

Finansinspektionen's Regulatory Code

Publisher: Finansinspektionen, Sweden, www.fi.se
ISSN 1102-7460



This translation is furnished solely for information purposes. Only the printed version of the regulation in Swedish applies for the application of the law.

Finansinspektionen's regulations and general guidelines regarding management of credit risks in credit institutions and securities companies;

FFFS 2018:16

Published on
24 September 2018

decided on 18 September 2018.

Finansinspektionen prescribes the following pursuant to Chapter 5, section 2, points 5, 13 and 14 of the Banking and Financing Business Ordinance (2004:329) and Chapter 6, section 1, point 9 of the Securities Market Ordinance (2007:572).

Finansinspektionen also provides the following general guidelines.

Chapter 1 Scope and definitions

Scope

Section 1 These regulations and general guidelines stipulate how an undertaking shall manage its credit risks. They apply to

1. banking companies,
2. savings banks,
3. members' banks,
4. credit market companies,
5. credit market associations, and
6. securities companies.

The regulations and general guidelines shall also apply to the securities business in the undertaking in accordance with the first paragraph, points 1–5.

The regulations shall be applied at the group or subgroup level in accordance with that set out in Chapter 3, section 4 of the Special Supervision of Credit Institutions and Investment Firms Act (2014:968).

Section 2 For securities companies, only the regulations set out in Chapter 3, section 1, first paragraph, point 7; Chapter 3, section 1, second paragraph; and Chapter 3, section 2, first paragraph shall apply.

Section 3 The regulations set out in Chapters 4 and 5 apply only to credits to borrowers other than consumers and for credits to consumers that constitute mortgages in accordance with section 2 of the Consumer Credit Act (2010:1846).

Contents of the regulations

Section 4 The regulatory framework contains regulations and general guidelines regarding the following:

- Scope and definitions (Chapter 1),
- Governance and responsibility (Chapter 2),
- Identification and measurement (Chapter 3),
- Credit assessment (Chapter 4),
- Credit decision (Chapter 5),
- Review (Chapter 6),
- Credits with increased risk (Chapter 7), and
- Credits to related parties (Chapter 8).

Definitions

Section 5 The definitions used in these regulations and general guidelines are the same as those in Chapter 1, section 3 of Finansinspektionen's regulations and general guidelines (FFFS 2014:1) regarding governance, risk management and control in credit institution, unless otherwise specified. In addition, the following terms shall be defined as:

1. *Group of connected clients*: the same as in Article 4(1)(39) of the Credit Requirements Regulation (575/2013/EU).
2. *Credit*: agreement, other legal relationship or limit that entails that an undertaking in its business has or via an agreement can have a claim on a counterparty.
3. *Credit decision*: decision to grant or deny a limit, change the terms of a previously granted limit, decisions on individually assessed provisions, reversals of individually assessed provisions, write-offs and other decisions regarding value adjustments for a credit.
4. *Credit procedure*: the entire chain of events from the credit application until a credit in its entirety is terminated.
5. *Credit risk*: the risk of losses due to the failure of a credit or an arrangement similar to that of a credit to be fulfilled.
6. *Credit risk management*: identifying, measuring, governing, reporting internally and exercising control over credit risks.
7. *Country risk*: credit risks due to transfer risk, regulatory environment and political risks in a specific country.
8. *Review*: reassessment of the undertaking's credit risk for the relevant credit.
9. *Co-limitation*: compilation of credit facilities for a group of clients.
10. *Transfer risk*: risk of not being able to transfer currency to and from a specific country.
11. *Repayment capacity*: the borrower's capacity for fulfilling the credit terms in accordance with the credit agreement.

Chapter 2 Governance and responsibility

Section 1 Chapter 2, section 3 of Finansinspektionen's regulations and general guidelines (2014:1) regarding governance, risk management and control at credit institutions contains regulations governing an undertaking's documented risk appetite.

The undertaking's documented risk appetite for credit risk shall specify the scope and focus of the total credit risk to which the undertaking may be exposed, the

composition of the credit portfolio, diversification and concentration. Within the framework for its risk appetite, the undertaking shall also have limits for its credit risks.

A decision to change the risk appetite for credit risks shall be preceded by a written analysis of how the change in risk appetite may affect the undertaking's total credit risk and the credit portfolio's composition, diversification and concentration. The effects of a change to the risk appetite must be monitored and evaluated.

Section 2 Chapter 2, section 4 of Finansinspektionen's regulations and general guidelines (2014:1) regarding governance, risk management and control at credit institutions contains regulations governing an undertaking's documented risk strategy.

The undertaking's documented risk strategy for credit risks shall specify how the undertaking shall actively ensure that the risk appetite for credit risks is not breached. The risk appetite and risk strategy shall be in line with the undertaking's internal rules and strategic targets.

