same as in the graphs above.

Table 6.1. Total risk-based capital requirement and total leverage ratio requirement  
Unit: SEK million

		SEB	SFB	Swedbank	Lands hypotek	Länsförsäkringar	SEK	SBAB	Skandia	Nordnet	Avarca	Sum	Share of total capital requirement (%)
Minimum requirement (8 %)	Banking package	59 637	56 390	55 388	2 556	10 024	7 438	10 166	1 735	948	693	204 974	47
	Second quarter	59 637	56 390	55 388	2 556	10 024	7 438	10 166	1 735	948	693	204 974	49
Pillar 2-requirement, excl systemic risk 2 %	Banking package	17 220	17 892	11 551	648	1 644	3 880	2 249	280	371	113	55 947	13
	Second quarter	17 220	17 892	11 551	648	1 644	3 880	2 249	280	371	113	55 947	13
Systemic risk in pillar 2	Banking package	-	-	-	-	-	-	-	-	-	-	-	-
	Second quarter	14 909	14 089	13 647	-	-	-	-	-	-	-	42 694	10
Systemic risk buffer (3 %)	Banking package	22 364	21 146	20 771	-	-	-	-	-	-	-	64 281	15
	Second quarter	22 364	21 146	20 771	-	-	-	-	-	-	-	64 281	15
O-SII buffer	Banking package	7 455	7 049	6 924	-	-	-	-	-	-	-	21 427	5
	Second quarter	7 455	7 049	6 924	-	-	-	-	-	-	-	21 427	5
Capital conservation buffer (2.5 %)	Banking package	18 636	17 622	17 309	799	3 132	2 324	3 177	542	296	217	64 054	15
	Second quarter	18 636	17 622	17 309	799	3 132	2 324	3 177	542	296	217	64 054	15
Countercyclical capital buffer	Banking package	481	612	205	0	0	37	12	1	15	0	1 363	0
	Second quarter	481	612	205	0	0	37	12	1	15	0	1 363	0
Capital planning buffer	Banking package	-	-	-	-	-	-	-	-	-	-	-	-
	Second quarter	-	-	-	-	-	-	-	-	-	-	208	0
Pillar 2 guidance	Banking package	7 455	7 049	6 924	319	1 253	930	1 271	286	118	87	25 691	6
	Second quarter	7 455	7 049	6 924	319	1 253	930	1 271	286	118	87	25 691	6
<b>Total riskbased capital requirement</b>	Banking package	<b>133 246</b>	<b>127 760</b>	<b>119 071</b>	<b>4 322</b>	<b>16 053</b>	<b>14 609</b>	<b>16 875</b>	<b>2 044</b>	<b>1 740</b>	<b>1 109</b>	<b>437 636</b>	<b>100</b>
	Second quarter	132 143	127 669	116 472	4 063	14 806	13 678	15 604	2 844	1 638	1 623	425 972	100
Leverage ratio minimum requirement		101 877	105 044	92 425	2 722	12 807	10 618	16 236	2 721	2 159	1 517	338 127	90
		11 896	12 255	9 616	318	1 494	1 239	1 694	319	252	177	39 448	10
<b>Total leverage ratio requirement</b>		<b>113 773</b>	<b>117 299</b>	<b>102 041</b>	<b>3 040</b>	<b>14 301</b>	<b>11 857</b>	<b>17 930</b>	<b>3 040</b>	<b>2 411</b>	<b>1 694</b>	<b>377 575</b>	<b>100</b>
		113 773	117 299	102 041	3 040	14 301	11 857	17 930	3 040	2 411	1 694	377 575	100

Source: FI

Note: The buffer for O-SII was also present as per Q2 but did not have any effect on total capital requirement at that time.

