Questions and answers

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DNR [Diarienummer]

Questions and answers on the proposal for higher capital requirements for the major Swedish banking groups

NB! The year with regard to the systemic-risk surcharge has been incorrectly stated as 2012 and 2013 and is now corrected to 2013 and 2015 (25-11-2011).

Why do you want to have higher requirements in Sweden?

The financial system will be more secure if the major Swedish banks have better capital ratios. The Ministry of Finance, the Riksbank and Finansinspektionen (the Swedish Financial Supervisory Authority) assess that the minimum requirements in the regulations with regard to capital are far too low from an economic perspective. This applies in particular to the really large banks. Better capital adequacy in the major Swedish banks reduces the risk of financial crises and the cost to the tax-payers. There are several important reasons for imposing particularly strict requirements on the major Swedish banks.

- The major banks are very large in relation to the size of the Swedish economy.
- The markets assume that the government will rescue large banks and the tax-payers thus vouch for an implicit guarantee.
- The major banks have extensive cross-border operations that may be difficult to manage in a crisis.
- The major banks are very dependent on market funding in both Swedish krona and foreign currencies, which makes them sensitive to market turbulence.

Are you worried about the Swedish banking sector? Is it the euro crisis that makes you call for higher capital adequacy requirements?

We see no acute threats to the Swedish banking sector. The Swedish banks are well-capitalised and resilient. At the same time, we are not isolated from events in other countries. We want to ensure that the Swedish banking sector will remain strong. As the banks already have a good position, Sweden does not need particularly long transition periods to attain the higher capital ratios.

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Isn't it better that Finansinspektionen exercises a thorough supervision of the banks instead?

Supervision and capital adequacy requirements complement one another. Banking operations always entail risks and good capital ratios are needed to ensure that tax-payers do not need to cover unexpected losses.

Introduction

When will the new requirements begin to apply?

The requirements regarding common equity Tier 1 capital ratios for the four major banks (the financial corporate groups) will be 10 per cent with effect from 1 January 2013 and 12 per cent with effect from 1 January 2015.

What will the new requirements be for Tier 1 capital and total capital?

The requirements for Tier 1 capital and total capital will be raised to a corresponding degree. This means, as in Basel III, that the requirement for Tier 1 capital will be 1.5 percentage points higher than that for common equity Tier 1 capital. The proposal in Sweden thus entails 11.5 per cent from 1 January 2013 and 13.5 per cent from 1 January 2015. The requirement for total capital will be 3.5 percentage points higher than that for common equity Tier 1 capital, that is, 13.5 per cent from 1 January 2013 and 15.5 per cent from 1 January 2015.

Do these requirements only apply to the four major banks?

The aim is, as before, to speed up the implementation of the entire regulatory framework for all affected Companies. The required level of Common Equity Tier 1 for these firms will be 7 per cent, including the capital conservation buffer but excluding any countercyclical buffer.

The surcharge for systemically important banks of 3 per cent by 2013 and 5 per cent by 2015 * will primarily apply to the four major banks at financial corporation group level, that is, Handelsbanken, Nordea, SEB and Swedbank. However, more banks may be included in this further ahead. It is not possible to say whether this will be the case, or which banks will be affected, until the actual legislation has been drawn up.

*) NB! The year with regard to the systemic-risk surcharge has been incorrectly stated as 2012 and 2013 and is now corrected to 2013 and 2015 (25-11-2011).

How does this relate to Basel III?

Basel III is a global regulation that aims to strengthen the regulation, supervision and risk management in the banking sector. The regulations have been drawn up by the Basel Committee on Banking Supervision.

The Basel Committee's proposal, which was published in December 2010, contains recommendations on capital adequacy requirements for banks with international operations. The regulations are minimum requirements, that is, there is nothing in the Basel III Accord that prevents countries from implementing stricter requirements. Put simply, Basel III sets the minimum level for common equity Tier 1 capital at 7 per

cent of the risk-weighted assets from no later than 2019. We believe that the capital adequacy requirement for the four major banking groups should instead be at least 10 per cent from 1 January 2013 and 12 per cent from 1 January 2015.

How will Sweden introduce these requirements?

At present, negotiations on new capital adequacy regulations are underway within the EU (what is known as CRD 4). Sweden is striving to ensure that member states will have the opportunity to set higher national requirements to safeguard national financial stability. The outcome of the EU negotiations will affect whether Sweden can introduce these requirements in legislation or whether it will be done under the auspices of Finansinspektionen's supervision.

