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# Response to the Swedish National Debt Office's memorandum Application of the Minimum Requirement for Eligible Liabilities (Dnr RG 2016/425)

## Executive summary

The Bank Recovery and Resolution Directive has been implemented in Sweden primarily through the Resolution Act.[1] The objective of the Resolution Act is to make resolution a credible and effective response to the failure of systemically important banks, for society and for the economy. From Finansinspektionen's (FI) perspective it is important that the new rules and requirements, including requirements for liabilities which can be written down or converted in resolution, which are introduced with the Resolution Act, are well integrated with FI's supervision and the capital requirements currently applicable to the banks.

FI sees particular advantages in the Swedish National Debt Office's (the Debt Office) proposed methodology for determining the minimum requirement for own funds and eligible liabilities (MREL) in the sense that it results in a certain amount of buffers and in the sense that the resolvability assessment is given a prominent role.

FI's principal view is that the new requirements for eligible liabilities should be consistent with the capital and liquidity requirements, and should be set in consideration of the fundamental purpose of these requirements. The objective of the current capital and liquidity requirements is to protect, as far as possible, the banks' ability to manage risk and absorb different types of loss, in normal situations as well as in periods of crisis. This reduces the risk of bank failure, which in turn reduces the risk that problems spread to other banks and to the economy generally.

In FI's view, these *going concern*-capital requirements have been effective in reducing and mitigating financial stability risks in Sweden. New *gone concern*-

[1] Swedish: Lagen (2015:1016) om resolution.

rules, which introduce new resolution tools with the objective of improving the resolvability of banks after they have failed, should, to the extent possible, be designed in ways which align with the going concern-principle.

Resolution is an important framework for effective crisis management. However, the starting point for any regulation should nevertheless be to avoid – insofar as it is possible –situations where problems in banks develop in such a way that they must be put into resolution. Even under relatively benign conditions, resolution can be expected to have significant costs for society and the economy, including the risk of impairing the ability of the financial system to fulfil its fundamental role and obligations. This is not least the case if banks were to be put into resolution despite not having suffered losses which would otherwise threaten their solvency. This suggests the overarching principle of bank regulation should emphasise high capital requirements, which protect banks in going concern – in other words, in other scenarios than failure.

This philosophy underlies FI’s positions and responses to the Debt Office’s proposal. FI elects not to comment on the aggregate level of loss-absorbing liabilities, and instead focuses on the allocation between capital and debt, and the balance between the minimum and buffer requirements.

FI’s comments and objections regarding the Debt Office’s proposal can be summarised as follows:

- The role of debt instruments as part of the new MREL requirements should be more limited than the Debt Office proposes. In FI’s view, the Debt Office’s proposal for a certain minimum share of debt instruments (as part of the resolvability assessment) introduces new refinancing risks. Given that the Swedish banking system is already today exposed to material refinancing risks, this is not unproblematic. Consequently a thorough impact analysis is required before any subordination requirement is introduced. A method which does not disfavor capital as a funding source should be considered. FI otherwise agrees in principle with the assessment that subordination requirements may be appropriate in the long term (assuming the level of the requirement is reasonable).

- The proposed automatic link between MREL and the capital requirements needs to be amended to ensure that the new MREL rules do not impact adversely on the economy generally and financial stability in particular. Such adverse effects could potentially materialize if any increase in the going-concern capital requirements – and thus the resilience of banks - would *increase* the need for gone-concern capital (eligible liabilities), instead of decreasing it or letting it to remain constant. FI considers that a mechanic “translation” of capital requirements into MREL is inappropriate.

- The application of the MREL requirement needs to provide for a significant element of buffer in order to account for both existing risk of losses and additional risks which MREL introduces, in particular those relating to the need to refinance MREL-eligible debt. In this respect the proposal entails an inappropriate balance between the minimum MREL requirement and the MREL buffer. FI considers that the proposal underestimates the need for a buffer and overestimates the minimum requirement. High capital requirements in principle lead to alower, not higher, need for MREL-eligible liabilities.

