

EBA/Op/2023/11

12 October 2023

Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013

Introduction and legal basis

1. On 12 September 2023, the European Banking Authority (EBA) received a notification from the European Systemic Risk Board (ESRB) on the intention of the *Finansinspektionen*, the Swedish Financial Supervisory Authority, to apply Article 458(9) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (Capital Requirements Regulation, CRR)¹.
2. The notification concerns the two-year extension of a measure introduced by the *Finansinspektionen* in 2018 and already extended in 2020 and in 2021, making use of Article 458(2)(d)(vi)² of that Regulation. The measure is a credit institution-specific minimum level of 25% for the average risk weight of retail exposures to borrowers that reside in Sweden collateralised by immovable property, applicable to credit institutions that have adopted the internal ratings based approach.
3. The EBA's authority to deliver an opinion is based on the second subparagraph of Article 458(4) in conjunction with Article 458(9) of the CRR.
4. In accordance with the second subparagraph of Article 458(4) of the CRR, within one month of receiving the notification from the designated or competent authority entrusted with the national application of Article 458 of the CRR, the EBA is required to provide its opinion on the points referred to in Article 458(2) of the CRR to the Council, the European Commission and the Member State concerned.
5. In accordance with Article 14(2) of the Rules of Procedure of the EBA³, the Board of Supervisors has adopted this Opinion.

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

² Currently Art.458(2)(d)(iv) of Regulation (EU) No 575/2013.

³ Decision of the EBA concerning the Rules of Procedure of the Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

Background of the measure to be extended

6. The proposed measure under Article 458 of the CRR entails a credit institution-specific minimum level of 25% for the average risk weight of Swedish housing loans applicable to credit institutions that have adopted the internal ratings-based (IRB) approach. The requirement applies both to individual institutions and at the consolidated level. The measure targets retail exposures secured by real estate, both SME and non-SME exposures⁴. The period of application of the two-year extension will start from 31 December 2023.
7. In its Opinions dated 25 June 2018⁵, 16 October 2020⁶ and 19 October 2021⁷, the EBA did not object to the adoption of the measure and the subsequent first and second extensions. The EBA acknowledged the macroprudential risks in the Swedish economy related to residential mortgage loans and households' indebtedness.
8. Nevertheless, the EBA raised concerns in its Opinion dated 19 October 2021, including the following:
 - The Article 458 measure aims to correct issues in the modelling of IRB models that have remained throughout the years, rather than fixing the structural issues themselves.
 - The design of the risk weight floor included all retail exposures secured by real estate, for both SMEs and non-SMEs. The inclusion of SME exposures secured by real estate could solely be inferred from the reference to COREP, while the rationale for this inclusion required more explanation.
 - The EBA invited Finansinspektionen to reassess the rationale of the measure in light of the available (i.e. the sectoral SyRB) and forthcoming (i.e. the output floor) instruments at the time.

⁴ It should be noted that the exposures affected by the measure include also certain exposures collateralised by real estate other than residential property and some exposures collateralised by real estate located outside of Sweden. Their inclusion is a consequence of the need to operationalise the measure in a practical and simple way using COREP information.

⁵ Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013 of 25 June 2018 (EBA/Op/2018/06) available at <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2137845/6b62e4b6-7e8f-41eb-9492-0c270d5eeffc/EBA%20Opinion%20on%20measures%20in%20accordance%20with%20Article%20458%20%28EBA-Op-2018-06%29.pdf?retry=1>

⁶ Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013 of 16 October 2020 (EBA/Op/2020/16) available at https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2020/934115/EB-A-Op-2020-16%20-%20EBA%20Opinion%20on%20measures%20in%20accordance%20with%20Art%20458%20%28SE%29.pdf

⁷ Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013 of 19 October 2021 (EBA/Op/2021/10) available at https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2021/1022985/Opinion%20of%20the%20EBA%20on%20measures%20in%20accordance%20with%20Article%20458%20of%20Regulation

Opinion on the extension

Economic rationale for the measure

9. Finansinspektionen has notified an extension of the period of application of its earlier decision by two years, from 31 December 2023, as the vulnerabilities and systemic risks stemming from Swedish mortgages and the developments in the housing market persist.
10. In recent years, Sweden has experienced a significant and prolonged build-up of systemic risks linked to Swedish mortgages and residential real estate. Most of the vulnerabilities affecting the changes in the intensity of macroprudential risk or systemic risk are unchanged from those observed when the measure was previously extended. According to Finansinspektionen, the substantial level of systemic risk relating to the housing market and the persistence of macro financial vulnerabilities in Sweden are mainly linked to:
- 1) very high share of banks' exposures to mortgage lending to Swedish households, around 83% of banks' total lending to households;
 - 2) overvaluation in housing prices supported by a previous long period of low interest rates, strong economic growth, rising real wages, a strong mortgage lending market and a limited supply of housing;
 - 3) the persistence of household indebtedness and indeed a historically high DTI, in a rising interest rate economic environment;
 - 4) the majority of mortgages (56%) being tied to variable interest rates.
11. Swedish mortgages continue to constitute an important and large part of Swedish banks' balance sheets and amount to about 65% of Swedish GDP. Consequently, Finansinspektionen argues that, in the event of a severe downturn in the Swedish economy or turbulence in the financial system, a negative dynamic may arise between the residential real estate market, the macroeconomic situation and banks' behaviour. This could have negative repercussions for the Swedish real economy and in the long run pose a threat to the stability of the banking system. Moreover, Finansinspektionen points out that Swedish banks have close links with other countries in the Nordic and Baltic regions, which would also be affected through cross-border spillovers.
12. To mitigate the above risks and vulnerabilities, some borrower-based measures apply in addition to the risk weight floor measure for mortgages:
- From 2010, a loan-to-value (LTV) limit applies to new mortgage loans, which should not exceed 85% of the market value of the property;
 - From June 2016, households borrowing more than 50% of the residential property's value must amortise at least 1% of their mortgage a year, while households borrowing more than 70% must amortise at least 2%;