Please follow the link to the European Commission's proposals for new capital adequacy regulations:
http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm

But shouldn't Basel III be implemented the same way in all of the EU countries? Hasn't the Commission proposed to introduce Basel III into EU law through a directly applicable regulation?

The Commission has argued in favour of harmonising the regulations imposed in the legislation (what is known as Pillar 1), but opens the way for stricter national requirements through the financial supervisory authority's supervision (what is know as Pillar 2). In these negotiations, Sweden is arguing for flexibility for member states in the EU regulation so that legislation can be drawn up at national level. The final wording of the regulations is a question for the negotiations in the Economic and Financial Affairs Council and the European Parliament.

Should the new regulations be determined to include transition regulations from Basel I or not?

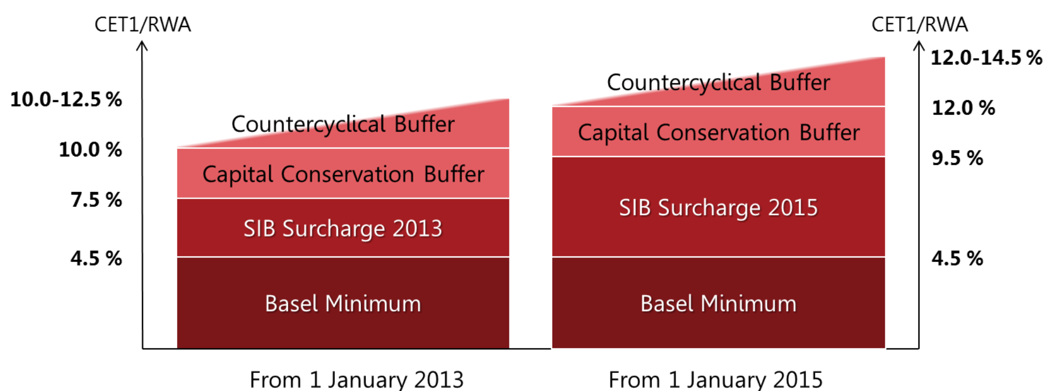
The new requirements assume full implementation of the new Basel III regulations, that is to say, without floor requirements. However, Finansinspektion makes an overview of the banks' risk weightings and will present proposals regarding how, for instance, the risk of mortgages with too low risk weightings can be managed.

How will you define common equity Tier 1 capital and risk-weighted assets?

The way that common equity Tier 1 capital and risk-weighted assets are defined will depend on the outcome of the on-going EU negotiations. Our aim is to follow the definition given in Basel III.

Do the levels of 10 and 12 per cent include capital buffers and supplements for systemically important banks?

They include the capital conservation buffer and a supplement for systemically important banks, but not a countercyclical buffer. In practice, this means that we extend the requirement compared with the Basel III Accord's minimum levels by 3 percentage points in 2013 and 5 percentage points in 2015 (this is what is labelled as the SIB supplement in the figure).



Will you also apply Basel III from 2013 with regard to the stricter requirements for deductions from the capital base?

Yes, the aim is to apply what will ultimately apply for Basel III in full from 2013 if this is possible in accordance with the EU regulations. The requirements for common equity Tier 1 capital are thus after deductions.

What applies for phasing out existing capital base instruments (hybrids) with regard to the total capital adequacy requirement and the common equity Tier 1 capital requirement?

The banks will not need to immediately replace existing hybrids, but if new capital base instruments are issued, they must meet the requirements in CRD IV.

Does the higher level you propose include supplements for the capital requirements the G20 and the Basel Committee want to see for globally systemically important banks?

Yes, the higher capital adequacy requirements for banks of global systemic importance announced by the Basel Committee and the G20 should be covered by the requirements we propose.

A few weeks ago the G20/FSB announced that Nordea is regarded as of global systemic importance (G-SIB) and therefore must have higher capital adequacy requirements than the other Swedish banks. Does this still apply?

The higher capital adequacy requirements for banks of global systemic importance announced by the Basel Committee should be covered by the requirements we propose. The idea in this case is not that the capital adequacy requirements will be higher for Nordea than for the other major Swedish banks.

Basel's G-SIB regulations entail an increase in the capital conservation buffer. You say that it is the minimum level that should be increased. Which is it?

The proposal involves higher minimum requirements for the major Swedish banks. The Basel III regulations are international minimum requirements. Our proposal is stricter than the Basel proposal – and therefore completely in line with the global regulations.

Introducing a higher capital requirement for banks in Swedish legislation surely only applies to the banks' Swedish companies, how will the recommendation work at group level?

The requirement will be worded so that the Swedish parent company shall ensure there is sufficient capital to meet the minimum requirement at financial corporation group level.

