



**Financial Stability Committee**  
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## Minutes from the meeting of the Financial Stability Council held on 12 June 2018

### Summary

The Stability Council<sup>1</sup> discussed the stability situation.

The financial markets are functioning well and the Swedish economy is strong. However, there continue to be several vulnerabilities and risks that make the Swedish financial system sensitive to shocks. The greatest risk is household indebtedness. Many households have a high debt ratio or a high loan-to-value ratio, which may reinforce a downturn and ultimately threaten financial stability if households cut back on their consumption. Measures such as the amortisation requirement build resilience among households, but it is also important for the banks to have sufficient capital and liquidity buffers.

The Stability Council discussed the measures taken to increase households' resilience, and the effects they have had. The authorities considered the price fall that took place in the housing market in autumn 2017 as having had several explanations. The market has stabilised in recent months. The Stability Council also discussed the new mortgage actors that have started to compete with the banks. Increased competition is deemed to be positive if it is sound, but the risks of the new business models need to be monitored, from the perspectives of both consumer protection and stability.

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<sup>1</sup> Present: *Ministry of Finance*: Per Bolund, Chair, Ulf Holm, Aino Bunge; *Finansinspektionen*: Erik Thedéen, Martin Noréus, Stefan Palmqvist; *National Debt Office*: Hans Lindblad, Johanna Fager Wettergren, Mattias Persson; *Riksbank*: Stefan Ingves, Kerstin af Jochnick, Olof Sandstedt; and *Financial Stability Council Secretariat*: Niclas Alsén

The Stability Council also discussed Nordea's imminent move. The authorities emphasised that risks to financial stability remain in Sweden despite the move. The development of these risks depends among other things on the nature of future capital requirements and the further development of the Banking Union.

Ahead of the next meeting of the Stability Council on 4 December 2018, the Council members will continue to analyse several of the matters discussed at the meeting, including household indebtedness and resilience of the banks. In addition, the Committee will make a joint analysis of cyber risks.

## § 1 Stability assessment

The authorities presented their stability assessments.

Growth has been good in recent years, both in Sweden and internationally. At the same time, low global interest rates have led to a relatively high appetite for risk, which means continued high prices for several asset classes and high debt levels. When interest rates are low and the economy is doing well, risks may build up, a development that could be observed in the USA before the 2008 crisis.

The greatest risk to the Swedish economy is household indebtedness. Households' combined debt in relation to disposable incomes is currently more than 185 per cent and about 340 per cent for households with mortgages. In addition to their bank loans, many households are also indirectly in debt via tenant-owner associations' loans.

Many households have a high debt ratio or a high loan-to-value ratio, which may reinforce a downturn and ultimately threaten financial stability if households cut back on their consumption. To increase the resilience of households Finansinspektionen has introduced an amortisation requirement.

There was a decline in housing prices in the autumn after a long period of increases. In 2018 prices have been more stable, but the uncertainty about future price trends remains. A drastic fall in housing prices would have serious consequences for the Swedish economy.

Vulnerability in the Swedish financial system is high. Structural factors in the housing market and a large financial system have increased the risks. In

addition, a concentrated and interconnected banking system with a high level of market funding means that both contagion risks and liquidity risks are high. Lending to property companies has also increased. These companies are borrowing an increasing amount in relation to their revenues, and are sensitive to interest rate increases. The authorities are agreed that the banks need sufficient resilience in the form of capital and liquidity buffers.

Stress tests show that life insurance companies have good resilience, and would cope with even severe falls in the stock market without being forced to make major reallocations of assets. The authorities also noted that operational risk in the financial infrastructure is heightened by the risk of cyberattacks, for example.

The recovery in the European banking sector has continued, with better profitability and a lower percentage of non-performing loans. At the same time, the risks associated with international trends, not least political, remain. The political situation in Italy has contributed to rising risk premiums in the market. Turbulence in the international capital market has also negatively affected the functioning of the Swedish government bond market, as investors suddenly seek safe assets. In addition, international stock markets have been characterised by volatility in 2018, partly due to trade policy and inflation concerns.

## § 2 Discussion of analyses and potential measures

### Household indebtedness: Effect of measures taken and the need for potential further measures

Finansinspektionen presented its view of the risks associated with household debt. The amortisation requirement was aimed at reducing the percentage of households with high loan-to-value ratios, while the stricter amortisation requirement aims at reducing the number of households that have high credit in relation to their incomes. Other measures that have contributed to improved resilience for households are the mortgage loan-to-value ceiling and the banks' capital requirements, though the latter are mainly intended to increase the banks' resilience.

Prices in the Swedish housing market fell by almost 10 per cent between August and December last year. Since then they have stabilised and even increased slightly. This followed a long period of strong price increases. In

combination, there are several factors that contributed to the fall in prices, but it is difficult to identify exactly which. But after a very long period of rising prices it is not surprising that at some point a decrease will come. Major new production, high price levels and a reduced element of speculation in the market for new construction are thought to have contributed to the price fall. The stricter amortisation requirement may also have contributed. The fact that prices have fallen means that households have become more careful and particular about the risks they take, which is positive for both consumer protection and financial stability.

