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EUROPEAN
COMMISSION

Brussels, 6.11.2023
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COMMISSION DECISION

of 6.11.2023

not to propose an implementing act to reject the intended extension of the period of application of the national measure notified on 12 September 2023 by Sweden under Article 458(9) in conjunction with Article 458(4) of Regulation (EU) No 575/2013 of the European Parliament and of the Council

(Text with EEA relevance)

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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[1], and in particular Article 458 thereof,

Having regard to the opinions of the European Systemic Risk Board[2] and the European Banking Authority[3],

Whereas:

(1) On 12 September 2023, Finansinspektionen, the Swedish Financial Supervisory Authority (hereafter 'the FSA'), which is the national designated authority in charge of the application of Article 458 of Regulation (EU) No 575/2013 in Sweden, notified the Commission of its intention to extend for two years the period of application of a national measure concerning risk weights for targeting asset bubbles in the domestic residential immovable property sector as referred to in Article 458(2), point (d)(iv), of Regulation (EU) No 575/2013 ('the current measure'). The current measure is due to expire on 30 December 2023.

(2) The current measure was notified for the first time to the Commission on 24 May 2018. Its first extension by one year was notified to the Commission on 16 September 2020, followed by a second extension of two years that was notified to the Commission on 20 September 2021. The Commission adopted on 12 November 2020 Decision C(2020) 7723 and on 12 November 2021 Decision C (2021) 8001, respectively. In both cases, the Commission did not to propose to the Council an implementing act rejecting such extensions.

(3) The current measure addresses a macroprudential risk originating in the domestic market for residential mortgage loans and consists of an average risk weight floor of 25 % on mortgage exposure portfolios to Swedish borrowers of credit institutions

1 OJ L 176, 27.6.2013, p.1.

2 Opinion of the European Systemic Risk Board of 10 October 2023 on the Swedish notification of the extended application of a stricter national measure based on Article 458 of Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions (ESRB/2023/10).

3 Opinion of the European Banking Authority on measures in accordance with Article 458 of Regulation (EU) No 575/2013, EBA/Op/2023/11 of 12 October 2023.

that use the internal ratings based ('IRB') approach. According to the FSA, the extension of the period of application of the current measure is necessary in view of the prevailing vulnerabilities in the Swedish residential immovable property sector.

(4) Pursuant to Article 458(9) of Regulation (EU) No 575/2013, a Member State is required, in consultation with the European Systemic Risk Board ('ESRB') and the European Banking Authority ('EBA'), to review the situation that led to the implementation of a national measure as referred to in Article 458(2), point (d), of Regulation (EU) No 575/2013. That Member State may subsequently adopt, in accordance with the procedure laid down in Article 458(4) of that Regulation, a new decision for the extension of the period of application of that national measure for up to two additional years each time or sooner if the identified vulnerabilities and sources of systemic risks cease to exist.

(5) Pursuant to Article 458(4), second subparagraph, of Regulation (EU) No 575/2013, the EBA and the ESRB are to provide the Council, the Commission and the Member State concerned with their opinion on an intended extension of the period of application of a national measure within 1 month of receipt of a notification as referred to in paragraph 2 of that Article. On 10 October 2023, the ESRB adopted its opinion on the intended extension of the period of application of the current measure. The EBA adopted its opinion on 12 October 2023. The ESRB and EBA did not object to the envisaged extension of the period of application of the current measure.

(6) Article 458(2) of Regulation (EU) No 575/2013 requires that a national authority that wishes to apply a national measure as referred to in Article 458(2), point (d), of that Regulation, submits to the Commission, the ESRB and EBA certain information and, where appropriate, relevant quantitative and qualitative evidence showing that the criteria set out in paragraph 2 of that Article are fulfilled. The Commission has to consider that evidence before proposing to the Council an implementing act to reject the envisaged national measures. The Commission has thus to ascertain whether there is sufficient evidence of a continued heightened systemic risk and that such risk poses a threat to the financial system and the real economy of the Member State concerned. The Commission has also to consider the suitability, effectiveness and proportionality of the envisaged measure, as well as the availability of alternative measures. Pursuant to Article 458(4), the Commission may only propose to the Council an implementing act to reject the envisaged national measure where, taking utmost account of the opinions of EBA and the ESRB, there is robust, strong and detailed evidence that the envisaged measure will have a negative impact on the internal market that outweighs the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified.

(7) The FSA provided the Commission, the ESRB and EBA with its assessment of the national macroeconomic environment, and explained the persistence of previously identified systemic risks and vulnerabilities in the domestic residential immovable property sector, despite a downward rationalisation in house prices and household credit growths in 2022. According to the FSA, the elevated vulnerabilities at the macro level and the resulting systemic risk are not fully reflected in the modelled risk weights for mortgage exposures. In its notification, the FSA notes that credit institutions' IRB approaches have limitations in accurately assessing the present credit loss risk associated with Swedish mortgages during a significant economic downturn, which could result in severe spillover effects for the Swedish and regional economies, as Swedish credit institutions are interlinked with other countries in the Nordic-Baltic region. IRB credit institutions in Sweden constitute around 94% of the

total mortgage market, while for the three major IRB credit institutions, mortgage loans to households constitute almost 50% of their total lending. The FSA concludes that a negative development in the housing market would be detrimental to these credit institutions and to the supply of mortgages to households.

