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**Consultation response to the report of the commission of inquiry into new capital adequacy regulations (SOU 2013:65)** 20/11/2013

*The Riksbank welcomes to a great extent the amendments that the commission of inquiry proposes in order to adapting current Swedish law to the regulation and the Directive on new capital adequacy regulations adopted by the European Parliament and the Council.<sup>1</sup>*

*The Riksbank supports the commission's proposal to implement all capital buffers listed in the Directive into Swedish law. The Riksbank also supports the commission's opinion that the provisions on the capital conservation buffer and the provisions for the countercyclical capital buffer should take effect from the moment the Directive applies since this will contribute to safeguarding financial stability. Furthermore, the Riksbank welcomes the commission's proposal to introduce the provisions of the Directive on a systemic risk buffer in order to be able to further tighten the capital requirements if needed.*

*The Riksbank finds, unlike the commission, that the Directive allows the capital conservation measures associated with the capital conservation buffer and the countercyclical buffer to be applied in connection with the introduction of the buffer requirements.*

*The Riksbank supports the commission's proposal that calculations based on models are required for establishing the countercyclical capital buffer, but wishes to highlight the need to also use qualitative assessments of the sustainability of credit growth and the level of cyclical systemic risk. Furthermore, the Riksbank finds reason that Finansinspektionen ought to consider measures to prevent distributions of the capital that is released if the countercyclical buffer is reduced.*

<sup>1</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 and amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC and Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

■ *The Riksbank finds, unlike the Commission, that supervisory authorities when assessing if special own fund requirements should be imposed on the institution should take account both the risk which the institution is exposed to and the risk to which the institution exposes the financial system. This would increase flexibility for Finansinspektionen in its assessment of the capital requirements of the institution.*

*Furthermore, the Riksbank would like to see clear and public decisions regarding institution specific own fund requirements (Pillar II). Therefore, the Riksbank is of the opinion that there ought to be introduced a requirement into Swedish law for Finansinspektionen to publish decisions regarding a bank's specific own fund requirement. There should also be a requirement for the banks to publish the specific own fund requirements that are imposed to them. This would make it easier for external market participants to perform a risk assessment of the bank. Finansinspektionen has already published effects of such own fund requirements on individual banks in connection with the introduction of the risk weight floor for mortgages. Therefore the Riksbank finds that such legislation is a natural step towards greater transparency.*

*The Riksbank finds that, in the Capital Buffers Act, it should be clarified that it should be possible to use the systemic risk buffer to counteract the risks that systemically important institutions pose to the financial system. The Riksbank also finds that, in the same act, it should be clarified that different systemic risk buffer requirements may be introduced for different parts of the financial sector.*

*The circumstances of the commission's proposal on choice of competent authority for the countercyclical buffer have changed following the Government's declaration of intent regarding a strengthened financial stability framework. Therefore, the Riksbank finds no reason to comment further on the proposal. However, the Riksbank wishes to emphasise that it is natural to have smoothly functioning consultation between the authorities regarding macroprudential tools – especially the cyclical ones.*

## **INTRODUCTION OF THE CAPITAL BUFFERS**

### **Proposal of the commission**

The commission proposes that the Directive's provisions on capital buffers be introduced into Swedish law through a new act – the Capital Buffers Act. The entry into effect of this act is addressed in the Capital Buffers Implementation Act (the Implementation Act). The Capital Buffers Act implements all of the Directive's capital buffers, i.e. the capital conservation buffer and the countercyclical capital buffer, as well as the systemic risk buffer and buffer requirements for systemically important institutions. Member States can introduce the systemic risk buffer on a voluntary basis. According to the Implementation Act, it is proposed that Sweden utilises the possibility of introducing the capital conservation buffer and the countercyclical capital buffer earlier than specified by the general rule of the Directive. According to the Implementation Act, however, the provisions on capital conservation measures (i.e. restrictions on distributions, etc.) required of an institution if the combined buffer requirement is not met, should not apply until as

of 2016, regardless of whether Sweden chooses to implement the Directive's provisions on capital buffers from an earlier point in time. The reason for this provision is that the Directive does not allow the provisions on intervention and restrictions to come into force at an earlier point in time.

### **The Riksbank's opinion and proposal**

#### *Timing and scope*

The Riksbank supports the commission's proposal to incorporate all capital buffers in the Directive into law. The Riksbank particularly welcomes the proposal to introduce the provisions of the Directive on a systemic risk buffer in order to enable stricter capital requirements.