The National Debt Office pointed out that fundamentally the situation is a relative price problem. Population growth, low interest rates and wage growth are factors that have influenced housing prices. However, a review is needed to see why it is so expensive to build in Sweden, and analyse whether there are lock-in effects that influence the supply on the secondary market.

The Riksbank argued that there are fundamental imbalances in the Swedish housing market, and when they are not dealt with, the problems leak out in other places, which means that attempts must be made to deal with the problems using macroprudential supervision measures. The measures taken so far have only affected new mortgages, rather than the entire stock. Measures are needed to achieve a more efficient housing market. This is a matter of achieving a better balance between housing supply and demand. The Riksbank also believes that part of achieving a better balance in the housing market is to conduct a review of rent regulation and the taxation system. The Riksbank also considers that reviewing the regulations for early repayment of mortgages is an important measure and that a central register for deposits in tenant-owned housing is needed. In addition, the Riksbank pointed out the need for measures to deal with banks' liquidity risks in important currencies and considered it important that work is done in that area.

Finansinspektionen shared the Riksbank's view that the rules for early repayment of mortgages should be reasonable.

The Chair expressed thanks for the presentations. The Government is always prepared to take more measures if necessary, but it would be wise to first await the effect of measures already taken. Concerning further changes, the next Government will probably need to review tax deductions for

interest payments. It will then be important that the combined effect of various measures is right, so as to avoid causing the problems we want to prevent.

### **New mortgage actors**

Finansinspektionen presented its view of the new actors that have started to compete with banks for mortgage customers. The development is driven by the high margins on mortgages, but also by more cyclical factors such as low interest rates. FI regards increased competition in a positive light, as long as the competition is sound. FI raised two policy issues that are now being analysed. One is that refinancing risks are being moved from banks to the market or to households themselves. The other is that the duty of care could be undermined – a mortgage is a long-term commitment in relation to the household regardless of who finances it. There are also legal issues that FI needs to investigate. There is great interest in how FI regards this possibility of alternative financing of mortgages and FI intends to revisit this issue.

The Riksbank thinks increased competition is positive. If the development means that mortgages through the new actors are financed at longer maturities than is currently the case, this may reduce liquidity risks. The Riksbank considers that a higher degree of maturity matching is important. At the same time, new risks and challenges may arise due to new actors and therefore it is important that the new actors are covered by relevant macroprudential regulation.

The National Debt Office has long talked of the need for increased competition and that mortgage margins are too high. It is important, however, that the new risks that arise from a potential change in market structure are dealt with.

### **Nordea's move and FI's work on the risk weight floor**

Finansinspektionen presented the timetable. The new bank is expected to be authorised by the ECB in the near future. FI's board is expected to make a decision on the merger in the third quarter this year.

When Nordea moves many of the risks remain for Sweden. FI is now conducting a close dialogue with the ECB about the design of future supervision and capital ratios. The starting point for the FI in the discussions is that the capital requirements in absolute terms should not be changed and

that the close cooperation on supervision that exists today should be retained.

As regards the risk weight floor for mortgages, the FI needs to use another legal tool than at present for Nordea's capital requirements to remain at the same level. The proposal is currently being circulated for comment at the EBA and the European Systemic Risk Board. The European Commission will subsequently announce its decision.

The Riksbank estimates that a move somewhat increases the risks to financial stability in the short term. Going forward, the risks will be influenced by how the Banking Union develops, among other things. At present the Banking Union is not fully developed, for example as regards a common deposit guarantee fund and resolution fund. Much of the responsibility lies at the national level, which will thus be Finland if Nordea moves. The Riksbank pointed out that it is the Bank of Finland that is expected to process an application for emergency liquidity assistance even as regards liquidity in Swedish kronor. In addition, it can be noted that about 75 per cent of Nordea's operations lie outside the Banking Union.

In the view of the National Debt Office the risks that Nordea poses to Swedish financial stability, not least contagion risks, will remain even when the parent company moves to Finland. However, in the public debate there are many who forget that the new resolution regulations are in place and that the banks are now reconstructing their balance sheets to increase the percentage of eligible liabilities. This means that the direct risks are primarily borne by shareholders and lenders. This framework now applies both in Sweden and in the Banking Union.

The ability of Swedish authorities to prevent and deal with financial stability risks associated with Nordea will decrease when Nordea's head office moves. In light of that, the National Debt Office welcomes Finansinspektionen's proposal to change the method of applying the risk weight floor to mortgages. This improves the prospects of maintaining the capital requirements and minimum requirements for eligible liabilities (MREL) imposed on banks and other credit institutions.

The Chair expressed thanks for the presentation and stressed the importance of continued transparency and cooperation concerning the bank.