- From March 2018, households borrowing more than 4.5 times their annual income before tax must amortise an additional 1% of their mortgage per year.

13. The calibration of the risk weight floor measure remains unchanged with respect to the original measure and the previous extensions of 2020 and 2021. Finansinspektionen has assessed that this calibration is set so that the minimum level for the average risk weight covers future loss levels in Swedish residential mortgages in a severe downturn with high financial stress, taking into account the broader systemic risks that could arise from spillovers. A risk weight floor of 25% is still considered to be adequate for this purpose, as the underlying risks have not materially changed since 2018 when the measure was originally calibrated.

14. Finansinspektionen estimates that the capital requirement that corresponds to a 25% average risk weight floor for Swedish mortgages is, in nominal terms, SEK 123 billion at the consolidated level (data from Q2 2023), or about 23% of the total capital requirement for the largest Swedish banks at the consolidated level (compared with SEK 111 billion at the time of the original notification in 2018 or 15% of the total capital requirement for the largest IRB banks, compared with SEK 96 billion and just under 22% at the time of the second extension in 2021 respectively). The measure increases the implied risk weights on Swedish mortgage exposures from 5% on average (exposure-weighted) to 25%. Thus, the risk weight floor has increased capital levels and created additional loss-absorbing capacity in the Swedish banks targeted by the measure.

15. Finansinspektionen considers that the proposed measure is necessary, suitable, effective and proportionate. The proposed measure is intended to ensure that important residential mortgage banks are fully resilient and can withstand a potentially severe downturn in the housing market without restricting the supply of credit. The measure is deemed to be effective and proportionate as it targets those specific exposures that give rise to the risks linked to Swedish mortgages and residential real estate. The measure addresses the risks entailed by those exposures for IRB banks. Finansinspektionen assesses that the measure is suitable and effective, as it is intended to ensure a level playing field for all banks that operate in the Swedish residential mortgage market while also upholding resilience and safeguarding financial stability. The measure ensures that capital levels are upheld and contributes to mitigating the risks highlighted in the European Systemic Risk Board's assessment⁸ in February 2022.

16. Finansinspektionen does not expect the measure to have a negative impact on the internal market. All significant lenders with IRB exposures to the Swedish mortgage market are consolidated in Sweden, though some lending occurs via branches of foreign banks. Therefore, the reciprocity in the application of the measure is assessed as necessary to avoid leakages and regulatory arbitrage, but also certain forms of competitive advantage. Finansinspektionen emphasises that a Memorandum of Understanding (MoU) on prudential supervision of

⁸ https://www.esrb.europa.eu/pub/pdf/reports/esrb.report220211_vulnerabilities_eea_countries~27e571112b.en.pdf?cb8132dc3e0f0f53a4fce3292a690bd6.

The ESRB's 2022 assessment follows on from the ESRB warning to Sweden in November 2016 and the ESRB recommendation in June 2019 about the vulnerabilities in the residential real estate sector as a source of systemic risk to financial stability.

significant branches applies to the Nordic-Baltic macroprudential network.⁹ Further, an additional MoU on cooperation and coordination on cross-border financial stability was signed in 2018 by the ministries of finance, financial supervisory authorities, central banks, and resolution authorities of the Nordic and Baltic countries.¹⁰ Finansinspektionen assesses that the continued presence of the measure will have a positive impact on the Internal Market as it will bring benefits to financial stability to the region by reducing and mitigating the macroprudential or systemic risk identified.

Rationale for not using alternative measures

17. Regulation (EU) No 575/2013 (CRR) and Directive 2013/36/EU (CRD) offer various options for addressing macroprudential or systemic risks. Article 458(2)(c) and (e) of that Regulation requires the designated authority to demonstrate that the stricter national measure is suitable, effective, and proportionate, and why other possible measures (i.e., under Articles 124 and 164 of the Regulation (EU) No 575/2013 and Article 133 and 136 of Directive 2013/36/EU) would be less suitable and effective than Article 458 of the CRR in dealing with the macroprudential or systemic risk identified.

