



## Minutes from the meeting of the Financial Stability Council held on 5 December 2017

### Summary

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

At present developments in the financial markets are relatively stable and the global economy is progressing strongly. The Swedish economy is in a position of high growth, low interest rates and low risk premiums. This has pushed up the prices of such things as shares, bonds and real property. Such a position increases the probability of major price falls in these assets. This may in turn lead to turbulence in the financial markets and increase the cost of, or in the worst case impede, Swedish banks' funding.

Housing prices have increased over a longer period as a consequence of demand driven by strong employment, increasing incomes and falling interest rates, along with previous slow growth in housing supply. However, since the middle of the year there has been some fall in prices. This is reasonable after the long and major price rise and current increase in supply.

The high housing prices and recent years' high rate of housing construction drive up household debt, which continues to be the greatest vulnerability in the Swedish economy. Consequently, the authorities are agreed that it is important that the proposed tightened amortisation requirement is put in place.

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<sup>1</sup> Present: *Ministry of Finance*: Per Bolund, Chair, Ulf Holm, Aino Bunge; *Finansinspektionen*: Erik Thedéen, Martin Noréus, Henrik Braconier; *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 discussed future regulation at EU and international level that is of significance for capital and liquidity requirements and requirements concerning subordinated liabilities.

Ahead of the next meeting of the Stability Council on 12 June 2018 the Council's members will continue to discuss several of the matters that were dealt with at the meeting, including household indebtedness and the progress of housing construction, as well as banks' exposure to the property market. The Stability Council will continue to work together on scenario exercises.

## § 1 Stability assessment

### The authorities presented their stability assessments.

The situation in the financial markets is calm at present. At the same time, the Swedish economy is experiencing high growth and low interest rates, which along with low risk premiums has pushed up the prices of many assets such as shares, bonds and real property. This situation increases the probability of noticeable price falls and volatility in asset markets. This may in turn lead to turbulence in the financial markets and increase the cost of, or in the worst case impede, Swedish banks' funding. As the Swedish banking sector is large, interwoven and to a great extent uses market funding, it is therefore important that Swedish banks have sufficient resilience in terms of capital and liquidity buffers.

Housing prices have increased over a longer period as a consequence of demand driven by strong employment, increasing incomes and falling interest rates, along with previous slow growth in housing supply. However, since the middle of the year there has been some fall in prices. This is reasonable after the long and large rise that has taken place. Increased construction may have contributed to the price fall. The Stability Council discussed the consequences of increased construction. Fundamentally it is positive for the Swedish economy that construction has increased, but it is important that what is built is adapted to demand in the form of correct size, location and price. More vulnerable housing developers may have problems when prices fall. However, this need not be a major problem for the economy as a whole, when growth is high and unemployment low.

High housing prices and the fact that more people own their homes as a result of the high rate of housing construction, drive up household debt,

which continues to be the greatest vulnerability in the Swedish economy. An increasing number of Swedish households have a high rate of indebtedness, making the economy more vulnerable in a future crisis, when highly indebted households are expected to cut back on their consumption considerably. The authorities are agreed that it would be beneficial if the proposed tightened amortisation requirement is put in place. At the same time, unsecured credit to households is rapidly increasing, which calls for extra vigilance in future.

The authorities also discussed risks linked to the Swedish commercial property sector, where the Swedish banking system has considerable exposure.

The authorities are agreed that the banks need sufficient resilience in the form of liquidity and capital buffers. High profitability in Swedish banks contributes to resilience.

The Chair noted that overall there is a shared view of the risks. Regarding housing construction it was noted that the level of construction has been too low for a long time. The Government sees the need for measures to improve the housing market, and several steps have been taken in that direction.

## § 2 Discussion of analyses and any measures

### Regulatory issues, including the banking package

The Ministry of Finance reported on the EU negotiations on the banking package, concerning changes in capital and liquidity requirements, as well as minimum requirements for eligible liabilities (MREL). As far as Sweden is concerned, it is important to be able to handle systemic risks well even in the future. A fast track has been negotiated for handling subordinated liabilities in MREL. To implement this under Swedish law there must be Swedish legislation and it is expected that a proposal for comment can be circulated in early 2018. The negotiations on central counterparties in the derivatives market (CCPs) include the question of resolution of these firms and supervision of CCPs in third countries, which may have great significance after the United Kingdom's exit from the EU.