The Riksbank also supports the commission's opinion that the provisions for the capital conservation buffer and the provisions for the countercyclical capital buffer should take effect from the moment the Directive applies in order to safeguard financial stability. Normally, an increase in the buffer rate of the countercyclical capital buffer starts to apply 12 months following the announcement of the decision. However, if substantial systemic risks are present when the buffer framework is introduced, a shorter time frame could be motivated by exceptional circumstances.

#### *Measures if the buffer requirement is not met*

The Riksbank does not share the commission's opinion that the provisions on the capital conservation measures set out in the Directive (Article 141 on restrictions on distributions and Article 142 on the requirement to prepare a capital conservation plan) should start to apply as of 1 January 2016 despite the capital buffer provisions being introduced earlier. The commission's interpretation would involve an institution that violates the buffer requirement not automatically being subjected to capital conservation measure requirements aimed at strengthening own funds to the buffer requirement level. Thus the buffers would not fulfil their purpose. Even if Finansinspektionen (the Swedish Financial Supervisory Authority) were to prohibit the institution from distributions, or impose demands on the institution in terms of preparing capital conservation plans as a part of its "ordinary sanctions system", Finansinspektionen would not be obliged to do so. The Riksbank sees problems in a rule in which these provisions are not complied with because, during the transition period, the buffer requirements cease to be "buffers" by nature.

The Riksbank therefore finds that the reasonable interpretation is that the buffer requirements be introduced together with other provisions about capital conservation measures. The Riksbank finds support in the Directive for this interpretation. See the appendix for a further elaboration on this.

To sum up, the Riksbank is hence of the view that, when the buffer requirements are introduced prematurely, the same should apply to the provisions in Articles 141 and 142 of the Directive. If the Government does not share the Riksbank's opinion, the Riksbank believes that guidance should be provided about what applies if an

■ institution is in breach of the prematurely introduced buffer requirements. This is important for the institution as well as its shareholders and investors.

## THE COUNTERCYCLICAL CAPITAL BUFFER

### Proposal of the commission

The commission proposes that the countercyclical capital buffer be set according to Article 136(2) and 136(3) of the Directive. This involves the designated authority observing an EU-wide systemic risk indicator, known as the credit gap, and a number of criteria established at EU level. At the same time, the designated authority is given scope to take account of the specificities of the national economy. The authority should also observe other variables deemed relevant to managing cyclical systemic risks. The commission proposes that the designated authority be given a mandate to develop, independently and in collaboration with other authorities, own models and methods. This mandate should, according to the commission, also include a possibility of observing various indicators for activating or reducing the buffer so that account may be taken of the fact that different circumstances can prevail in the build-up of cyclical systemic risk and when it actually materialises.

### The Riksbank's opinion and proposal

The Riksbank finds that the countercyclical capital buffer is an important instrument for managing cyclical systemic risks and supports the commission's proposal about how it is to be set. The Riksbank shares the commission's view that EU-wide systemic risk indicator, known as the credit gap, should not lead to mechanical setting of the countercyclical buffer rate, but that other indicators should also be considered and that there is scope for judgement. In this context, the Riksbank wishes to highlight in particular the need to use qualitative assessments of the sustainability of credit growth and the level of systemic risk, in accordance with the guidance of the Basel Committee.<sup>2</sup> The credit gap has, for example, generally been a useful indicator for signalling the build-up of systemic risks, but is a poorer indicator for decisions about releasing the buffer. Quantitative indicators can also give misleading results, and basing buffer rate decisions on indicators alone would not be appropriate. The Riksbank therefore finds it important that the quantitative indicators be supplemented with assessments of the sustainability of credit growth and the level of systemic risk in decisions about the buffer rate of the countercyclical capital buffer.

The primary purpose of the countercyclical capital buffer is to enhance the resilience of the financial system. It can also reduce the risk of excessive credit growth in upturn phases. Resilience is primarily enhanced by the banks building up sufficient own funds to cover losses that may arise in tougher times. In this way, the banking sector has sufficient capital to avoid a credit crunch in times of financial

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<sup>2</sup> *Guidance for national authorities operating the countercyclical capital buffer*, Basel Committee on Banking Supervision, December 2010.

stress. When the countercyclical capital buffer is reduced there is scope for distributions of the capital released. Institutions can then choose to distribute to shareholders and employees the released capital (e.g. dividends, repurchases of shares, bonuses, etc.). In a state of financial unease on the market, the institution may however need the capital to absorb potential losses in the operations while maintaining its lending. The Basel Committee calls attention to this in its guidance on the countercyclical capital buffer and finds that the supervisory authority, in the framework of its supervisory review of the institutions (Pillar II) should, if appropriate, be able to prohibit the institutions from performing distributions when the countercyclical capital buffer reduced.<sup>3</sup> The Riksbank therefore sees a need to clarify that Finansinspektionen, in the framework of its Pillar II review, has the possibility of considering measures to prevent such distributions if they were to consider it necessary. In so doing Finansinspektionen may, where needed, limit distributions in order to ensure that the banks have sufficient capital to absorb losses and maintain lending, even when the buffer is not activated.