### 6.2.3.3 Description of the outcome of the capital requirements

All in all, the calculations indicate a relatively unchanged capital requirement, expressed in per cent, for the major banks. The increase of an average of around 1 per cent is due to the addition of the Pillar 2 add-on for commercial real estate as communicated previously. However, the major banks' Common Equity Tier 1 capital requirements decrease (Graph 6.3). One important explanation for this is that the way in which the Pillar 2 requirements are to be met is defined in law. Through the current application, FI has worked on the premise that a higher percentage of Common Equity Tier 1 capital shall be used in order to meet the existing Pillar 2 requirements (Table 6.2) than is stipulated as a basis under the amended law.

The add-on for systemic risk continues to form a substantial portion of the capital requirement. The systemic risk buffer, the O-SII buffer and the countercyclical buffer make up an average of approximately 23 per cent of the major banks' capital requirements. In view of Svensk Exportkredit's response to the consultation, FI would like to point out that the major banks remain subject to a significantly higher buffer requirement than other banks. On top of this there is the risk weight floor for mortgages pursuant to Article 458, which has also been introduced largely for reasons of systemic risk.

Table 6.2. Type of capital for covering risk-based Pillar 2 requirements in accordance with the main rule in the memorandum from 2014, compared with the banking package  
Unit: per cent

	New capital allocation according to the banking package	Current capital allocation (the main method)		Change in per centage	
		Major banks	Other banks	Major banks	Other banks
Tier 1 capital	75.0	85.2	81.0	-12.0	-7.4
Common Equity Tier 1	56.3	74.1	66.7	-24.1	-15.6

Source: FI

Note: The table does not take into account the fact that FI is able, under certain circumstances, to decide that the additional own funds requirement shall be met with a larger proportion of Tier 1 capital or Common Equity Tier 1 capital.

Graph 6.2 shows an increase in the total risk-based capital requirement of around 5–10 per cent for the majority of other banks. This increase is due to the fact that FI intends to apply Pillar 2 guidance to a slightly higher number of banks that are subject to a capital planning buffer under the current application. The introduction of Pillar 2 guidance is not expected to have any significant impact on those banks that are already subject to a capital planning buffer.

However, the level of the total capital requirement for the other banks is still below the major banks' capital requirement. Nevertheless, the increase in the Common Equity Tier 1 capital requirement is not as large (Graph 6.4) as a result of the lower proportion of Common Equity Tier 1 capital that shall be used to meet the Pillar 2 requirements (Table 6.2). The outcome of the risk-based requirements should be considered on the basis of the fact that the leverage ratio requirement itself may already result in higher Tier 1 capital requirements for certain banks (see section 6.2.3.5).

#### 6.2.3.4 Reduced scope for automatic restrictions on value transfers

There is a reduction in the scope between the banks' Common Equity Tier 1 capital level and the level at which automatic restrictions on value transfers apply, given the current level of Common Equity Tier 1 capital (Table 6.3). Consequently, the automatic restrictions may end up occurring earlier. This is because the Pillar 2 requirements shall be decided and thus placed under the combined buffer requirement in the capital requirements column. For the major banks, there is the addition of the fact that the effect of the O-SII buffer has to be included in the combined buffer requirement.

FI has made it clear that it is already the case under the current application that Pillar 2 requirements can be decided for firms, which would bring forward the time at which the firm is given automatic restrictions. FI has also made it clear that the size of the Pillar 2 requirement can also be changed under the new rules. However, there is a difference between conducting a new supervisory review and evaluation based on the reduced requirement, compared with being able to refrain from deciding on a requirement for the firm. Accordingly, the fact that the Pillar 2 requirements shall be decided and thus placed under the combined buffer requirement in the capital requirement structure entails a clear difference compared to the current application.