Consequences for consumers and companies

How will your proposals affect people with mortgages? Won't the banks just shift the costs onto their customers?

The major gain from higher requirements is that we in Sweden will have a more stable banking sector and reduce the risk of problems in the financial system.

More capital in the major banks will lead to the risk in the banking sector declining, and thus to a decrease in shareholders' return on equity requirement. Everyone will benefit from the banks having less risk. The way that bank customers are affected by the requirements will depend on both the competition in the banking market and how active we are as customers.

Won't the supply of credit decline when the capital requirement for the major banks increases? This must ultimately have negative consequences for the Swedish economy? How great will these consequences be?

There is nothing to indicate that well-capitalised banks will lead to lower growth in credit. Higher capital adequacy requirements for the major Swedish banks will lead to a more secure banking sector, and will in the long run strengthen growth in Sweden. Our assessment is that the economic benefit of higher capital requirements is much greater than the economic cost.

Competition in Sweden and abroad

How do you justify only the four major banks being affected by the requirements?

In the initial stage, at least, the requirements are expected to apply to large banks with international operations. This means that at least the four major banks will be affected. If one looks at the banks' assets, for instance, one can see that the four major banks have a special position. However, more banks may be included. Whether this will happen, and which banks will be included, are questions that can only be answered when the actual legislation is drawn up.

Why should the capital requirement for the major Swedish banks be higher than for banks in other European countries?

The Swedish banking sector is large and concentrated. The strong links to international markets and to one another mean that the major Swedish banks risk being hit hard by international problems. Other large European banking countries such as Switzerland and the United Kingdom are drawing the same conclusions and imposing higher requirements on their banks.

High requirements give Swedish banks a disadvantage, shouldn't there be a level playing field within Europe?

It is extremely important that both Sweden as a country and Swedish banks are well-equipped to face future crises. Ultimately, it is Swedish citizens who face the greatest risk of all if we have a new financial crisis in Sweden, and Sweden must therefore determine what capital adequacy ratios are appropriate.

About Basel III

What is Basel III?

Basel III is a global regulation that aims to strengthen the regulation, supervision and risk management in the banking sector. The regulations have been drawn up by the international Basel Committee on Banking Supervision.

The Basel III regulation aims to strengthen the banks' resilience to financial and economic shocks, to improve risk management and control, and to strengthen the banks' transparency and openness.

Follow the link to the Basel Committee:

http://www.bis.org/publ/bcbsca.htm

or

http://www.riksbank.se/templates/Page.aspx?id=46127

Are all countries included in the Basel Committee?

No. The Basel Committee consists of representatives of authorities in 27 countries. The banks in these countries account for an overwhelming percentage of the world's bank assets. Sweden is one of the countries included in the committee, and Riksbank Governor Stefan Ingves is currently chairman.

How does this proposal relate to Basel III?

The Basel Committee's text, which was published in December 2010, contains recommendations on capital requirements for banks with international operations. The requirements in this proposal will begin to be introduced on 1 January 2013. The regulations will be gradually phased in up to 1 January 2019. Some transition regulations apply as far ahead as 2023.

The regulations are minimum requirements, that is, there is nothing in the Basel III Accord that prevents countries from implementing stricter requirements. The Basel Committee's recommendations will be implemented in the EU by being converted into binding EU laws. Put simply, Basel III sets the minimum level for common equity Tier 1 capital at 7 per cent of the risk-weighted assets from 2019. We believe that the common equity Tier 1 capital ratio for the four major banking groups should instead be at least 10 per cent from 1 January 2013 and 12 per cent from 1 January 2015. These levels include the supplement for systemically-important banks that has now been negotiated by the Basel Committee, and which comes on top of the 7 per cent in the Basel III Accord.

Regulation theory

In the Basel III regulations the capital adequacy requirements are supplemented with a requirement on leverage? Will you tighten these requirements too, as they are doing in the United Kingdom?

This is not included in our current proposal. The higher capital adequacy according to our proposal will make the Swedish banking system more resilient.

In Switzerland and the United Kingdom they have chosen to fill part of the banks' capital adequacy requirement with debt instruments – bail-in bonds and CoCos. Why don't we do this in Sweden?

The crisis has demonstrated that the most important thing is that the banks have sufficient equity capital of high quality. This is why they are now tightening the requirements regarding the banks' equity capital in both Switzerland and the United Kingdom. But it is also probable that we in Sweden will need to tighten regulations in other aspects, too. The management of banks in distress is a subject that the financial crisis commission is looking into, and the European Commission is expected to present proposals on this soon. This also includes the question of whether and how creditors should be involved and carry the costs when banks default.