### **SPECIFIC OWN FUND REQUIREMENTS AND SYSTEMIC RISKS**

Article 104(2) of the Directive specifies a number of situations in which supervisory authorities should require an institution to have own funds exceeding the capital requirements specified in the regulation and in the chapter on capital buffers with respect to risk elements and risks not captured by Article 1 of the regulation or the capital buffer regulation. Such own fund requirements are sometimes known as own fund requirements according to Pillar II.

According to article 104(3) of the Directive, supervisory authorities should observe systemic risk when assessing whether to impose such a specific own fund requirement on an institution.

#### **Proposal of the commission**

According to Chapter 2, section 2 of the Act of prudential supervision of credit institutions and investment firms, Finansinspektionen shall decide that an institution is to meet a specific own fund requirement if it finds it necessary, in connection with evaluating the institution, to capture risks to which the institution is or might be exposed. According to the commission, the assessment of whether an institution is to have a specific own fund requirement should be based, as it is currently, only on risks to which the institution is exposed.

#### **The Riksbank's opinion and proposal**

The Riksbank's interpretation of the Directive, unlike that of the Commission, is that supervisory authorities shall also take account of the risk to which the bank exposes the financial system. This would involve Finansinspektionen also being able to base a specific own fund requirement on the risk the institution poses to the financial system.

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<sup>3</sup> *Guidance for national authorities operating the countercyclical capital buffer*, Basel Committee on Banking Supervision, December 2010, p.6.

■ In the Riksbank's view, it is reasonable for Finansinspektionen, which is to identify which institutions are systemically important and have a specific focus on them in its supervision, to have the possibility of managing any risks which the systemically important institutions are deemed to pose. The Riksbank finds scope for such an interpretation in the Directive.

It should also be remembered that the institutions' risk models usually only take account of the risk of default of the institution itself. The institutions' risk models therefore do not take full account of the risks to which the institutions expose the financial system. Although such risks could lead to the institution itself defaulting, they are mainly about the effect of the institution's default, or its other serious problems, on the financial system in general and on the real economy. The Government thus has an interest in providing systemically important institutions with an incentive to reduce the risk to which the institution exposes the financial system by imposing a higher capital requirement on the institution.

In order for an institution to be sufficiently capitalised from an economic point of view, it needs to have capital that covers both the risks to which the institution is exposed (risk of default), and the risk it poses to the financial system and the real economy (effect of default). The Riksbank finds that Article 97 etc. of the Directive aims to address both of these risk aspects. See the appendix for a further elaboration on the Riksbank's view of the implication of the Directive.

The Riksbank also notes that the European Banking Authority (EBA) has interpreted the Directive such that supervisory authorities, within the framework of the review process, shall ensure that institutions have sufficient capital to also cover the risks that the institution poses to the financial system.<sup>4</sup>

To sum up, the Riksbank finds that an institution's systemic importance should be taken into account when assessing the capital it is to hold. In its decisions, Finansinspektionen should also report on how it has taken account of the institutions' systemic importance (or absence thereof) in assessing the capital they need to hold.

That which is expressed by the Riksbank above on the own fund requirement also applies to liquidity requirements and other supervisory requirements.

## **SPECIFIC OWN FUND REQUIREMENTS AND TRANSPARENCY**

### **Proposal of the commission**

The report contains no rationale about whether institutions and Finansinspektionen should be obliged to disclose the specific own fund requirement. Neither does the report address how such a requirement stands in relation to the regulation's rule on institutions having to disclose information of significance to the assessment of their risk profile, or the obligation to disclose price-sensitive information under the Securities Market Act.

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<sup>4</sup> <http://www.eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2>.