The Riksbank sees a need to introduce EU rules as a minimum harmonisation instead of maximum harmonisation, i.e. that individual

countries should be able to introduce stricter rules than those negotiated in the banking package. This is important, not least in light of Sweden's large banking system. In addition, it is very important to have liquidity buffer requirements in all important currencies. In the view of the Riksbank, this should be part of the supervisory requirements of Finansinspektionen and the Riksbank would like to work with Finansinspektionen on this matter going forward. An agreement in the Basel Committee is of great importance for Sweden and it is important that countries now implement the regulations consistently. For Sweden there is reason to review the relation between minimum requirements and buffers. Another important question concerns the clearing of Swedish interest rate derivatives, which largely takes place in London. The regulations should be designed in such a way that they do not lead to increased stability risks, fragmentation and poorer performance.

The National Debt Office welcomes the work of the Ministry of Finance to get Swedish insolvency legislation regarding MREL in place. This ensures that credit institutions and securities companies will be able to start issuing subordinate debt effectively. In addition, the National Debt Office also stresses the importance of opposing maximum harmonisation in new EU rules, not least as regards the minimum requirement for eligible liabilities (MREL).

Finansinspektionen is looking forward to the results of the Basel negotiations, and it is important for Sweden that they are successful. It is important that Swedish capital requirements can continue to include substantial buffers. In light of coming European liquidity regulation, it is important that the banks can hold liquidity buffers with high quality and liquid assets even in the future. In this perspective, large buffers in EUR and USD are particularly important, as they may be expected to be easy to convert to other currencies in an emergency. In a crisis situation it may, however, be more difficult to convert buffers held in smaller currencies, which is the reason that Finansinspektionen does not consider it necessary to regulate these in more detail than follows from the regulations. As regards CCPs, Finansinspektionen sees problems with centralising supervision at European level.

## Household indebtedness: measures being taken by the Government and authorities

The Chair mentioned that on 30 November the Government decided to say yes to the stricter amortisation requirement, which met with the approval of the members of the Council. The Ministry of Finance shares the view of Finansinspektionen that the change will have long-term positive effects on the risks and at the same time will have minor short-term consequences. The Government has submitted a bill to the Riksdag aimed at creating a larger toolbox for Finansinspektionen to promote its work on macroprudential supervision. The bill's proposal is supported by the centre-right parties and the Left Party. Regarding housing policy, the Government has set aside more than SEK 6 billion per year, the largest initiative for 20 years. In addition, the Government is now carrying out a 22-point programme to increase the construction rate. This includes measures to increase efficiency and reduce municipalities' costs for erecting housing. Investment support has been given to more than 10 000 rental apartments, including student housing. The Government has taken the initiative for broader political agreement in this area, but this has not yet been possible to fully achieve.

Finansinspektionen will now proceed further with the stricter amortisation requirement, after the Government's assent. The process for macroprudential supervision measures is such that it is Finansinspektionen that investigates, analyses and proposes and the Government then says yes or no. The process has worked well, and the Government has given a prompt response. As regards the effects, there has been discussion that the stricter amortisation requirement would create substantial price falls in the housing market, but in the opinion of Finansinspektionen the consequences will be limited. The measure is structural rather than cyclical.

Finansinspektionen will carefully monitor developments and after a time will make an evaluation. Finansinspektionen is now also conducting a study of consumer credit, which analyses developments in unsecured loans and what drives them.

The National Debt Office's assessment is that debt is the single greatest vulnerability in the Swedish economy and welcomes the stricter amortisation requirement. Apart from analysing unsecured loans, it would be of benefit to analyse any lock-in effects in the housing market.

The National Debt Office pointed out that various methods to rectify the problems in the housing market and high household indebtedness have distributional effects and there is no discussion of these in the Swedish debate. The amortisation requirement is a measure that concerns redistribution of households' own resources, reduced tax relief on interest will provide more money to the public purse and strengthen central government finances, while higher mortgage rates will possibly accrue to bank owners. The distributional effects of these and other potential measures should be discussed.