(8) According to the notification, the house prices remain high, namely 2.5 times the level of 2005. After a correction in 2022, prices began to show again signs of a gradual increase at the beginning of 2023, and they have remained steady in recent months. The FSA notes that residential properties in Sweden are in long standing overvaluation as estimated by the International Monetary Fund and the ESRB. While the magnitude of this overvaluation may have decreased, there is still a heightened risk of a significant price correction in the housing market, as the FSA assessed in their latest report on the Swedish mortgage market[4]. This conclusion was supported by the ESRB assessment published in February 2022[5], which broadly concluded that vulnerabilities related to the residential immovable property sector in Sweden remained high. The FSA also points in its notification to significant vulnerabilities in the household sector, as household debt has increased much faster than both household disposable income and GDP for a prolonged period. Also, many Swedish households appear to be relatively highly leveraged in relation to the value of the homes.

(9) This broader context of vulnerabilities and elevated risks that remain significant in Sweden, combined with the fact that Swedish credit institutions are increasingly exposed and vulnerable to a downturn in the residential immovable property sector, as explained by the FSA, may result, in the event of a severe downturn in the Swedish economy or turbulence in the financial system, in a negative dynamic between the residential real estate immovable property sector, the macroeconomic situation and credit institutions' behaviour in Sweden. The financial stability of credit institutions and their capacity to provide credit to the economy may also be potentially impacted if investors show reluctance to finance credit institutions' covered bonds. These bonds are a crucial funding source for credit institutions and are entirely supported by residential mortgage portfolios.

(10) In their opinions on the intended extension of the current measure, both the ESRB and the EBA acknowledge the FSA's ongoing concerns regarding systemic risk relating to the housing market and the enduring presence of macroprudential vulnerabilities within the Swedish financial system. The ESRB considers that the calibration of the measure (which remains unchanged since its first introduction in 2014 under Pillar 2) continues to be adequate, despite changes in the vulnerabilities related to the housing market and mortgages, and the additional measures[6] implemented to target these risks since the introduction of the original measure. The EBA stresses that, given that the calibration is set so that the minimum level for the average risk weight floor covers future losses in Swedish residential mortgages in a severe downturn scenario with a high financial stress, it is important for the FSA to be mindful of any overlaps in different requirements, in particular the Pillar 2 Guidance, which is set based on the outcome of stress tests.

[4] The Swedish Mortgage Market, FI, March 2023. https://www.fi.se/en/published/reports/swedish-mortgage-reports/the-swedish-mortgage-market-2023/.

[5] Vulnerabilities in the residential real estate sectors of the EEA countries, ESRB, February 2022

[6] According to the notification, FSA has also taken several borrower-based measures with the objective of increasing households' resilience such as a mortgage cap and amortisation requirements.

(11) The Commission has considered the suitability, effectiveness and proportionality of the planned extension of the period of application of the current measure in accordance with Article 458(2), point (e), of Regulation (EU) No 575/2013. Taking utmost account also of the economic assessment provided by the ESRB and the EBA in their opinions, the Commission considers the extension of the current measure to be suitable and effective, as it will maintain Swedish credit institutions' resilience vis-à-vis financial stability risks emanating from the residential immovable property sector. The EBA notes that the measure addresses issues related to credit institutions' IRB models, which continue to generate risk weights for mortgage exposures that are significantly below expectations from the FSA and those reported by credit institutions in other Member States. The EBA also 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 Commission broadly concurs with ESRB's conclusion that it is not appropriate to discontinue the current measure at a moment where Swedish credit institutions continue to be increasingly exposed to the residential immovable property sector and house prices and household indebtedness remain historically high. The Commission considers the extension of the current measure as proportionate.

(12) After examining the arguments and evidence put forward by the FSA and giving utmost consideration to the ESRB and EBA opinions, the Commission considers that the current measure remains suitable, effective and proportionate in view of addressing the identified systemic risk.

(13) Article 458(2), point (c), of Regulation (EU) No 575/2013 requires a justification as to why the macroprudential tools set out in Articles 124 and 164 of Regulation (EU) No 575/2013 and Articles 133 and 136 of Directive 2013/36/EU are less suitable and effective to deal with the macroprudential or systemic risk identified. After examining the arguments and evidence put forward by the FSA and carefully considering the ESRB and EBA opinions, the Commission is of the opinion that the above-mentioned tools would be less suitable or effective to address the identified systemic risk.

