Minutes of the meeting of the Council for Cooperation on Macroprudential Policy held on 19 February 2013

Finansinspektionen and the Riksbank have held their third meeting within the framework of the Council for Cooperation on Macroprudential Policy. Those taking part in the meeting were Martin Andersson, Aino Bunge and Martin Noréus from Finansinspektionen and Stefan Ingves, Per Jansson and Mattias Persson from the Riksbank. The two authorities discussed, among other issues, the current situation on the financial markets, which currently shows signs of optimism despite the weak development in the real economy. In addition, they discussed household indebtedness, the housing market and the banks' risk weights for Swedish mortgages. International issues on the agenda included the European Systemic Risk Board's recommendations as well as the proposal for a banking union and its potential consequences. Finansinspektionen also gave an account of the authority's plans to introduce a discount rate adapted to Solvency II for insurance companies. Other topics discussed were the Swedish requirements for the major banks' capital adequacy ratios, Stibor and the Financial Crisis Committee's report.

Swedish banks and insurance companies continue to have good resilience.

The positive sentiment on the financial markets has continued to strengthen since Finansinspektionen and the Riksbank published their most recent respective assessments of the risks to, and stability of, the financial system. The improved sentiment is reflected in rising share prices and indicators of declining financial stress and is due to a number of different factors. Positive news has been predominant, including the fact that banks are repaying their loans to the ECB to a greater extent than expected. Moreover, long-term interest rates have fallen in the euro area countries with fiscal problems. The Swedish krona has strengthened recently, although the Riksbank assesses that the real exchange rate in trade-weighted terms is at a long-run normal level.

With regard to macroeconomic developments, there are signs of stabilisation. For instance, purchasing managers' indices have risen in several countries, including the euro area, albeit from low levels. In Sweden, the purchasing managers' index has risen and stabilisation can also be seen in other indicators for Sweden, such as export orders.

SVERIGES RIKSBANK
(Brunkebergstorg 11), SE-103 37 Stockholm. Tel +46 8 787 00 00. Fax +46 8 21 05 31.

FINANSINSPEKTIONEN
Box 7821, (Brunnsgatan 3), SE-103 97 Stockholm. Tel +46 8 787 80 00. Fax +46 8 24 13 35

Despite these signs of stabilisation in the real economy, the participants noted that it is still uncertain to what extent it justifies the improved sentiment on the financial markets and it is thus also uncertain how robust developments on these markets are. One explanation for the improved sentiment on the financial markets could be the extensive measures that central banks around the world have taken and which are still in operation.

In the euro area, which is by far Sweden's largest export market, the underlying structural problems remain, with weak competitiveness and weak public finances in several countries. Growth in the euro area is likely to be very weak for some time to come, which may also dampen growth in Sweden. The authorities noted that substantial work remains to be done before the structural problems in Europe are resolved.

Given this, the sovereign debt problems in Europe and the uncertainty over the state of the European banks remain the largest risk that the unease on the financial markets may increase again and potentially affect the Swedish financial system. In the long run, a deep and prolonged recession in the euro area could worsen the economic situation in Sweden, the other Nordic countries and also the Baltic countries, which could ultimately entail risks for the stability of the Swedish financial system.

Despite a relatively weak development in the real economy, the banks in Sweden are well-capitalised. Their resilience is, in the authorities' assessment, still good and they currently have good access to market funding. At the same time, the Swedish banks are vulnerable to increased unease in the financial markets as a result of their large use of market funding.

The situation for Swedish life insurance companies has also eased somewhat as the market index and long-term government bond yields in Sweden have risen in recent months and following the introduction of the temporary interest rate floor last year.

The charts on which the discussions of the current financial situation were based are attached.

Other macroprudential policy issues

Financial Crisis Committee's proposal for a macroprudential council

It was observed at the meeting that the Financial Crisis Committee has published a report in which it proposes that both Finansinspektionen and the Riksbank should be given responsibility for macroprudential policy. The Committee also proposes that a macroprudential policy council should be established by law. The council should consist of representatives of the Riksbank and Finansinspektionen, and be supplemented with independent experts and an observer from the Ministry of Finance. The participants emphasised that it is important that the mandates for macroprudential policy are made clear. The fact that the mandate for macroprudential policy needs to be clear is something that the European Systemic Risk Board (ESRB) also points out in its recommendation on national mandates for macroprudential supervision. The two authorities will further develop their views in coming consultation responses to the Committee's report. The authorities agreed to continue to meet within the Council for Cooperation on Macroprudential Policy until the responsibility and powers of authority regarding macroprudential policy have been regulated differently in law.