**The going concern principle and crisis management**

The main objective with the current high capital requirements for Swedish banks is to reduce the risk that banks fail and to reduce the costs if they anyway do so. The high capital requirements in turn mean banks can be expected to be recapitalized or resolved before they have fully depleted their capital buffers. This particularly applies to systemically important banks, whose failure can be expected to spread, through contagion effects, to other parts of the financial system and to society and the economy generally. Since systemically important banks can cause risks and losses outside of the banks themselves when they encounter problems these banks need additional safety margins and are therefore subjected to additional capital requirements[2].

The new EU crisis management rules, which are implemented in Sweden primarily through the Resolution Act, strengthen the going-concern principles further. This is achieved by, among other things, new supervisory requirements for recovery plans and rules regarding early intervention. This further reduces the risk of costly banking failures. The crisis management rules also include new powers and requirements with the objective to protec the banks' so-called critical activities[3] in the event banks encounter problems, and to ensure that any losses and recapitalization requirements in resolution, in excess of existing capital, can be met by bondholders. These rules therefore have an explicit gone-concern focus as they are aimed at mitigating the negative consequences for systemically important banks' customers and for society generally when such banks fail. This is important both to protect financial stability and to provide sound incentives for risk management in the financial sector. Prevention of crises is therefore an important objective of resolution.

In order to ensure that the gone concern requirements (for example MREL) have the intended consequences for financial stability and for the economy generally, the rules must harmonise well with the going-concern requirements.

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[2] The higher capital requirements for systemically important banks take into account the additional losses such banks can cause, for other parts of the financial system and for society and the economy generally, when they fail. This is achieved through a further reduction in the probability of failure for the systemically important banks compared to what is achieved with the general capital requirements applicable to (non-systemic) banks. This lower probability of failure is meant to compensate for the systemic risk caused by such banks. For further explanation of the capital requirements for systemic risk, see page 3 of the Basel Committee's framework for systemically important banks (http://www.bis.org/publ/bcbs255.pdf).

[3] The banks' critical activities are defined in the resolution plans and often encompass, among other activities, payment services, liquidity management facilities and other socially or economically important activities.

Consequently it is important, firstly, that the overall, going- and gone-concern requirements strengthen (or, at a minimum, do not adversely impact on) the banks' risk and crisis management in going concern and ensure a stable composition of the banks' capital and debt financing. Secondly, which is particularly important from a financial stability point of view, the new MREL requirements must not increase the risk of failure for individual banks.

This creates challenges for the relevant authorities. Contradictions may exist between the gone-concern and going-concern perspectives which must be managed. One such challenge involves the refinancing risks the new rules for bail-in and MREL entail. Depending on how the gone-concern rules and requirements are designed they can have major implications on banks while they are going concern. If the gone-concern rules and requirements are designed in an inappropriate way they can impair the banks' recoverability and, thereby, increase the risk that the banks have to be put in resolution.

The banking sector is sensitive to market conditions given its dependence on market funding, such as the issuance of bonds to investors. This can be a positive factor due to the resulting market discipline – banks must continuously maintain market confidence in order to support their financing needs. On the other hand, this also exposes banks to rumours, whether justified or not, about their financial condition. Even more importantly, banks can be impacted by general changes in market participants' willingness or ability to take risk. In situations with risk aversion all banks – irrespectively of their financial condition – can face challenges to refinance liabilities as they fall due. Such changes in market behaviour can directly impact banks' ability to renew their funding, and they can quickly spread and adversely impact overall credit supply and the economy more broadly. Depending on how the regulatory framework for banks is implemented, changes in market conditions mean banks may fail and be put into resolution even in situations where they have not suffered significant credit (or other) losses.