Table 6.3. The level of Common Equity Tier 1 capital when the combined buffer requirement is breached  
Unit: per cent

		SEB	SHB	Swedbank	Lands- hypotek	Länsför- säkringar	SEK	SBAB	Skandia	Nordnet	Avanza
Breach of buffer requirement	Second quarter	10,1	10,1	10,0	7,0	7,0	7,0	7,0	7,0	7,1	7,0
	Banking package	12,4	12,5	12,0	8,1	7,7	9,4	8,0	7,7	8,9	7,7
Common Equity Tier 1 ratio		17,8	18,7	16,4	15,1	16,5	20,4	12,7	19,1	13,7	16,3

Source: FI

Note: The table shows the Common Equity Tier 1 capital level at which the combined buffer requirement is breached for the second quarter and under the banking package, based on the assumptions. The table is a simplification and assumes that the bank has sufficient other Tier 1 capital or Tier 2 capital to meet the requirements that have to be met with such capital.

*6.2.3.5 The leverage ratio requirement reduces the risk-based buffers' usability*  
Graph 6.5 shows that the three major banks' Tier 1 capital exceeds the leverage ratio requirement. The calculations show that the banks cannot use the capital that is covering the risk-based Pillar 2 guidance and the entire combined buffer requirement without breaching the leverage ratio requirement. Accordingly, the leverage ratio requirement limits the usability of the risk-based buffers.

The leverage ratio requirement has different effects on the banks in Supervision Category 2 (Graph 6.6). The leverage ratio requirement may become the highest requirement for most banks. The introduction of Pillar 2 guidance in excess of the leverage ratio requirement may involve the increase in the Tier 1 capital requirement becoming even larger. At the same time, the guidance means that there is also a buffer where the leverage ratio requirement is the highest requirement.

Some banks do not meet the leverage ratio requirement given the assumption used in the calculation and their current capital levels. The minimum requirement for leverage ratio does not become a binding requirement until 28 June 2021, which gives the banks time to adapt to the requirements.

#### *6.2.3.6 Impact on requirement own funds and eligible liabilities (MREL)*

The size of the MREL requirement is affected by the resolution authority's, i.e. the Swedish National Debt Office's, application. Given that the application with respect to MREL that applies by virtue of the changes in the banking package is not yet known, it is not possible in this memorandum to clarify the effects of FI's position on the MREL requirement.

However, it can be established that deciding on the Pillar 2 requirements provides greater clarity when determining the MREL requirement as the MREL requirement is based on the capital requirements. It can also be established that the changed levels of the Pillar 2 requirements<sup>89</sup> and the combined buffer requirement<sup>90</sup> entail altered starting points when setting the size of the MREL requirement.

<sup>89</sup> For example, as a result of the fact that the 2 per cent add-on for systemic risk in Pillar 2 is being abolished.

<sup>90</sup> Due to the O-SII buffer being added to the systemic risk buffer.

#### **6.2.4 Impact on other banks**

Banks other than those reported in the graph are also affected by the banking package and thus by the leverage ratio requirement, the Pillar 2 requirements set for the banks and the assessment of guidance. The capital requirements of medium-sized and smaller banks are expected to increase by around 5–10 per cent. For banks in Supervision Categories 3 and 4, the increase is largely due to the introduction of the risk-based Pillar 2 guidance to the extent the banks have not already been assigned one through a capital planning buffer. The calculations do not take into account the fact that the banking package also contains some relaxation of the capital requirements.<sup>91</sup>

Banks in Supervision Categories 3 and 4 are not normally subject to a supervisory review and evaluation as frequently as banks in Supervision Categories 1 and 2. This means that the position that the Pillar 2 requirements and guidance shall be expressed in percentage terms is particularly well suited to these banks (see section 3.8).

#### **6.3 The firms' adaptations**

The affected banks have a relatively short time in which to adapt their capital planning and thus their capital targets to the capital requirements that apply under this application. However, the banks have had longer to adapt to the probable changes that apply by law as the directive on which the law is based was adopted in spring 2019. In addition, the Basel Committee published guidelines that set out the methodology for calculating leverage ratio as early as 2010. Leverage ratio was included in the Capital Requirements Regulation introduced in 2014 and was encompassed in this by reporting requirements and requirements concerning public disclosure.

