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Annex 1

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■ Amended provisions governing collateral for credit at the Riksbank

This annex contains a detailed review of the amendments to the provisions in the Terms and Conditions for RIX and Monetary Policy Instruments (Terms and Conditions) relating to the use of covered bonds as collateral for credit at the Riksbank.

In the Riksbank's current provisions governing collateral in accordance with the Terms and Conditions, collateral is divided into two categories: A and B. Collateral in Category A can be used without limitation, while collateral in Category B is subject to a limit rule. Category B includes own-name covered bonds¹, securities with a credit rating of less than AA- but at least A- and own-name securities that are guaranteed by a central government or similar institution with unlimited powers of taxation.

According to the amended provisions governing collateral, the Riksbank will no longer accept collateral that is currently included in Category B. In addition, a new limit rule is to be introduced under which covered bonds may comprise a maximum of 60 per cent of a counterparty's total collateral value.

In order to reduce the concentration risks in covered bonds received by the Riksbank, a maximum of 50 per cent of the collateral made up of these may consist of covered bonds from the same issuer.

The amendments will be introduced in stages:

- As a first step, the Riksbank will stop accepting collateral that is now in Category B. The minimum credit rating requirement will thereby be raised from the current A- to AA-. The changes will come into force in January 2016 at the earliest.
- In the second step, a limit rule is to be introduced under which covered bonds as a percentage of a counterparty's total collateral value may amount to a maximum of 60 per cent. This rule will come into force in May 2016 at the earliest.
- The third step will be the introduction of a limit rule under which a maximum of 50 per cent of the share of a counterparty's collateral value that is

¹ The term "own-name securities" refers to securities issued by the party posting collateral itself or by an issuer closely associated with such party.

■ composed of covered bonds may consist of covered bonds from the same issuer. This rule will come into force in September 2016 at the earliest.

The relevant dates will be specified when the new terms and conditions are published on the Riksbank's website.

The definition of covered bonds will not be changed.² This means that the amendments to the provisions will not differentiate between covered bonds issued by issuers domiciled outside Sweden, but within the EEA, and issuers domiciled in Sweden.³

The amendments apply to⁴ collateral for intraday credit and monetary policy instruments⁵, but not collateral for general liquidity assistance or emergency credit.⁶

1 The amendments compared to the current provisions

1.1 Ban on the use of own-name covered bonds as collateral for credit at the Riksbank

1.1.1 Current provisions

Under the current provisions, the Riksbank does not, as a general rule, accept counterparties' own-name securities as collateral. However, the Riksbank does accept, to a limited extent, own-name covered bonds. These are covered by a limit rule (see Section 1.4), under which they may constitute a maximum of 40 per cent of the counterparty's total collateral value.

1.1.2 Proposed amendment

Own-name covered bonds will not be accepted as collateral for credit at the Riksbank. The change will come into force in January 2016 at the earliest.

1.1.3 Comments by referral bodies

The Swedish Bankers' Association has no substantive objections to the proposal. The Swedish National Debt Office and Finansinspektionen (The Authorities) in a joint statement oppose all the proposals on the grounds that it is not appropriate to implement measures requiring banks to increase their government bond holdings or moving government securities used as collateral for other purposes to the Riksbank. The other referral bodies do not take a position on the proposal or have refrained from commenting.

² Annex H4 uses the concept of "covered securities" which refer to securities that fulfil the requirements in Article 52.4 of Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

³ The Riksbank accepts securities issued in SEK, USD, GBP, DKK, EUR, JPY and NOK. The security's currency affects which haircut is applicable.

⁴ The amendments in sections 1.4.2. and 1.5.2. are not applicable to the special intraday credit that is granted separately by the Riksbank to RIX participants in order to facilitate securities settlement in Euroclear Sweden.

⁵ Monetary policy instruments include fine-tuning transactions, standing facilities and repos.

⁶ In order to provide liquidity assistance under exceptional circumstances, the Riksbank may grant extraordinary loans, general liquidity assistance or emergency liquidity assistance to an individual institution. Such measures are not covered by the terms that apply to the Riksbank's normal, day-to-day operations.

1.1.4 Reasons for the change

In principle, the Riksbank considers that the use of own-name securities as collateral for credit should not be encouraged as it is likely that the value of these will deteriorate if the borrower encounters payment difficulties. The credit risk for the Riksbank will thereby increase if the counterparties' own-name securities are used as collateral.