## ■ The Riksbank's opinion and proposal

The Riksbank believes that any specific own fund requirement for the institution should be known in order to enable market participants to gain a comprehensive overview of an institution's risk profile. This has become even more important through the introduction of the buffer requirements. The commission of inquiry states that capital buffers are to be placed above any specific own fund requirements. So, assessing whether a bank meets the buffer requirement requires knowing about any specific own fund requirements on the bank. In particular, if market participants do not know how much capital the institutions are to hold in excess of the minimum requirements, it will not be possible to assess the capital level at which the institutions would be subjected to restrictions on e.g. dividends or interest payments on tier 1 capital contributions. In order for market participants to make that assessment, which is necessary for market discipline to function, the specific own fund requirement must be disclosed. However, neither the Directive nor the commission of inquiry does specify whether there should be transparency. However, the Riksbank would like to see clear and public decisions regarding institution specific own fund requirements. The Riksbank would therefore find it desirable to introduce a transparency requirement into Swedish legislation for Finansinspektionen to publish decisions regarding a bank's specific own fund requirement.

Such legislation would be a natural continuation of a course that has already commenced towards greater transparency for specific own fund requirements. For example, Finansinspektionen has published the effects of the specific own fund requirement on individual banks in connection with the introduction of the risk weight floor for mortgages.<sup>5</sup> The Riksbank welcomes Finansinspektionen's endeavour to shed light on these effects within the review and evaluation of the supervisory authorities and in light of the fact that a further step towards greater transparency surrounding specific own fund requirements would be natural.

Furthermore, the Riksbank is of the opinion that Finansinspektionen should require the institutions to disclose information about the outcomes of the institutions' internal capital adequacy assessments. This is in accordance with Article 438(b) of the regulation, which specifies that the institutions, on the request of the relevant competent authority, shall disclose information about the outcome of the institution's internal capital adequacy assessment. This includes the compilation of the additional own fund requirements based on the supervisory procedure referred to in Article 104(1) of the Directive.

Finally, institutions shall, according to article 431(3) of the regulation, disclose the information required to provide market participants with a comprehensive presentation of their risk profiles. According to the Riksbank, this requirement involves the institutions having to publish the capital need resulting from

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<sup>5</sup> *Risk weight floor for Swedish mortgages*, Finansinspektionen, May 2013.

■ Finansinspektionen's review and supervisory process as well as a possible decision regarding a specific own fund requirement.<sup>6</sup>

## **APPLICATION OF SUPERVISORY MEASURES TO INSTITUTIONS WITH SIMILAR RISK PROFILES**

According to Article 97 of the Directive, the competent authority shall review the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with the Directive and evaluate the risks to which the institutions are or might become exposed to. Article 103 describes a situation in which the supervisory authorities, according to Article 97, determine that institutions with similar risk profiles are or might be exposed to similar risks or pose similar risks to the financial system. Article 103 states that, in such a situation, the supervisory authorities may apply the supervisory review and evaluation process referred to in Article 97 to those institutions in a similar or identical manner. For those purposes, Member States shall ensure that competent authorities have the necessary legal powers to impose requirements under the Directive and the regulation on those institutions in a similar or identical manner, in particular the supervisory powers under Articles 104–106.

### **Proposal of the commission**

According to the commission, there is nothing in Swedish law to prevent Finansinspektionen from making identical or similar intervention decisions, and Article 103 primarily serves to clarify that competent authorities shall have the possibility of making such similar assessments.

### **The Riksbank's opinion and proposal**

The Riksbank is not convinced of the commission's conclusions and finds that the principle in Article 103 of the Directive should be clearly expressed in Swedish law, not least because it is linked to intervention against institutions.

For example, the provision in Chapter 2, sections 2 and 3 of the Act of prudential supervision of credit institutions and investment firms requires, in line with current law, performing an individual assessment of the institution's risk management etc. or of the necessity of imposing a specific own fund requirement on that particular institution. According to the Riksbank's interpretation of the provisions of Article 103, their purpose is to clarify that it is not necessary, ahead of imposing a potential additional capital requirement, to analyse in detail the internal models of the institutions or how their risk management systems are devised if institutions with similar risk profiles are exposed to or pose to the financial system similar risks. (However, this does not rule out nevertheless taking account of clear differences between the institutions). This interpretation ought to be expressed in the recitals.

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<sup>6</sup> This already works in Denmark, where the banks have been required to report their specific own fund requirements since 2010.



## ■ THE RELATIONSHIP BETWEEN THE BUFFERS AND THE SPECIFIC OWN FUND REQUIREMENT

It is not clear in the Directive whether Member States may introduce a specific own fund requirement for risks that can be managed by the buffer for systemically important institutions and the systemic risk buffer, or if these buffer requirements<sup>7</sup> shall only be imposed on institutions that have not had a specific own fund requirement imposed.