(14) Article 124 of Regulation (EU) No 575/2013 allows the competent authorities to set higher risk weights for exposures secured by mortgages on immovable property where the standardised approach is used for calculating the own funds requirements for credit risk which are deemed appropriate by the FSA. However, the current measure addresses risk emanating in credit institutions using the IRB approach as about 94% of Swedish mortgage market exposures are held by credit institutions applying the IRB approach. Under Article 164 of Regulation (EU) No 575/2013, competent authorities may set higher minimum values of exposure weighted average loss given default (LGD) for exposures secured by immovable property in their territory. The Commission understands that increasing the LGD floor for mortgages would serve to widen the differences in risk weights between IRB credit institutions and result in a disproportionate increase in risk weights for the credit institutions with the highest probabilities of default. Also, as indicated by the FSA, the use of Article 164 of that Regulation would have unintended implications beyond the calculation of risk-weighted exposure amounts as it would also apply to the calculation of expected loss amounts as per Articles 158 and 159 of that Regulation which would add further complexity to the determination of capital requirements and could reduce the transparency of IRB risk weights for market participants.

(15) Regarding the countercyclical capital buffer set out in Article 136 of Directive 2013/36/EU, the Commission recalls that it would apply to all Swedish credit exposures and not just to mortgage exposures. The FSA argues that using the countercyclical capital buffer to specifically target the systemic risks linked to the Swedish mortgage and housing markets, would penalise other exposures which are not the target of the measure. Therefore, the Commission agrees with the FSA that considers that it would not be effective or appropriate to further increase its countercyclical capital buffer rate[7] to address the systemic risks linked to Swedish mortgages and the residential immovable property sector.

(16) In what concerns the systemic risk buffer, the FSA already applies a systemic risk buffer of 3% to the three major Swedish credit institutions, which addresses the structural risks associated with the large and concentrated banking sector in Sweden. The FSA assesses that it would not be effective or appropriate to further increase the systemic risk buffer to address the systemic risks linked to Swedish mortgages and the residential immovable property sector. The FSA also considers that while a sectoral variant of the systemic risk buffer could target the identified systemic risks, it would be less appropriate and effective than the proposed measure. As noted above, the FSA expressed its concerns about unjustified variability in modelled risk weights and it is currently reviewing credit institutions' internal models. The FSA explained that, until that review is completed, only a floor that binds low IRB risk weights is a viable alternative because a sectoral systemic risk buffer would have disproportionate impacts. The sectoral systemic risk buffer would not act as a floor, but rather as a multiplier in terms of nominal capital requirements, impacting most heavily IRB credit institutions with the highest risk weights and least heavily IRB credit institutions with the lowest risk weights. According to the FSA, 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.

(17) The Commission notes that the ESRB is of the view that measures such as those listed in Articles 124 and 164 of Regulation (EU) No 575/2013, as well as the systemic risk buffer and the countercyclical capital buffer set out in Articles 133 and 136 of Directive 2013/36/EU respectively, are considered to be less adequate. More specifically, these measures do not incentivise low risk weight IRB credit institutions to revise such risk weights upwards, are too broad-based, or do not, to the same extent, address the same risk, exposures or credit institutions. However, once the ongoing IRB models review has been completed, the ESRB supports the FSA's intention to conduct a more thorough assessment and review the need for or the calibration of the measure on the basis of the residual systemic risk, including its potential substitution with a sectoral systemic risk buffer. Additionally, both the ESRB and the EBA encourage the initiative of the FSA to assess and implement the changes that might become necessary for the introduction of the output floor in the future, to avoid overlaps and maintain the effectiveness and appropriateness of the measures.

(18) Article 458(2), point (f), of Regulation (EU) No 575/2013 requires that an assessment is made of the likely positive or negative impact of the current measure on the internal market. As the current measure is in place since 2014, it should not

[7] The FSA applies a CCyB rate of 1% from 29 September 2022 and raised it further to 2% from June 2023.

introduce any disproportionate adverse effects for the internal market or other national financial systems. According to the ESRB economic assessment, the measure should further maintain the resilience of Swedish credit institutions to shocks in the Swedish residential immovable property sector and thereby reduce potential channels for contagion from Sweden to other Member States. Furthermore, as specified in the notification, the current measure does not induce any additional capital requirements for concerned credit institutions as they are already applying the risk-weight floor since 2014. The measure also does not seem to have affected households' access to domestic mortgage lending, which has continued to grow since the introduction of the risk-weight floor. Based on this assessment, and in agreement with the ESRB's opinion, the Commission finds that the extension of the measure does not entail disproportionate adverse effects on the internal market or on other national financial systems.

(19) The Commission, after assessing the notification and the evidence submitted by the FSA and taking utmost account of the ESRB and EBA opinions, concludes that there is no robust, strong and detailed evidence that the intended extension of the period of application of the current measure will have a negative impact on the internal market that outweighs the financial stability benefits resulting in a reduction of the macroprudential or systemic risk identified.

(20) The Commission nevertheless stresses the importance of closely monitoring the evolution of systemic risks related to the residential immovable property sector, IRB risk weights and a periodic evaluation of the necessity, effectiveness, suitability and proportionality of the measure and its calibration,

HAS DECIDED AS FOLLOWS:

Sole Article

The Commission does not propose to the Council an implementing act to reject the intended extension of the period of application of the national measure, notified on 12 September 2023 by Sweden in accordance with Article 458(4) of Regulation (EU) No 575/2013, from 31 December 2023 until 30 December 2025.

Done at Brussels, 6.11.2023

For the Commission
Mairead McGUINNESS
Member of the Commission