All banks are subject to refinancing risks. However, the rules regarding bail-in can significantly reinforce such risks. Liabilities which are used to meet MREL must be continuously refinanced in order for banks to meet the minimum requirement (or be forced to abruptly reduce the size of their activities). Because of contagion effects, such risks can spread quickly to other banks, even sound ones.

If banks fail to refinance their liabilities during an extended period, to an extent which means they can no longer meet the minimum requirement for MREL-eligible liabilities, they risk being put into resolution. [4] In such situations bondholders risk write-downs or conversion of their debt holdings into more

[4] Resolution is not a necessary consequence of a breach of MREL. However, at a minimum a breach of MREL can be expected to be a critical contributing factor. The negative spiral referred to in the body of the text can in itself contribute to the conditions for resolution being met. See chapter 8 of the Resolution Act.

risky equity instruments, with uncertain valuation outcomes. When the risk of resolution and write-down is seen by investors to increase, the banks' ability to issue the liabilities they need to meet the minimum requirements is impaired. As a consequence, problems with refinancing can be self-fulfilling. As mentioned, this can happen even in the absence of losses impacting capital negatively.

The risk of such negative spirals is larger in situations where the share of debt as part of the minimum requirement is greater. This is the case with MREL. The Debt Office's proposed implementation increases the share of debt further given that the Debt Office introduces a large and specific requirement as to the proportion of debt instruments. The risks are further exacerbated given that the Debt Office proposes that MREL-eligible debt should be subordinated to other liabilities. This follows as a consequence of subordinated liabilities ranking junior to other liabilities in resolution, thereby causing investors to become less prone to invest in such liabilities during periods of market stress.

It is worth pointing out that MREL differs fundamentally from the capital requirements in these respects. The capital requirements greatly restrict the degree to which these can be met with debt instruments, in favour of so-called common equity tier 1 capital (CET1). As it is perpetual, CET1 capital does not cause refinancing risk. The role of CET1 capital is proportionately even greater in Sweden as a result of FI further constraining the degree to which Swedish capital requirements can be met with debt instruments, beyond the constraints inherent in the internationally agreed capital requirements. This has made banks less dependent on market conditions, and less exposed to refinancing risk, which FI believes has contributed to strengthening financial stability. Consequently, this is a situation which should be preserved.

FI notes that the possibilities to issue loss absorbing debt have fluctuated, both during and after the financial crisis. The implementation of the bail-in tool (although essential to eliminate the "too-big-to-fail" problem) may, however, increase the risk of disruption in the capital markets. This in turn adversely impacts the banks' ability to issue loss-absorbing liabilities, especially during periods of economic and market stress. At the same time, the new MREL requirements increase the need for banks to repeatedly issue MREL-eligible liabilities. The banks' ability to adapt their MREL issuance plans to market conditions diminishes, since the minimum requirements must be met at all times. A development which means that the *demand* for eligible liabilities is more likely to be disrupted, combined with the *supply* of such liabilities becoming greater and less flexible, is intrinsically problematic.

The Financial Stability Board has conducted a survey which shows that many market participants expect banks to have great difficulty, or be unable, to issue loss-absorbing debt during economic downturns, especially in cases when these have to be formally subordinated to other liabilities.[5]

[5] See pages 17–18 in FSB's summary findings from the TLAC impact assessment studies (http://www.fsb.org/2015/11/summary-of-findings-from-the-tlac-impact-assessment-studies/).

In FI's assessment this requires caution in at least two aspects. Firstly, caution is required in the design and implementation of MREL in order to avoid adverse financial stability consequences. Excessively high minimum requirements – especially as regards any debt component of MREL – can result in significant refinancing risks which means that the new requirements can cause greater damage than benefits for financial stability and the economy generally. Secondly, significant MREL buffers above the minimum requirement are necessary. This is because the MREL buffers have to take into account both the risk of loss, which is reflected in the buffer capital requirements, and the additional refinancing risks caused by the debt component of MREL and the bail-in tool.