### **Proposal of the commission**

The report of the commission does not clearly specify either how the specific own fund requirement stands in relation to the buffer requirements.

### **The Riksbank's opinion and proposal**

As the provision of Chapter 2, section 2 of the Act of prudential supervision of credit institutions and investment firms has been devised, the Riksbank draws the primary conclusion that the specific own fund requirement shall refer to risks other than those captured by the regulation and the buffer requirements. However, it is not clear and the report does not address this question specifically.

Because a specific own fund requirement is an intervening decision for the institutions, the Riksbank believes that the principle for utilising specific own fund requirements ought to be clear. The Riksbank believes that a reasonable interpretation is that specific own fund requirements should only capture such risks or risk elements that are not comprised in or fully captured by the regulation or the buffer requirements. (See Articles 104(1a) and 104(2b) of the Directive; compare Article 133(12e)). One example of this is if the regulation and the buffer requirements do not suffice to fully cover the systemic risks to which an institution is exposed or which an institution poses to the financial system. In such cases, supervisory authorities ought to be able to impose a specific own fund requirement on an institution.

## **SPECIFIC OWN FUND REQUIREMENTS AND OWN FUND COMPOSITION**

The Directive does not state explicitly whether decisions on specific own fund requirements may contain capital class requirements.

### **Proposal of the commission**

According to the proposal of the commission, decisions on specific own fund requirements should contain requirements both on amounts and on capital classes.

### **The Riksbank's opinion and proposal**

The Riksbank welcomes the commission's proposal and believes that it is consistent with the Directive. The Riksbank finds it important for Finansinspektionen to be

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<sup>7</sup> In the Riksbank's view, the capital conservation buffer and the countercyclical capital buffer are not problematic in this respect.

■ able to impose requirements on capital class. Different risks may need covering by different classes of capital. If Finansinspektionen may not place requirements on capital class, the capital held by institutions to manage their risks could prove insufficient.

## THE PURPOSE OF THE SYSTEMIC RISK BUFFER

The Directive states in Article 133(1) that the purpose of the systemic risk buffer is to prevent and mitigate long-term structural systemic or macroprudential risks not covered by the regulation, in the meaning of a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State. The Directive also states that a systemic risk buffer shall apply to all institutions, or one or more subsets of those institutions, for which the authorities of the Member State concerned are competent (Article 133(9)).

### Proposal of the commission

The commissioner has interpreted that the systemic risk buffer is a broad instrument that can be used to strengthen the resilience of the financial sector, or parts thereof, to financial disruptions that may arise from structural systemic risk. Furthermore, the commissioner interprets that the systemic risk buffer does not take individual systemically important institutions as its starting point. Instead, the systemic risk buffer, according to the commissioner, is a broader instrument to be applied to the entire financial sector or parts thereof (p. 201). In terms of the type of structural systemic risks for which the systemic risk buffer is intended for use, the commissioner provides examples from the ESRB's recommendation on intermediate objectives and instruments for macroprudential policy in the EU countries.<sup>8</sup> The examples are systemic risks that may arise from changes in legislation and accounting standards, cyclical spill-over effects from the real economy, a large financial system in relation to GDP or financial innovations that increase complexity.

The commission also discusses how the systemic risk buffer relates to the capital buffers for systemically important institutions. In cases where the systemic risk buffer is applied to exposures in other Member States, it should, according to the commission, be possible to refer to the systemic importance of an institution as a reason for a systemic risk buffer, even though this should normally be taken care of by the capital requirements ensuing from the capital buffers for systemically important institutions. The commissioner's reason for this is that in such cases, only the highest of the systemic risk buffer and the capital buffers for systemically important institutions shall be applied.

This can be perceived as the commissioner finding that, in certain cases, it should be possible to use the systemic risk buffer to counteract the risks that systemically important institutions pose to the financial system.

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<sup>8</sup> Recommendation of the ESRB of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1), EUT C 170, 15.6.2013.

■ In the statute comments, however, the commissioner makes a statement that provides scope for a different interpretation. There, the commissioner writes that the systemic risk buffer can be applied to the financial sector as such, i.e. all institutions, or to one or more groups of institutions that show similar risk profiles in their business operations. The commissioner finds this means that the systemic risk buffer can be applied to institutions with similar exposures, either to an economic sector in their own country, or to a financially uneasy geographic sector, and which according to the commissioner are hence exposed to similar types of risks.