In December 2007, however, the Riksbank began accepting own-name covered bonds as collateral for credit. The reason for this was the prevailing global financial unease and the liquidity problems in banks the world over. Since there is no longer any liquidity shortage in the Swedish financial system, a return to the rules that applied before December 2007, that is, to not accept any own-name covered bonds as collateral for credit, is therefore justified.

Furthermore, different financial regulations are placing increasingly high demands on the collateral pledged by the banks for their credit.⁷ The regulations are, for instance, restricting the scope for using own-name covered bonds as collateral. If the Riksbank continues to accept own-name covered bonds as collateral while other participants do not, it may lead to a change in the composition of the collateral pledged to the Riksbank in a way that is unfavourable to the Riksbank.

1.2 Ban on own-name securities guaranteed by a central government or equivalent institution as collateral for credit at the Riksbank

1.2.1 Current rules

As specified above, the Riksbank does not normally accept own-name securities as collateral for credit. To a limited extent, however, own-name securities that are guaranteed by a central government or equivalent institution can be used as collateral under the current terms. These are covered by the same limit rule (see Section 1.4), which is applicable to own-name covered bonds and under which collateral covered by the rule may constitute a maximum of 40 per cent of the counterparty's total collateral value.

1.2.2 Proposed amendment

Own-name securities guaranteed by a central government or equivalent institution will not be accepted as collateral for credit at the Riksbank. The change will come into force in January 2016 at the earliest.

1.2.3 Comments by referral bodies

The Swedish Bankers' Association has no substantive objections to the proposal. The Authorities in a joint statement oppose all the proposals on the grounds that it is not appropriate to implement measures requiring banks to increase their government

⁷ A noteworthy example is the fact that in the EU, the United States and other parts of the world, requirements are being imposed on derivative counterparties to exchange liquid collateral when clearing derivatives. The European rules on this can be found in Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR). Further extensive principles for requirements for liquid collateral for uncleared derivatives are being developed by the Basel Committee on Banking Supervisions (BCBS) and the International Organisation of Securities Commissions (IOSCO).

■ security holdings or to move government securities used as collateral for other purposes to the Riksbank. The other referral bodies do not take a position on the proposal or have refrained from commenting.

1.2.4 Reasons for the change

The justification for this proposal is the same as for the ban on own-name covered bonds (see Section 1.1.4) given that there is no longer a shortage of liquidity in the Swedish financial system.

1.3 The Riksbank does not accept securities with a credit rating of less than AA- as collateral for credit at the Riksbank

1.3.1 Current rules

The Riksbank accepts securities with a credit rating of less than AA- but not less than A-. These are covered by a limit rule (see Section 1.4), according to which collateral that comes under the rule may constitute a maximum of 40 per cent of the counterparty's total collateral value.

1.3.2 Proposed amendment

Securities with a credit rating of less than AA- will not be accepted as collateral for credit at the Riksbank. The change will come into force in January 2016 at the earliest.

1.3.3 Comments by referral bodies

The Swedish Bankers' Association has no substantive objections to the proposal. The Authorities in a joint statement oppose all the proposals on the grounds that it is not appropriate to implement measures requiring banks to increase their government security holdings or to move government securities used as collateral for other purposes to the Riksbank. The other referral bodies do not take a position on the proposal or have refrained from commenting.

1.3.4 Reasons for the change

The minimum credit rating requirements are being raised in order to reduce the Riksbank's credit risk.

Under the current terms and conditions, securities with a credit rating of less than AA- are subject to the same limit rule as own-name securities that are either covered or guaranteed by a central government. According to the amended provision, the Riksbank will continue to apply just one limit rule governing diversification of the collateral among different asset classes. Since the new limit rule (see Section 1.4) provides greater scope (60 per cent) than the current rules (40 per cent) governing securities that are subject to the limit rule, an unchanged credit rating requirement would allow a greater share of the collateral volume to be made up of securities with a credit rating of less than AA- than is currently the case. To avoid providing the counterparties with an incentive to pledge more securities with lower credit ratings as collateral, the Riksbank will, in accordance with the amended provisions, no longer accept securities with a credit rating of less than AA-.