The Riksbank noted that the measures implemented so far have mainly been directed at new lending. For better balance in the housing market the Riksbank considers that measures are required that affect the entire stock, for example a review of tax relief on interest and real estate tax. The Riksbank also considered that it will always be difficult to find the perfect time for taking action, and there is great risk in waiting with measures.

#### **Nordea's move and feedback on work with reciprocity**

The Chair started by noting that the authorities have a joint working group that is following the work ahead of a possible move of Nordea's head office. As a result of Nordea's planned move the reciprocity of macroprudential supervision measures between countries has become even more relevant for Sweden, and it is important for the Council to continue discussing.

Finansinspektionen presented information on the preparatory work in progress with reference to Nordea, as well as on the contacts with the supervisory authority ECB and the Finnish Financial Supervisory Authority. As regards reciprocity, a move may mean that macroprudential supervision measures already introduced or planned will need to be subject to reciprocity.

The Riksbank underlined that even if the head office is moved, Nordea's extensive operations in the Swedish market will remain, which the authorities need to take into consideration. At present the Riksbank has several forums and forms of cooperation that will be reviewed in the light of any move.

The National Debt Office underlined that moving the head office is not synonymous with the disappearance of Sweden's risks in the event of a

future crisis in Nordea. It is true that the new bank recovery and resolution framework means that the direct costs of a bank in crisis must now be borne by the banks' owners and lenders. But the risks entailed by Nordea's operations in Sweden to Swedish financial stability and Sweden's economy remain, at the same time as Sweden's ability to prevent and manage them is considerably reduced. In so far as requirements on Nordea are reduced, defences will be weakened and if anything the risks will increase.

### **Recovery and resolution in Europe**

The National Debt Office has analysed the cases of banking crises handled in Europe since the new recovery and resolution framework was put in place. This mainly applies to banks in Spain and Italy. The conclusions of the National Debt Office are that countries in Europe have made different progress in getting the new framework in place. The handling of Banco Popular is a good example of how resolution can be carried out. Experiences show that it is problematic to write down senior bond holders. This indicates that the minimum requirement for eligible liabilities should be fully met with subordinated liabilities, which is also in line with the National Debt Office's application of the requirement in Sweden.

The Chair expressed thanks for the report and noted that these are sound lessons.

### **§ 3 Other international questions**

#### **The United Kingdom's exit from the EU**

The Ministry of Finance reported on the situation in the negotiations between the EU and the United Kingdom. In connection with a summit meeting in the EU at the end of the year, a decision is expected that the negotiations can go on to the next level, where various financial market questions will be dealt with.

Finansinspektionen presented information on the ongoing work related to the United Kingdom's exit and Swedish financial companies.

#### **The banking union and the ESA review**

The Chair reported that a dialogue is in progress with the European Commission on the current review of the European Supervisory structure in the financial area, "the ESA review". This is an important area for Sweden

and the Government is doubtful about the proposed changes concerning governance and direct supervision. At the same time, it is positive that the European supervisory authorities are being tasked with sustainability and Fintech considerations. The negotiations have not yet started. As regards the banking union, an inquiry will be set up, and the terms of reference are being drafted in the Government Offices.

The authorities discussed various consequences for Sweden of the ESA review.

#### **§ 4 Scenario exercises**

The Riksbank presented information on the crisis management work being organised within the framework of the Nordic Baltic Stability Group, aimed at strengthening the countries' crisis management capability.

The Stability Council Secretariat presented information on current projects in the Stability Council. This refers to work on a crisis management manual, work with experiences of the scenario exercises carried out by the Stability Council and work on another scenario exercise in 2018.

The Chair underlined the value of having a crisis management manual that clarifies responsibility and it would be a good thing if it can be tested in the time ahead.

#### **§ 5 Future work**

Ahead of the next meeting of the Stability Council on 12 June 2018 the Council's members will continue to discuss several of the matters that were dealt with at today's meeting, including household indebtedness, the progress of housing construction, the banks' exposure to the property market, as well as Nordea's move and implementation of the banking package. The Stability Council will work together on scenario exercises and a crisis management manual and utilise lessons from scenario exercises already held.