18. The present notification reiterates the previous justifications for deploying Article 458 of the CRR, and that the measure under Article 458 of the CRR is the most appropriate for Finansinspektionen at this time, specifying that:

- Article 124 of the CRR does not apply to credit institutions using the IRB approach.
- Article 164 enables the competent authority to increase the exposure weighted average LGD floor applied by IRB banks on their mortgage exposures. According to Finansinspektionen, an increase in the LGD would widen the differences in risk weights between IRB banks and result in a disproportionate increase in risk weights for some banks. In addition, Finansinspektionen stressed that using Article 164 would increase the complexity of determining capital requirements and could reduce the transparency of IRB risk weights for market participants.
- Regarding Article 133 of the CRD, in relation to the systemic risk buffer (SyRB), Finansinspektionen states that it already applies a SyRB of 3% to all exposures of the three major banks to address the structural risks associated with the large, concentrated and interconnected banking sector in Sweden. Finansinspektionen assesses that a further increase in the SyRB would not address the systemic risks identified effectively or

⁹ Memorandum of Understanding between FINANSINSPEKTIONEN (Sweden), FINANSTILSYNET (Norway), FINANSTILSYNET (Denmark), FINANSSIVALVONTA (Finland) and the EUROPEAN CENTRAL BANK on prudential supervision of significant branches in Sweden, Norway, Denmark and Finland of 2 December 2016 available at <https://www.fi.se/contentassets/dbde31519a7543a18808d3db1deacb4e/mou-filialer-nordiska-lander-2016-12-19n.pdf>

¹⁰ Memorandum of Understanding on Cooperation and Coordination on cross-border financial stability between relevant Ministries, Central Banks, Financial Supervisory Authorities and Resolution Authorities of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden of 31 January 2018 available at <https://www.fi.se/contentassets/5529800727444fb0851249b985883373/samforstandsavtal-mou-finansiell-stabilitet-2018-01-31.pdf>

appropriately because the SyRB applies to all types of exposure. Regarding the sectoral application of the SyRB (sSyRB), Finansinspektionen argues that the sSyRB would not act as a floor, but rather as a multiplier in terms of nominal capital requirements, impacting most heavily on IRB banks with the highest risk weights and least heavily on IRB banks with the lowest risk weights. The size of the buffer required to generate the equivalent capital impact would also be extremely high and therefore challenging from both a communication and reciprocity perspective. Finally, due to the ongoing review of banks' internal models, sSyRB would be based on varying risk weights and, therefore, would require frequent recalibrations.

- Regarding Article 136 of the CRD, the countercyclical capital buffer (CCyB) is applied to all Swedish credit exposures and not just to mortgage exposures. The Finansinspektionen considers the CCyB not to be appropriate as it would affect non-targeted exposures and penalise banks with the lowest share of relevant exposures in mortgage loans.

Assessment and conclusions

19. Based on the evidence provided by Finansinspektionen, the EBA takes note of Finansinspektionen ongoing concerns regarding systemic risk relating to the housing market and the persistence of macroprudential vulnerabilities in the Swedish financial system. The EBA does not object to the extension of the current measure for 2 years or a shorter period if risks at stake cease to exist sooner.
20. This measure has been in place in one form or another since 2014, originally introduced through Pillar 2 and then replaced in 2018 by the current Article 458 of the CRR measure. The EBA notes that the calibration of the measure was performed in 2014 and has not changed since. According to Finansinspektionen, the risk weight floor of 25% continues to be adequate despite changes in the housing market, the macroeconomic environment and further macroprudential measures implemented since the application of the original measure.
21. The calibration is set so that the average risk weight floor covers future losses in Swedish residential mortgages in a severe downturn scenario with a high financial stress. Therefore, the EBA stresses the need to avoid overlaps with other requirements, in particular with the Pillar 2 Guidance (Article 104b Directive 2013/36/EU), which is set based on the outcome of stress tests.
22. The Article 458 of the CRR measure addresses issues related to banks' IRB models, which continue to generate risk weights for mortgage exposures that are relatively low, with concerns about unjustified variability between banks. The EBA acknowledges that IRB model estimates are based on the extremely low historical credit losses from Swedish mortgages and partly reflect the absence of a major crisis in Sweden in recent decades. The EBA welcomes the ongoing review of banks' internal models and invites Finansinspektionen to

closely monitor the situation and to stand ready to reassess the appropriateness of the notified measure.

23. The envisaged introduction of relevant changes to the Regulation (EU) No 575/2013 (following European Commission proposal COM (2021) 664¹¹, so-called, CRR3) might create possible overlaps with the current measure, in particular, with the introduction of the output floor. Accordingly, taking into account the outcome of the internal model review and the changes that CRR3 will most likely bring, the EBA encourages Finansinspektionen to undertake a comprehensive assessment on the necessity and appropriateness of the existing macroprudential measures.

This Opinion will be published on the EBA's website.

Done at Paris, 12 October 2023

[signed]

Jose Manuel Campa

Chairperson

For the Board of Supervisors

¹¹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0664>
https://eur-lex.europa.eu/procedure/EN/2021_342.