## FI's interpretation of the Debt Office's proposal

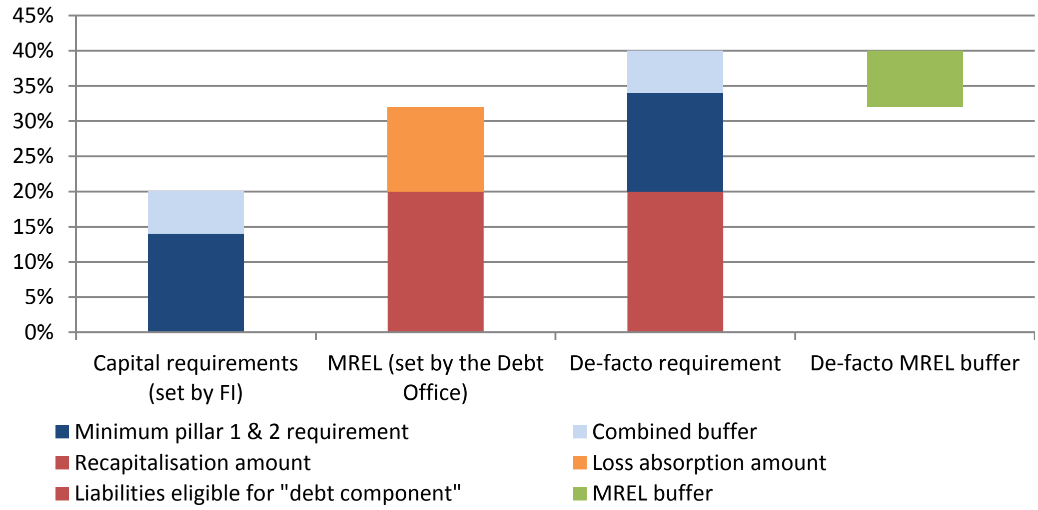
MREL is a minimum requirement which is decided by the resolution authority and which banks must meet at all times. MREL is calculated as the sum of a loss absorption amount and a recapitalisation amount. Both amounts are calculated based on the capital requirements for the banks, as set by the supervisory authority, but with certain adjustments. According to the Debt Office's proposal, the adjustments mean that MREL will be less than two times the capital requirements, which is otherwise a level which can be considered a default level given the EU rules. For a more comprehensive explanation, please refer to the Debt Office's memorandum.

The Debt Office proposes to introduce a separate debt component within MREL, which is described in further detail below. This debt component cannot be met with capital instruments and is therefore, in practice, an additional requirement, on top of the capital requirements.[6]

The debt component within MREL is proposed to be identical in size to the recapitalisation amount which, in turn, is identical to the total capital requirement as imposed on the banks, under normal situations, by FI. This results in an aggregate requirement for capital and loss-absorbing debt at two times the capital requirements. This de-facto requirement however is not a formally decided minimum requirement. The difference between this total de-facto requirement and the formally decided MREL therefore becomes a form of buffer, which in this document is referred to as the MREL buffer. A bank would not meet the MREL buffer requirement in a situation where it complies with the overall MREL requirement but fails to comply with the share of debt in the MREL.

[6] The term capital instruments include Common Equity Tier 1 and Additional Tier 1 instruments, both of which are perpetual, as well as Tier 2. Tier 2 instruments are normally fixed maturity instruments. The rules regarding these instruments are provided in the Capital Requirements Regulation.