The European Systemic Risk Board's recommendations on banks' funding and lending in foreign currencies.

The Council discussed the on-going work on following up the ESRB's recommendation on lending in foreign currency and the upcoming work on implementing the recommendations regarding banks' funding. The recommendations regarding banks' funding aim to limit banks' refunding risks and are addressed to all national financial supervisory authorities and other authorities with a mandate for macroprudential supervision.

The ESRB's recommendation on FX-lending implies that caution should be exercised when granting such loans. The participants in the Council noted that only a limited number of loans in foreign currency are granted in Sweden. On the other hand, such loans are common in Latvia, Lithuania and Poland, where Swedish banks have operations. The participants noted that loans in foreign currency currently comprise a smaller percentage of the Swedish banks' loan portfolio than previously, not least in relation to their capital. This is largely an outcome of the low credit growth in Latvia and Lithuania. However, it is still positive and relevant for the financial stability in Sweden that such loans continue to decline as a share of the Swedish banks' loan portfolios. Finansinspektionen will closely monitor the development and gather in reports and make stress tests to ensure that the banks' risks are acceptable. Finansinspektionen is also planning to rework its general guidelines on credit risk management (FFFS 2004:6) into regulations and in connection to this also take into account the ESRB's recommendation on lending in foreign currency, where relevant.

The implementation of Basel III at EU level and stricter requirements for Swedish banks

Work is currently under way within the EU on introducing the Basel III Accord regarding the capital requirements for banks into EU legislation. The participants discussed at the meeting how the negotiations between the European Council and the European Parliament on the proposal for new capital adequacy rules are progressing.

In Sweden, the question of higher capital adequacy requirements for Swedish banks is being prepared within the Ministry of Finance and the so-called capital adequacy inquiry is to report its results on 15 May 2013. The participants in the Council noted that the earlier agreement, in which the Ministry of Finance, Finansinspektionen and the Riksbank advocated requirements of at least 10 per cent Common Equity Tier 1 capital from 2013 and 12 per cent from 2015 for the four major banks, still stands. However, the timetable is dependent on the progress of the negotiations within the EU.

The Council participants also noted that within the scope of the negotiations on new capital adequacy rules within the EU, discussions are currently also going on regarding a decision-making form for the introduction of a Liquidity Coverage Ratio (LCR) in the EU. Finansinspektionen introduced LCRs in Sweden at the beginning of this year, aggregated for all currencies as well as separately for the euro and the US dollar. The participants noted at the meeting that it remains to be seen how the Swedish regulation will be affected by a future introduction of LCRs in the EU. In connection to this, the participants from the Riksbank expressed the view, in accordance with the Riksbank's earlier consultation response on this issue, that the introduction of an LCR in Swedish krona should be investigated.

The Swedish reference rate for the interbank market

Since the Council's previous meeting in October, the Swedish Bankers' Association has assumed the responsibility for reforming Stibor and published a proposal for a new framework (December 2012). It was noted at the meeting that the actions of the Swedish Bankers' Association constitute significant progress in the work on reforming Stibor.

One important element of the new framework is the requirement that it should be possible to borrow or invest at the bids placed by the Stibor banks, which strengthens the incentives for the banks to make correct bids. The possibility to trade at the Stibor bids is an aspect that distinguishes Stibor from the reference rates in many other countries.

The participants also noted that the responsibility for Stibor now rests with the Swedish Bankers Association, and ultimately its Board, and it is therefore important that the Association ensures that there is a clear structure for following up and monitoring compliance with the framework.

In this context, the participants also discussed the on-going extensive international work on reference rates. They noted that it is important to account for this in the continued reform work, as it may have implications for how the Stibor framework is designed and how the supervision is conducted. This applies to the European Commission's work as well as the work conducted by the European Banking Authority and the European Securities and Market Authority but also to the work on reference rates being carried out by authorities in Denmark and Norway.

Developments on the mortgage market, risk weights and the need for inquiries

The Council participants discussed developments on the Swedish mortgage market and possible consequences thereof. Swedish households have large debts in relation to their incomes, from both a historical and an international perspective. Both authorities were of the opinion that this is a development that needs to be closely monitored.