Section 3 An undertaking shall have suitable internal rules for its credit risk management. The internal rules shall cover as a minimum the following:

1. The undertaking's organisation and distribution of responsibility for identifying, measuring, governing, internally reporting and controlling credit risks, including
 - which bodies pursuant to the Delegated Procedure may make credit decisions and their authorisations,
 - which bodies pursuant to the Delegation Procedure may make credit decisions about credits with increased risk,
 - conditions that must be met for a quorum,
 - conditions that must be met for a single person to be able to decide to grant a credit, and
 - other regulations that govern the bodies in which a credit decision may be made.
2. The undertaking's procedures and methods for identifying, measuring, governing, internally reporting and controlling credit risks.
3. Special rules for
 - country risks, including transfer risks,
 - credits with increased risk, including criteria for which credits entail an increased risk and methods for identifying credits with increased risk,
 - credits to related parties, including which persons are considered to fall under the term *related parties*, and
 - co-limitation, including criteria for when co-limitation shall apply.
4. The undertaking's criteria and procedures for credit assessments, reviews and credit decisions.
5. Rules regarding the assets that are eligible as collateral and the valuation and leverage principles that apply to them.
6. Rules regarding the conditions that apply for granting a credit without collateral.
7. Principles for how a limit is determined and under which conditions a limit will be reviewed.

8. Rules regarding the required material upon which the decision shall be based for credit assessments and reviews.

9. Documentation requirements for managing credit matters, including the material upon which the decision shall be based and documentation of credit decisions.

When the undertaking designs internal rules, it shall take into consideration the nature, scope and complexity of the operations.

Section 4 Chapter 5, section 6 of Finansinspektionen's regulations and general guidelines (2014:1) regarding governance, risk management and control at credit institutions contains regulations governing an undertaking's risk culture.

The undertaking's risk culture for credit risks – from the board to administrators – shall be maintained through good knowledge, sound values and standard practice in credit matters in the undertaking. The risk culture shall ensure that the undertaking maintains a common and sound view on governance, management and control of credit risks.

General guidelines

A sound risk culture for credit risks is based on many different factors, which should include as a minimum:

1. a risk-conscious approach to credit matters,
2. good knowledge about the customer,
3. suitable and effective credit procedure,
4. suitable manuals for the practical work related to the credit procedure,
5. suitable procedures and functions that prevent undesired events and incorrect assessments and breaches of authorisations,
6. the prevention of any person alone administering a credit matter at any point along the entire credit-granting procedure,
7. a restrictive approach to single-person decisions, and
8. control that a potential remuneration system does not promote an unhealthy risk culture for credit risks.

Section 5 An undertaking's board of directors shall annually evaluate and determine the suitability of the undertaking's delegation rules regarding credit decisions.

Chapter 3 Identification and measurement

Section 1 An undertaking shall have procedures, methods and effective systems for regularly identifying, measuring, internally reporting and controlling its exposure to and management of credit risks that as a minimum cover the following:

1. the credit risk in individual credits,
2. the credit risk for individual borrowers,
3. the country risk for individual borrowers,
4. the credit risk for a co-limited group of clients,
5. the credit risk per portfolio,
6. the undertaking's total credit risk per country,
7. the undertaking's total credit risk, and
8. the undertaking's provisions, reversals of provisions, write-offs and other decisions regarding value adjustments for a credit.

The design of the undertaking's procedures, methods and systems for identifying, measuring, internally reporting and controlling credit risks shall take into consideration the nature, scope and complexity of the operations. The undertaking's procedures, methods and systems shall make it possible to analyse the risks and risk sensitivity in the credit portfolio.

Section 2 An undertaking shall have procedures and methods to regularly identify, measure, internally report and control the level of its credit risks, including the probability of default and loss given default. The underlying data shall be reliable and complete.

A decision to change the methods referred to in the first paragraph shall be preceded by a written analysis of how the change will impact the undertaking's identification and measurement of credit risk. The effects of the changes shall be monitored and evaluated.

Chapter 4 Credit assessment

Section 1 An undertaking's credit assessment shall be based on well-defined criteria.

Section 2 The credit assessment shall investigate, identify and document the need for co-limitation for a group of connected clients. Co-limitation shall be applied if a need for co-limitation has been identified.

Section 3 The credit assessment shall take into consideration both the individual borrower and the total risk profile for a group of connected clients and how the repayment capacity is affected by connectivity. If there is a guarantor, the guarantor must also undergo a credit assessment.

Section 4 The credit assessment shall be performed on a basis that provides an accurate overview of the borrower's repayment capacity and the pledged collateral and other credit risk mitigation techniques. The credit assessment shall be forward-looking based on available historical data.

Section 5 For exposures to institutions and undertakings, the credit assessment shall include a sensitivity analysis of the borrower's repayment capacity and risk of a deterioration in the value of pledged collateral.

Section 6 If a credit is issued in another currency than the currency in which the borrower earns its primary income, and the borrower does not have a natural currency hedge, the borrower's repayment capacity shall be reviewed based on assumptions of negative foreign exchange rate changes.