**Illustration of MREL and the MREL buffer**




In the illustration above, using numbers from the Debt Office's proposal, the minimum capital requirement in pillar 1 and pillar 2 (dark blue bars) is assumed to be 14 percent. This includes the full mortgage risk-weight floor and the systemic risk requirement of 2 percent, both applied in pillar 2, as per FI's methodologies. The combined buffer (light blue bars) is assumed to be 6 percent. MREL is set as the sum of a loss absorption amount (yellow bar), which is assumed to be 12 percent, and the recapitalization amount (red bar) which the Debt Office proposes to be identical to the total capital requirement which in this case is assumed to be 20 percent. MREL is thus 32 percent. However as the required debt component is set equal to the recapitalization amount (both the debt component and the recapitalization amount are thus red bars) and cannot, according to the Debt Office's proposal, be met with instruments used to meet the capital requirements, this debt share is additive to the capital requirements. The sum of these two requirements therefore amounts to an aggregate de-facto requirement which is shown separately in the illustration above. Given that this aggregate de-facto requirement is not a formally decided minimum requirement, the difference between this de-facto requirement and the formally decided MREL becomes a de-facto MREL buffer (green bar in the illustration).

**FI's views on the Debt Office's positions**

In the following paragraphs FI provides its views on the Debt Office's positions in sequence, based on FI's principal views as expressed above.

**Position statement 1: The size of the minimum requirement**

*The Debt Office proposes, in line with the European Banking Authority's (EBA) technical standards, that MREL be determined as the sum of a loss absorption amount and a recapitalisation amount. Both amounts are calculated based on the applicable capital requirements.*

FI has no specific objections to the Debt Office's overall position in this regard, which is in conformance with the EBA's technical standards.

However, FI wants to make a general statement about the MREL calibration. As is explained further above, FI believes all requirements applied to banks should be seen and assessed in aggregate. High capital requirements under going concern reduce the need for additional loss absorbing liabilities as part of MREL. The reason for this is that sizeable capital buffers reduce the probability of failure and resolution. High resilience and sizeable buffers increase the degrees of freedom for both authorities and banks to deal with problems. The banks' recoverability, including their ability to raise capital during going concern, is thereby improved.

Conversely, it is not clear that the presence of loss-absorbing liabilities is as important as strong capital levels. With the proposed methodology the requirement for eligible liabilities would decline if the capital requirement is reduced. The inverse would be more reasonable – bank with limited amounts of capital need more, not less, eligible liabilities. This illustrates the need to break the mechanical connection between capital requirements and MREL which the Debt Office proposes. The new refinancing risks which are caused by the minimum requirements for debt instruments, which are described in further detail in the preceding section, reinforce the need to ensure that the level of such minimum requirements is appropriately calibrated. FI therefore believes that the resolvability assessment should specifically inform the calibration of MREL and the MREL buffer.  This would ensure that the calibration properly reflects the new risks arising from the need to refinance maturing debt instruments used to meet MREL and any minimum debt requirement.

The issuance requirements of MREL-eligible liabilities which would result from the Debt Office's proposal are very large. The debt component of the MREL requirement in the Debt Office's proposal equals the total capital requirements, which in turn amount to SEK 635 billion for the ten largest banks as per the first quarter 2016. However, the real issuance requirements will be even bigger. This follows from the fact that liabilities lose eligibility during their last year before maturity, as well as other factors such as risk weight increases due to the application of FI's new supervisory methods and the need to keep a management buffer on the top of minimum requirements. This becomes particularly challenging to the extent MREL-eligible liabilities must to be subordinated to other existing debt instruments. FI believes the Debt Office in its final position statement needs to give careful consideration to the banks' ability to issue MREL-eligible liabilities in the market in sufficient volumes.

**Position statement 2: The loss absorption amount**

*The Debt Office proposes that the loss absorption amount shall be determined without reference to the Basel 1 floor or the companies' leverage ratio.*

FI supports the Debt Office's position in this regard given that neither the Basel 1 floor nor the upcoming leverage ratio requirement is calibrated based on individual banks' risk of loss.