The majority of FI's positions have a direct link to legislative amendments and therefore need to enter into force at the same time as these in order to allow the law to be applied in full. At the same time, a large portion of the amendments have no effect in practice before a later date (see section 5).

FI makes the assessment that the positions the authority has adopted mean that the banks do not need to make any significant changes to their operations in order to adapt. For the few banks that currently have capital levels that are insufficient for the future capital requirement, FI makes the assessment that these banks will be able to reinforce their capital primarily through retained earnings instead of raising new funding.

FI continually monitors the position of the banks, including their capital strength, financing, lending and profitability and engages in a continual dialogue with them. This gives FI the opportunity to detect any unforeseen repercussions of new regulatory frameworks and applications at an early stage.

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<sup>91</sup> For example through the introduction of expanded concessions on risk-weighted assets for exposures to small and medium-sized enterprises and concessions when calculating the exposure amount for leverage ratio.

## **6.4 Costs to the banks**

The costs that FI's positions entail to the banks are only deemed to comprise a small portion of the total costs resulting from the introduction of the banking package. This is because the basis of the change is largely that which applies by virtue of law and regulations and because FI's positions primarily clarify details, for example the unit in which Pillar 2 requirements and guidance shall be expressed and communicated, and levels, for example with regard to the O-SII buffer.

### ***6.4.1 Costs related to the capital level***

The analysis shows that the effect of the banking package on the capital level may be different for different banks.

All in all, the structure of the regulatory framework and the proposed application mean that the capital requirement will at least not decrease significantly for the banks. At an overarching level, it is instead an increase in capital requirements, at the same time as the total proportion that needs to be met with Common Equity Tier 1 capital is decreasing for the major banks. The increase in capital requirements is largely being driven by changes that apply by virtue of law.

The cost that may be associated with higher capital requirements is important but difficult to clearly define and measure. Higher capital levels may affect the banks' capital costs, financing costs and, ultimately, the cost to customers. When a bank is forced to hold more capital, this is associated with a cost to its owners. At the same time, a better capitalised bank can be presumed to have lower borrowing costs. The effect is therefore not unambiguous.

## **6.5 Impact on society and consumers**

A stable banking system is key to a robust economy, which is beneficial to the public, for example citizens and consumers. The banking package aims both to strengthen banks' resilience to crises and to ensure that critical functions can be maintained in the event of a crisis. All in all, this shall lead to a reduction in the probability that tax revenue or other public funds need to be used in the event of a crisis.

FI believes it is important to have usable buffers in excess of the minimum requirements in order to strengthen the banks' resilience. The existence of such resilience is important, irrespective of the size of the bank. This also applies from the perspective of consumer protection as failures of even a small bank are associated by uncertainty, despite the existence of a deposit insurance scheme. For example, it can damage the relationship with customers. Pillar 2 guidance is therefore an important addition for all banks in terms of improving resilience, especially given the reduced flexibility that accompanies Pillar 2 requirements being decided.

The increase in capital requirements primarily applies to banks in Supervision Categories 2, 3 and 4. However, this increase consists largely of the Pillar 2 guidance, the purpose of which is to cover risks and manage future financial stress. Consequently, it does not in itself bring forward the time at which the

bank becomes subject to automatic restrictions or is placed in resolution or liquidated. Instead, it means that the banks are given yet another buffer that makes them better able to manage stress and thus avoid ending up in serious difficulties. The major banks will also in future have greater demands placed on them by virtue of systemic risk components, but the difference between the banks decreased somewhat. This may affect the competitive situation between them.

## **6.6 Impact on FI**

The repercussions of the proposed application is deemed to have a certain but limited impact on FI. However, the combined changes to the regulatory framework, especially given the parallel requirements, will make the analysis of the banks' positions more complex. FI's assessment is that the additional costs will primarily be contained within existing frameworks.