In the statute comments, the commissioner thus places the emphasis on the risks to which institutions expose themselves. However, the risks that systemically important institutions pose to the financial system are not mentioned by the commissioner at all in the capital buffers bill or the statute comments.

### **The Riksbank's opinion and proposal**

The Riksbank interprets the Directive such that the purpose of the systemic risk buffer is to counteract all types of structural systemic risks insofar that they involve such a risk of disruption in the financial system with the potential to have serious negative consequences to the financial system and the real economy in a specific Member State (Article 133(1)). This includes both structural systemic risks to which an institution is exposed and structural systemic risks which an institution poses to the financial system and real economy in its own Member State. The latter type of systemic risk is that which is usually associated with systemically important institutions. In particular, these systemic risks are associated with domestically systemically important institutions, because they focus on the consequence in the specific Member State in the event of the risk transpiring (i.e. if the institution were to default or experience other serious problems).

Therefore, according to the Riksbank, it should also be possible to use the systemic risk buffer to counteract the risks that systemically important institutions pose to the financial system and real economy. More specifically, the Riksbank finds that the systemic risk buffer should be used to counteract such risks if they are not fully covered by the capital buffers for systemically important institutions. The capital buffer for globally systemically important institutions is limited to 3.5 per cent, and the capital buffer for other systemically important institutions is limited to 2 per cent. The systemic risk buffer may, however, be set higher. The Riksbank therefore believes there are cases in which the capital buffers for systemically important institutions do not suffice to cover the risks posed by systemically important institutions and where the systemic risk buffer therefore should be used as a complement.

To sum up, the Riksbank finds that it should be clarified in part that the systemic risk buffer may be used for systemic risks to which institutions are exposed, and in part that the systemic risk buffer may in certain cases be used to strengthen the buffers for systemically important institutions and hence counteract the risks posed by systemically important institutions.

## DIFFERENT SYSTEMIC RISK BUFFERS ON DIFFERENT INSTITUTIONS

The Directive prescribes that a systemic risk buffer may be introduced for the financial sector or for one or several parts of this sector. Furthermore, the Directive establishes that different systemic risk buffer requirements may be introduced for different parts of the financial sector (Article 133(9)).

### Proposal of the commission

In the commissioner's proposal, it is stated that Finansinspektionen should be entitled by law, with the limitations set forth in the Directive, to decide on *a* systemic risk buffer and specify the institutions and geographic exposures for which *it* shall apply following consultation with the Riksbank. In Chapter 4, section 1 of the capital buffers bill, Finansinspektionen may decide *that institutions* shall have a systemic risk buffer. The same wording is used in the statute comments. The provision of the Directive on the ability to apply different systemic risk buffer requirements to different institutions at the same time is not brought up either in the deliberations of the commissioner or in the commissioner's proposal.

### The Riksbank's opinion and proposal

The Riksbank finds that the Directive is clear in that different systemic risk buffer requirements may be introduced for different parts of the financial sector. The Riksbank finds it important that it is clear in the capital buffers bill that Finansinspektionen has the possibility to make decisions regarding different systemic risk buffer requirements for different parts of the financial sector because different institutions can expose the system to different risks, or be exposed to different systemic risks. This should therefore be clarified in the capital buffers bill.

## RECOGNITION OF THE SYSTEMIC RISK BUFFERS OF OTHER MEMBER STATES

According to the Directive, other Member States may recognise the systemic risk buffer rate set and may apply that buffer rate to domestically authorised institutions for the exposures located in the Member State that sets that buffer rate (Article 134(1)).

### Proposal of the commission

The commission states in the capital buffers bill and in the statute comments that an institution in Sweden can, for their exposures in the EEA, be required to apply the systemic risk buffer determined by the competent authorities in those countries.

### The Riksbank's opinion and proposal

Neither the Directive nor the commission specifies in further detail which foreign systemic risk buffer rates may be applied to which domestically authorised institutions.

It is, for example, unclear what the requirements are for Finansinspektionen to be able to apply a systemic risk buffer rate from another Member State to a

domestically authorised institution's exposures in that other Member State. A conceivable interpretation is that it is required that the other Member State has introduced a systemic risk buffer rate for the domestically authorised institution's subsidiaries in the other Member State, if any. Another conceivable interpretation is that it is required that the other Member State has introduced a systemic risk buffer rate that applies to the entire financial sector in the other member state.