**Position statement 3: Conditions for a lower loss absorption amount**

*The Debt Office proposes that the combined buffer requirement and the systemic risk requirement under pillar 2 are excluded in the calculation of the loss absorption amount.*

FI shares the Debt Office's view that neither the combined buffer requirement nor the capital requirement for systemic risk under pillar 2 should be included in the loss absorption amount. Additionally to the Debt Office's proposal, FI believes that the part of the risk weight floor for Swedish mortgages in excess of 15 percent should also be excluded since this component does not reflect loss risk for the individual banks.[7]

To the extent the risk weight floor is included the loss absorption amount needs to be adjusted such that it only encompasses the minimum capital requirement and not the combined buffer requirement or the capital requirement for systemic risk under pillar 2 (which both are included in the capital requirement relating to the risk weight floor). This is required in order to ensure that the buffer capital requirements are treated consistently.

**Position statement 4: Determination of the recapitalisation amount**

*The Debt Office proposes that the recapitalisation amount be based on the company's total capital requirement including the Basel 1-floor (if relevant).*

FI does not share the Debt Office's position in this regard. The purpose of the recapitalization amount is to reflect the capital needs of the bank after resolution. Against that background, it is questionable whether a systemically important bank after resolution shall be required to hold capital for macro-economic risks which most likely have already materialized in such a situation. Consequently it is reasonable from a regulatory point of view to assume that the capital buffer requirements after resolution will be lower than is the case under normal situations.

Additionally, the financial system is made less resilient if capital buffers are turned into minimum requirements. FI's capital requirements consist of minimum requirements and buffers. In order for the buffer requirements to work

[7] The Swedish risk weight floor for household mortgages has been raised in two steps. The first risk weight floor of 15 percent reflects the expected risk of loss in the underlying exposures, which in FI's view is understated under the IRB Approach. The increase of the risk weight floor from 15 to 25 percent however reflected the risks to financial stability and to the economy generally which are caused by excessive household leverage. In other words, this part of the risk weight floor has similarities with the capital requirements for systemic risk in that it does not reflect greater risk of loss for individual banks.

as intended, and to be properly loss absorbing, a bank must be allowed to breach the buffer requirements for a period of time (although naturally not without consequences in the form of a requirement for a plan to restore the buffers and intensified supervision). If this is not the case the buffer requirements effectively become a minimum requirement, which is neither intended nor appropriate. Thus, the combined buffer requirement and the systemic and macro-prudential components under pillar 2 should be deducted in the calculation of the recapitalisation amount. If this is not done the capital buffers are transformed into minimum requirements for MREL-eligible capital and debt and lose their ability to absorb the risks they were intended for.

To the extent pillar 2 requirements are included in the recapitalisation amount this should only be the case for bank-specific capital requirements or, in other words, those requirements meant to absorb individual banks' risk of loss. This normally includes the capital requirements for credit-related concentration risk, interest risk in the banking book, pension risk and the risk weight floor for household mortgages up to 15 percent. FI also notes that the Bank of England proposes, in its implementation of MREL, to include neither the buffer requirement nor the so-called Pillar 2B requirement (which is similar to the Swedish capital planning buffer) in the recapitalisation amount.[8]

FI considers that those parts of the capital requirements which are not included in the recapitalisation amount should be included in the MREL buffer.

**Position statement 5: Companies for which the recapitalisation amount can be set at zero**

*The Debt Office proposes that the recapitalisation amount be set at zero for companies which the Debt Office has decided shall be subject to simplified obligations.*

FI has no objections to the Debt Office's position in this regard.

**Position statement 6: Liabilities exempt from write-down or conversion**

*The Debt Office proposes that the minimum requirement should not be adjusted with regard to the potential exemption of certain liabilities from write-down or conversion.*

FI has no objections to the Debt Office's position in this regard.

[8] See Bank of England's consultation document *The Bank's approach to setting a minimum requirement for own funds and eligible liabilities (MREL)*, December 2015 (http://www.bankofengland.co.uk/publications/Pages/news/2015/098.aspx).

**Position statement 7: The possibility of deduction relating to contributions from the deposit guarantee scheme**

*The Debt Office proposes that the minimum requirement shall not be adjusted for contributions from the deposit guarantee scheme.*

FI has no objections to the Debt Office's position in this regard.