1.4 Introduction of a limit rule for covered bonds

1.4.1 Current rules

The Riksbank currently applies a limit rule for

- (i) own-name covered bonds
- (ii) own-name securities guaranteed by a central government or equivalent institution
- (iii) securities with a credit rating of less than AA- (see Sections 1.1, 1.2 and 1.3 above).

Under the current limit rule, the collateral value of the securities covered by the limit rule may constitute a maximum of 40 per cent of a counterparty's total collateral value.

1.4.2 Proposed amendment

The current limit rule will be removed. Instead, a new limit rule will be introduced under which covered bonds may comprise a maximum of 60 per cent of a counterparty's total collateral value.

The amendments are not applicable to the special intraday credit that is granted separately by the Riksbank to RIX participants in order to facilitate securities settlement in Euroclear Sweden.

1.4.3 Comments by referral bodies

The Swedish Bankers' Association has no substantive objections to the proposal. The Authorities in a joint statement oppose all the proposals on the grounds that it is not appropriate to implement measures requiring banks to increase their government security holdings or to move government securities used as collateral for other purposes to the Riksbank. The other referral bodies do not take a position on the proposal or have refrained from commenting.

1.4.4 Reasons for the change

As a result of the ban on using own-name covered bonds (see Section 1.1.2), own-name securities guaranteed by a central government or equivalent institution (see Section 1.2.2) and securities with a credit rating of less than AA- (see Section 1.3.2) as collateral for credit at the Riksbank, the current limit rule is no longer relevant and will therefore be abolished.

Covered bonds issued by Swedish issuers are currently given the highest possible credit rating by external credit rating agencies and are therefore accepted as collateral for credit at the Riksbank. Despite similar credit ratings, Swedish covered bonds are traded at a risk premium in relation to Swedish government bonds, which, for example, became clearer during the recent financial crisis. Furthermore, there are certain structural risks and vulnerabilities associated with covered bonds. The Riksbank's exposure to these risks can be mitigated if the pledged collateral is more diversified and the exposure to covered bonds thereby becomes more limited than is normally the case. Since covered bonds normally comprise the majority of the

■ collateral pledged by counterparties for credit at the Riksbank, the introduction of a rule limiting the Riksbank's exposure to this type of security is justified.

Furthermore, the limit rule should be designed in such a way as to improve the diversification of collateral while at the same time enabling the Riksbank to continue supplying credit to counterparties in an efficient manner.

The share of covered bonds out of the total securities pledged by the banks and other participants as collateral at the Riksbank is normally about 70 per cent on average. In order for the limit rule to incentivise greater diversification, it should therefore be set at a level below 70 per cent. How far under this level a limit rule should be set will ultimately be a question of balancing the effects of the rule on the efficiency of the payment system, monetary policy, the counterparties and the financial markets against the Riksbank's need to limit its credit risk (see Section 2).

The Riksbank considers a limit level of 60 per cent to be appropriate, i.e. a maximum of 60 per cent of a counterparty's total collateral value may consist of covered bonds. A limit rule on this level contributes to greater diversification of the collateral pledged to the Riksbank since several counterparties only, or to a considerable extent, pledge covered bonds as collateral, and will therefore need to rebalance their collateral portfolio at the Riksbank.

A similar limit rule is applied when calculating the Liquidity Coverage Ratio (LCR). The rule limits the share of a bank's liquidity reserve that may consist of covered bonds. The limit is 40 per cent in the Basel III regulatory framework and 70 per cent in the European implementation of LCR.⁸ A limit rule of 60 per cent is therefore within this interval.

1.5 Introduction of a limit rule for covered bonds from the same issuer

1.5.1 Current rules

There is no equivalent limit rule in the current terms.

1.5.2 Proposed amendment

The share of a counterparty's collateral value that is composed of covered bonds may consist of a maximum of 50 per cent covered bonds from the same issuer.

The amendments are not applicable to the special intraday credit that is granted separately by the Riksbank to RIX participants in order to facilitate securities settlement in Euroclear Sweden.