The Riksbank finds it important that the provisions on the recognition of the systemic risk buffers of other member states can be used in practice. In the Riksbank's view, which foreign systemic risk buffer rates may be recognised by domestic authorities and applied to which domestically authorised institutions should therefore be legislated.

## **CALCULATION OF THE SYSTEMIC RISK BUFFER**

### **Proposal of the commission**

Regarding the calculation of the systemic risk buffer, the commission has interpreted Article 133(3) of the Directive such that the buffer shall amount to a certain percentage of the risk-weighted exposure amount. Furthermore, the commission has not taken a stance on the matter as to how the jurisdiction of an exposure is to be determined.

The report summarises the content of Articles 133(11)–14 of the Directive, which describe what processes with which competent authorities are to comply for setting a systemic risk buffer depending on the size and geographic scope of the buffer.

### **The Riksbank's opinion and proposal**

The Riksbank shares the commission's interpretation regarding calculating the systemic risk buffer. However, the Riksbank sees a need for further explanations of the calculation method, and proposes that this should be clarified. The Riksbank also believes that how an exposure's jurisdiction is determined should be clarified.

The interpretation of the interplay between Articles 133(11) and 133(13) is of great significance to the competent authorities' options regarding the buffer. In the Riksbank's view, the choices in Articles 133(11) and 133(13) are supplementary, i.e. a systemic risk buffer of up to 3% can be applied to all exposures within the EU while, at the same time, after 1 January 2015, a buffer of 5% will be applied to Swedish and third-country exposures. The Riksbank has no comments on the commission's wording for the introduction of these Articles in Chapter 4, sections 3–7 in the new Capital Buffers bill, but believes that the description in the report should be clarified.

## **CHOICE OF AUTHORITIES**

### **Proposal of the commission**

The commissioner takes as a starting point the conclusions of the Financial Crisis Committee on a new structure for macroprudential measures, and proposes that the Riksbank be given the task of setting the countercyclical capital buffer at

national level following consultation with Finansinspektionen. Furthermore, the commissioner proposes that Finansinspektionen should monitor to ensure that the institution-specific countercyclical capital buffer is applied according to the provisions. The commissioner also believes that Finansinspektionen should be appointed as the designated authority for the application of other capital buffers, i.e. the capital buffers for systemically important institutions and the systemic risk buffer. Decisions about these shall, according to the commissioner, be made following consultation with the Riksbank.

### **The Riksbank's opinion and proposal**

The Government has announced in a press release its intention to propose that Finansinspektionen be given the main responsibility for the tools available to promote financial stability.<sup>9</sup> This brings about a change in the conditions for the commission's proposal about choice of authority. The Riksbank therefore sees no reason to comment further on the commission's proposal regarding choice of competent authority for the various capital buffers.

The Riksbank shares the opinion of the commission and the Financial Crisis Committee that, whichever authority is responsible for the tools, it will be important to capitalise on the angles of approach and knowledge of the other authority. The European Systemic Risk Board (ESRB) underscores in one of its recommendations that Member States should, where a single institution is appointed as the macroprudential authority, establish mechanisms for cooperation among all authorities whose actions have a material impact on financial stability.<sup>10</sup>

In light of the recommendation of the ESRB, the Riksbank's responsibility for financial stability according to the Sveriges Riksbank Act and the expertise possessed by the Riksbank, the Riksbank finds it natural that there should be smoothly functioning consultation between the authorities on macroprudential tools, particularly the cyclical ones. It should therefore be natural that decisions about using the tools to be taken by Finansinspektionen after consultation with the Riksbank. In this context, the Riksbank can ascertain that there is already, under current law, a sound basis for consultation in matters pertaining to the stability of the payment system, an area which also includes macroprudential policy.<sup>11</sup> There is currently frequent ad hoc and systematised consultation according to memorandum of understanding.<sup>12</sup> However, if the fundamentals for consultation are sufficient especially regarding the cyclical macroprudential tools needs to be investigated. Therefore the Riksbank welcomes the Governments declaration of intent which suggests that further analysis regarding decision-making on the cyclical tools is needed.

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<sup>9</sup> *Ett förstärkt ramverk för finansiell stabilitet*, Ministry of Finance, August 2013.

<sup>10</sup> The European Systemic Risk Board's recommendation of 22 December 2011 on the macroprudential mandate of national authorities (ESRB/2011/3)

<sup>11</sup> The Sveriges Riksbank Act (1988:1385), Finansinspektionen's Instructions Ordinance (2009:93).

<sup>12</sup> Memorandum of Understanding between Finansinspektionen and the Riksbank on a Council for Cooperation on Macroprudential Policy, January 2012.