General guidelines

Before issuing a credit in accordance with the first paragraph, the undertaking should provide the borrower with adequate information about the risks associated with such a credit. This information should include an assessment of the probable effects of negative currency changes.

Chapter 5 Credit decisions

Section 1 An undertaking shall ensure that

1. persons making a credit decision have sufficient experience and credit-related competence given the size, risk level and terms of the credit,
2. credit decisions are made in accordance with a sound risk culture pursuant to Chapter 2, section 4,
3. credit decisions are made in accordance with the undertaking's internal rules for credit risk, and
4. the decision documentation for a credit decision specifies how the requirements in Chapter 4 regarding the credit assessment are met.

Section 2 An undertaking's credit decisions shall be documented such that as a minimum it is stated which body and which persons made the decision and the terms of the decided credit. The documentation shall also include the considerations that formed the basis for the decision.

Chapter 6 Review

Section 1 An undertaking shall review all credits at least once a year. Credits with increased risk shall be reviewed more frequently.

Section 2 The review shall apply a forward-looking perspective based on available historical data. The review shall include an assessment of the borrower's risk of default.

Section 3 The review shall be performed at the individual level when required in accordance with the undertaking's internal rules and taking into consideration the size and assessed risk level of the credit. An individual review shall be performed on material that provides an accurate overview of the borrower's repayment capacity and the pledged collateral and other credit risk mitigation techniques. An individually assessed review shall take into consideration the credit risk of the individual borrower and the total risk profile for a group of connected clients as well as how the repayment capacity is affected by connectivity. The repayment capacity of the guarantor, if one exists, shall also be reviewed.

Section 4 If the review refers to a credit that was issued in another currency than the currency in which the borrower earns its primary income, and the borrower does not have a natural currency hedge, the borrower's repayment capacity shall be reviewed based on assumptions of negative foreign exchange rate changes.

Chapter 7 Credits with increased risk

Section 1 An undertaking shall have an effective credit risk management in order to identify and manage credits with increased risk at an early stage. The undertaking shall be well prepared to manage credits with increased risk.

Section 2 An undertaking shall regularly review credits with increased risk. The review shall be conducted in accordance with Chapter 6.

General guidelines

The undertaking, in conjunction with a review of credits with increased risk, shall investigate whether an action plan with concrete and timed measures to achieve full repayment or in any other way reduce the credit risk for the

undertaking shall be initiated. Credits with increased risk should be regularly reviewed by a credit committee or similar decision-making forum.

Section 3 If an undertaking has identified that a borrower probably is not able to meet the conditions of the credit agreement, it shall immediately take steps to mitigate the credit risk.

Chapter 8 Credits to related parties

Section 1 Chapter 8, sections 5 and 6 of the Banking and Financing Business Act (2004:297) contains regulations regarding an undertaking's service offering to related parties.

This chapter contains special regulations that apply to an undertaking's management of credits to related parties.

Section 2 A person or employee who holds a management position in accordance with Chapter 8, section 5, point 2 or 3 of the Banking and Financing Business Act (2004:297) refers to as a minimum the following persons, their deputies and other persons with corresponding positions:

1. the undertaking's managing director,
2. the undertaking's risk manager and managers for the other independent control functions,
3. the undertaking's credit manager, and
4. other persons included in senior management in accordance with Chapter 1, section 4, point 8 of Finansinspektionen's regulations (FFFS 2011:1) regarding remuneration systems in credit institutions, investment firms and fund management companies licensed to conduct discretionary portfolio management;

The company shall regularly assess which persons hold a management position.

Section 3 A significant economic interest of owners or members according to Chapter 8, section 5, point 6 of the Banking and Financing Business Act (2004:297) includes both direct and indirect ownership in a legal person.

Section 4 An undertaking shall have special procedures and methods for identifying, managing, internally reporting and controlling credits to related parties. The undertaking's procedures and methods shall make it possible to compile the undertaking's credits to related parties, both for individual borrowers and for all related parties.

An undertaking's credit procedures shall be organised such that no person participates in the handling of a matter that applies to a related party, a related party's undertaking or in other situations where there is a risk for bias.

Section 5 An undertaking's list in accordance with Chapter 8, section 6 of the Banking and Financing Business Act (2004:297) of credits to related parties shall provide an accurate overview of its credits to related parties and as a minimum contain the following information:

1. name, position/spouse/partner/business partner/member, personal ID number or CIN for borrowers,
2. product type, limit, exposure, interest rate, amortisation schedule, collateral, pledge value for collateral, maturity and
3. date of the most recent credit decision.

These regulations and general guidelines shall enter into force on 1 March 2019, whereupon Finansinspektionen's general guidelines (FFFS 2004:6) regarding credit risk management in credit institutions and investment firms shall be repealed.

ERIK THEDÉEN

Elisabeth Siltberg