There was also discussion of Finansinspektionen's on-going mortgage survey and the discussion focused in particular on issues regarding the effects of the mortgage cap and borrowers' amortisation behaviour. Finansinspektionen will publish the conclusions of this year's mortgage survey on 7 March 2013.

The participants at the meeting noted that measures have been taken on the mortgage market. In October 2010, Finansinspektionen introduced a mortgage cap, which meant that new mortgages should not exceed 85 per cent of the market value of the property, a measure that has had a dampening effect on household debt and on housing prices. The participants from the Riksbank added that the risk of over indebtedness in the Swedish household sector was one motive for increasing the monetary policy rate, the repo rate, during the period summer 2010 to summer 2011.

Further measures are planned, in the form of a risk weight floor. In November 2012, Finansinspektionen announced its intention to introduce a risk weight floor of 15 per cent for Swedish mortgages within the framework of the total capital assessment in Pillar 2. One consequence of this is that the risk weights for Swedish mortgages are raised, which the Council participants have said at the two previous meetings is necessary. One of the motives for introducing a risk weight floor is the structural changes that have occurred on the Swedish mortgage market over the past 20 years, which may imply that losses on mortgages during a financial crisis could significantly exceed the historical loss levels. At the meeting

Finansinspektionen also gave a brief summary of the views received with regard to the risk weight floor. In general, those who were consulted regarding the proposal expressed support or understanding for the measure. None of the respondents rejected the measure entirely; rather the objections that were raised regarded certain specific aspects of the risk weight floor. The Riksbank's participants presented the Bank's views.

The two authorities noted that there is a need to jointly analyse the consequences of structural changes in the mortgage market, not least from a long-run perspective. The participants agreed at the meeting that the authorities would appoint a joint analysis group for this purpose. The group will work on the basis of the results of Finansinspektionen's mortgage survey and the respective authority's analysis to identify areas that require further analysis with regard to the development of the mortgage market and to try to find issues of common concern in this regard and areas of collaboration between Finansinspektionen and the Riksbank. An important area that has already been identified is the long-run consequences of various forms of amortisation behaviour. The analysis group will present its findings at the autumn meeting of the Council for Cooperation on Macroprudential Policy.

Finansinspektionen's proposal for a discount rate for insurance companies

The representatives of Finansinspektionen described the authority’s plans to introduce a discount rate for insurance companies, based on the principles behind the method in Solvency II, the upcoming EU regulation for the insurance sector. The aim is to avoid companies acting short-sightedly in a way that could be detrimental to future pensioners. The new discount rate should be in place at the end of the year. Until then, the temporary interest rate floor introduced in summer 2012 will remain in place. The proposal will be sent out for consultation during the spring and the new discount rate is planned to take effect on 31 December 2013.

Banking union

The Council participants discussed the European Council's proposal to establish a European banking union and what this might entail for regulation and supervision in Sweden.

The banking union consists of several parts; a joint banking supervision, a common deposit guarantee and a joint system for managing the resolution of banks in distress. The part where most progress has been made is the proposal for a joint banking supervision in the EU, which is currently being discussed in the European Council and the European Parliament. According to the proposal, the European Central Bank, ECB, will take over the responsibility for exercising supervision over all "significant" banks (based on size, systemic importance and cross-border operations) in the participating countries as well as the banks that have received, or have applied for, public support from the EU's crisis management funds.

The Council participants noted that regardless of whether or not Sweden joins the banking union, it will still be affected. For instance, the ECB will exercise supervision over Swedish banks' operations in other countries. Another consequence that was discussed is that the cooperation at the European level in the European Banking Authority, EBA, and the European Systemic Risk Board, ESRB, will probably change when the ECB takes on a new role. The most tangible consequence for Finansinspektionen is that the ECB will take part in the colleges of supervisors for the major banks, which means that both authorities will need to reach joint decisions on a number of processes.

Next meeting

At the meeting the participants agreed that the Council will meet again on 1 October 2013.

SVERIGES RIKSBANK
(Brunkebergstorg 11), SE-103 37 Stockholm. Tel +46 8 787 00 00. Fax +46 8 21 05 31.

FINANSINSPEKTIONEN
Box 7821, (Brunnsgatan 3), SE-103 97 Stockholm. Tel +46 8 787 80 00. Fax +46 8 24 13 35