1.5.3 Comments by referral bodies

The Swedish Bankers' Association has no substantive objections to the proposal. The Authorities in a joint statement oppose all the proposals on the grounds that it is not appropriate to implement measures requiring banks to increase their government security holdings or to move government securities used as collateral for other

⁸ See the Basel Committee's capital requirement standards "Basel III: A global regulatory framework for more resilient banks and banking systems" and Finansinspektionen regulations FFFS 2012:6 and European Commission Delegated Regulation (EU) 2015/61 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for credit institutions.

■ purposes to the Riksbank. The other referral bodies do not take a position on the proposal or have refrained from commenting.

1.5.4 Reasons for the change

Currently, all Swedish covered bonds have the highest credit rating possible. If their credit ratings change but they are still approved as collateral for credit at the Riksbank, the composition of the collateral pledged to the Riksbank without the proposed limitation may change in a way that will be unfavourable to the Riksbank. It is therefore the opinion of the Riksbank that the covered bonds pledged by a counterparty as collateral at the Riksbank should be issued by more than one issuer. This will lead to better diversification of the collateral pledged to the Riksbank by the banks for their loans, which in turn can alleviate the Riksbank's credit risks.

Under the current provisions, it is permitted to pledge covered bonds that are all issued by one and the same issuer as collateral. According to the amended limit rule, a counterparty's collateral value consisting of covered bonds must be composed of covered bonds from at least two issuers.⁹

2 Impact of the amended provisions

The effects of amended provisions governing collateral for credit at the Riksbank are considered to be positive for the Riksbank in that they will lead to better diversification of the collateral pledged by counterparties.

The consequences of no longer accepting Category B collateral are deemed insignificant since only a very small share of the counterparties' total collateral value (credit limit) consists of this kind of collateral. The credit limit will therefore basically remain unchanged. Neither is the limit rule for covered bonds from one and the same issuer deemed to have any substantial impact on the credit limit since the counterparties are considered capable of diversifying their covered bond holdings with respect to issuer without this leading to any significant costs.

The provision to limit the share of covered bonds in counterparties' collateral volume to 60 per cent will reduce the credit limit for counterparties with a share of covered bonds in excess of the limit. The counterparties' total credit limit exceeds the intraday credit by a relatively good margin, however, even after the provision amendments.

Counterparties still choosing to restore their credit limit will have to do so by pledging additional collateral that is not subject to a limit rule in the Terms and Conditions (for example government or local authority bonds). This can be done by counterparties either buying such securities or by moving existing securities to the Riksbank.

Furthermore, the Riksbank's purchases of government bonds are increasing the banking system's structure liquidity surplus in relation to the Riksbank. The Riksbank is offering its counterparties the option of investing this surplus in Riksbank Certificates, which are also included in Category A. The participants who sell government bonds to the Riksbank typically constitute a larger group than the Riksbank's counterparties, that is, those participants who are affected by the amendments to the terms and conditions. At the same time, the entire surplus

⁹ If a bank has covered bonds from one issuer only, the collateral value at the Riksbank of the covered bonds will be zero.

liquidity arising from the purchases of government bonds is acquired by the Riksbank's counterparties. This means that more collateral in Category A can be supplied to the counterparties than disappears as a result of government bond purchases.

On the whole, neither the efficacy of the payment system nor the markets for Swedish government bonds is expected to be affected by the amendments to any great extent.

Neither are the banks' funding capabilities expected to be impacted by the amended provisions to any significant degree. This is because the demand for covered bonds is mostly driven by participants other than the banks themselves, for example insurance companies and pension funds both in Sweden and overseas, who are not covered by the Riksbank's collateral terms and conditions.

The conditions for monetary policy are not being changed as a result of the amended provisions. A tightening of the terms and conditions for covered bonds could possibly increase the yields of these securities, for example as a result of a higher liquidity premium. This could, in turn, lead to slightly higher mortgage rates. Due to the design of the provisions, however, the effect of the amendments is deemed to be limited. Neither are the amendments expected to influence the Swedish exchange rate to any great degree.

The implementation of monetary policy will not be affected, either. Collateral subject to a limit rule (Category B collateral) can, however, no longer be accepted as underlying assets in monetary policy repos.¹⁰ But since the Riksbank, as a result of the bank system's structural liquidity surplus in relation to the Riksbank, does not currently offer monetary policy repos, this will not have any short-term practical consequences.

¹⁰ A limit rule can only be applied on a pool of collateral and not on one single security.