## Liquidity in the government bond market

The National Debt Office reported on liquidity in the Swedish government bond market. Liquidity continues to deteriorate in the government bond market. This deterioration is a consequence of both structural (e.g. regulation) and temporary (the Riksbank's bond purchases) factors. The government bond market functions relatively well as long as trading is in small lots and the market is stable. On the other hand, when there are larger volumes, major interest rate movements or events that suddenly increase the need to buy or sell government securities, trading is perceived to be difficult. This means that even small disruptions rapidly put a strain on the market situation. The National Debt Office's unlimited repo facility continues to be crucial for the functioning of the government bond market. The share of foreign holdings exceeded 50 per cent during the euro crisis and is now down to 20 per cent. Having good borrowing channels and a diversified investor base is central from a stability perspective and there is a risk that poorer market liquidity will lead to more expensive borrowing and poorer borrowing preparedness.

The Chair noted that the low central government debt in itself is positive, even though it has reduced liquidity in the government bond market.

The Riksbank noted that they own about 40 per cent of the stock, but also observed that turnover has been falling over several years, and that this had been a trend even before the start of the Riksbank's purchasing programme. Several factors affect market turnover, such as new regulation and fewer actors. All the same, the Riksbank argued that its auctions for buying government securities function well, with an average oversubscription of more than three times the volume of demand. It is important that the market functions well and the Riksbank follows developments closely.

Finansinspektionen pointed out that Sweden currently has extremely low borrowing costs, and that slightly decreased liquidity, which marginally increases the State's borrowing costs, should be seen in that perspective.

The National Debt Office mentioned that there is a cost target, and that costs stemming from malfunctioning markets cannot be allowed to rise indefinitely. It is important to care for the market, as the experience from other countries is that it may otherwise be very expensive to get investors to return to it.

### § 3 International questions

The Ministry of Finance presented current EU negotiations. As regards the United Kingdom's withdrawal from the EU, an EU summit will take place at the end of June, at which the current negotiating position on the withdrawal agreement will be dealt with, ahead of the expected finalisation at the October Council meeting. In the so-called banking package, on 25 May agreement was reached to adopt a general approach. There now remains the trilogue negotiations with the European Parliament before the final rules are in place. The agreement includes a number of new Basel standards in the form of a leverage ratio and the required introduction of a net stable funding ratio (NSFR). As regards recovery and resolution, some adjustments to the rules for minimum requirements for eligible liabilities (MREL) are being made and the global total loss-absorbing capacity standard (TLAC) for globally systemically important banks is also being implemented into EU law. For Sweden, it has been important that both supervisory and resolution authorities can impose sufficient requirements to accommodate the risks that arise nationally. In terms of capital requirements, it has for example been a matter of being able to impose requirements for systemic risk. Concerning MREL, it has been important to have flexibility concerning the quantity and quality of the liabilities that are eligible.

On 24 May the European Commission presented measures for sustainable financial markets, which includes three different legislative proposals that are to contribute to climate and environmental sustainability. It is a very positive development that the work of sustainability in the financial markets is now gaining momentum at the European level.

One proposal concerns supervision of central counterparties – CCPs. It addresses e.g. issues concerning supervision of central counterparties in third countries, a matter closely linked to Brexit, since most clearing of interest rate derivatives currently takes place in the United Kingdom.

### § 4 Other stability issues

#### Information on crypto-assets and the e-krona

The Riksbank noted that the payments market is facing major changes. The market is moving towards more real-time payments and new regulations are opening up for more engagement in cross-border operations. At the same time, the use of cash is decreasing. The Riksbank has recently issued two



consultation papers. One addresses opening hours in the RIX system and the other the Eurosystem's platform for real-time payments (TIPS). In addition, the Riksbank has begun to examine the possibility of issuing a digital currency – an e-krona. Thus, a major future transformation of the payment system can be expected, and in future work it will be important to analyse the broader implications for financial stability. Regarding crypto-assets, the Riksbank pointed out that it is for now mainly a consumer protection issue.

Finansinspektionen shares the Riksbank's view that crypto-assets do not pose any stability risk. But there are considerable consumer risks, since these are volatile assets. Many European authorities have issued warnings about this. As regards the e-krona, this raises a number of questions related to the banking market and financial stability that are important to examine.

### **Scenario exercises**

The Financial Stability Council Secretariat presented the scenario exercise carried out in May in which the Swedish authorities practiced dealing with a banking crisis. This was the third exercise in two years and the experiences acquired from the exercises are processed in various projects to strengthen the authorities' crisis management.

### **§ 5 Future work**

Ahead of the next meeting of the Stability Council on 4 December 2018, the Council members will continue to discuss several of the matters on the agenda of today's meeting, including household indebtedness, new mortgage actors and resilience of the banks. The Committee will work together on preparations for crisis management and utilise the lessons learned from the scenario exercises which have already been held. The Stability Council will also discuss cyber risks.