■ On behalf of the Executive Board

Stefan Ingves

Kerstin Haglund

The following took part in the decision: Stefan Ingves (Chairman), Kerstin af Jochnick, Karolina Ekholm, Martin Flodén, Per Jansson and Cecilia Skingsley.

The facts of the matter were presented by Lena Strömberg.

## ■ APPENDIX

### **Introduction of the capital buffers**

In the Articles that are to apply as early as when the Directive comes into effect – Article 129 on the capital conservation buffer, Article 130 on the institution-specific countercyclical capital buffer and Article 133 on the systemic risk buffer – there are provisions referring directly to the provisions on restrictions on distributions, etc. in Article 141(2) and 141(3). These provisions then make further reference to other items in the Article. This suggests that it should be possible to apply the restrictions on distributions from the time at which the buffers are introduced.

In terms of the capital conservation buffer and the countercyclical capital buffer, the Riksbank believes that the purpose of the provision to which the Commission refers for his opinion (Article 160(5)) is to inform that the capital conservation measures shall be applied to the buffer requirements applicable under the transition regulations of the Directive, and not to the values applicable when the provisions have been fully implemented. Their purpose is thus not to rule out the possibility of applying the capital conservation measures if Member States introduce the buffers sooner than specified by the Directive. In addition, the provision of Article 160(5) should be read together with the provision of Article 160(6). It means that, looking at the Directive provisions, if a Member State chooses to implement a shorter transition period than that of Directive Article 160(2–4), the national requirements come into effect instead of the requirements set in Article 160(2–4). This provision thus rather suggests that both the provisions on restrictions on distributions, etc. and on capital conservation plans shall be applied when the buffers are introduced, irrespective of when this occurs.

### **Specific own fund requirements and systemic risks**

According to Articles 97 (and 98) of the Directive, the competent authority shall review the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with the Directive and evaluate

1. risks to which the institutions are or might become exposed
2. risks that an institution poses to the financial system (according to criteria decided by the EBA).

On the basis of this review and evaluation, the competent authorities shall determine whether

1. arrangements, strategies, processes and mechanisms implemented to comply with the Directive
2. the own funds and liquidity at their disposal



are sufficient to ensure sound management and coverage of their risks.<sup>13</sup>

To sum up, according to Article 97, a supervisory authority shall thus, in its assessment of whether the capital of an institution is sufficient in relation to its risks, also take account of the extra capital requirement which could be motivated by the risk posed by the institution to the financial system. Whether or not the institution is deemed to have too little capital in relation to the risks to which it is exposed, or the risks it poses, is of no significance if overall capital is too low. The most important aspect is that the systemic importance of the institution is taken into account when assessing its overall capital requirement. There is further support for this opinion in Article 103 of the Directive.

Article 104 of the Directive specifies which measures and supervisory powers shall be held by the supervisory authorities in applying articles 97, 102 and 103. This includes requiring

1. that institutions hold the level of own funds specified in the provisions on the buffer requirements and in the regulation with respect to risk elements and risks not captured by Article 1 of that regulation
2. changes in arrangements, etc.

According to Article 104(2), an own fund requirement shall be imposed at least when risks or risk elements are not captured by the buffer requirements or the regulation.

Because the systemic importance of an institution shall be observed when assessing arrangements and capital under Article 97, the supervisory authority should thus also have the power to take measures against institutions which are systemically important.

Article 104(3) specifies that, for the purposes of determining the appropriate level of own funds on the basis of the review and evaluation carried out in accordance with Articles 97 and 98, the competent authorities shall assess whether any imposition of an additional own fund requirement in excess of the own fund requirement is necessary *to capture risks to which an institution is or might be exposed*. This includes

1. the outcome of the institution's own capital assessment;
2. an institution's arrangements, etc.;
3. the outcome of the review and evaluation carried out in accordance with Article 97 or 101;
4. the assessment of systemic risk.

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<sup>13</sup> The Riksbank believes that the Swedish translation of the wording "coverage of their risks" is incorrect compared to the English version. It is therefore better to take the wording of the English version.

- According to the report, it ensues from this provision that supervisory authorities shall assess which risk an institution is exposed to (p. 347 f). In the Riksbank's opinion, however, the provision of this Article must be read together with the provisions of Articles 97, 98 and 103. As described above, the Riksbank finds that the reference to the risks to which institutions are exposed does not rule out taking account of the systemic importance of an institution when determining the capital requirement.