**Position statement 8: The need for adjustment (with regard to the Resolution Fund)**

*The Debt Office proposes that the minimum requirement should not be determined with regard to the possibility to utilise the Resolution Fund for loss absorption or recapitalisation in resolution.*

FI has no objections to the Debt Office's position in this regard.

**Position statement 9: Meeting the minimum requirement**

*The Debt Office proposes to introduce criteria as regards MREL-eligible liabilities in its resolvability assessment (detailed proposals follow in separate position statements below).*

As a general statement, FI sees considerable value in the resolvability assessment, and that this assessment is based on principles which are transparent and, as far as possible, applied in similar ways for all banks. In FI's view the MREL buffer, applied above MREL, could be assessed and set in the resolvability assessment. The MREL buffer has a natural role in the resolvability assessment given that its key purpose should be to ensure that MREL is always (or at least in reasonably foreseeable scenarios) met by the bank. This creates a need for a buffer which is capable of absorbing the risks, both as regards losses and refinancing, which may otherwise lead to a breach of MREL. In this way the MREL buffer would have similarities to the capital planning buffer which is aimed at reducing the risk that the minimum requirements are breached.[9]

If MREL is based on the capital requirements including the combined buffers, as the Debt Office proposes, the loss absorbing capacity of the buffer capital requirements and the systemic capital requirements is impaired, given that the MREL buffer will also be exposed to refinancing risk. One way to achieve a larger MREL buffer is to include a specific component in the MREL buffer for refinancing risk, which should be additive to the part of the MREL buffer which reflects buffer capital requirements.[10] An alternative way would be to continue

[9] For a description of the capital planning buffer and FI's method to determine it, see http://www.fi.se/Folder-EN/Startpage/Supervision/Miscellaneous/Listan/Stress-test-methodology-for-assessment-of-the-capital-planning-buffer/
[10] There are arguments for the MREL buffer to be calibrated partly based on the remaining maturities of eligible liabilities. Such a methodology would provide incentives for banks to issue long-dated liabilities to meet MREL. However, with such a methodology there would be risks of

to base MREL on the capital requirements but to make further deductions from either the loss absorption amount or the recapitalisation amount and instead add these components of the capital requirements to the MREL buffer.

Breaches of an MREL buffer requirement would not in itself lead to resolution, but would rather result in a requirement for the bank to take reasonable measures to restore the MREL buffer. In the event of significant and lasting breaches of the MREL buffer requirement it should be possible for authorities to intervene more directly, for example through the Debt Office's powers to remove obstacles to resolvability.

FI sees no reason to limit the role of capital instruments either as part of MREL or the MREL buffer since capital instruments have better loss absorbing capacity than other eligible liabilities.

**Position statement 10: ”Liabilities proportion”**

*The Debt Office proposes that companies which are not expected to be subject to bankruptcy proceedings or liquidation and which could therefore be subject to resolution should, in order to be considered resolvable, have MREL-eligible liabilities which correspond to the recapitalisation amount.*

As is described above FI believes debt instruments have an excessively prominent role in the Debt Office's proposal – even if the proposal in respect of the minimum debt component in MREL is not implemented as a strict minimum requirement. FI therefore does not consider the proposed debt component in the MREL requirement to be appropriate – at least not at the high level resulting from the Debt Office's proposal. FI instead favours the introduction of a dedicated MREL buffer, on top of MREL as a minimum requirement.

**Position statement 11: Allocation and type of eligible liabilities in groups**

*The Debt Office proposes that MREL-eligible liabilities used to meet the requirement at group level for groups where the main resolution strategy is a so-called Single Point of Entry-strategy, should be issued by the parent company and not be held by other group entities. For subsidiaries, liabilities used to meet the minimum requirement on an individual entity-basis should be solely in the form of liabilities issued to the parent entity. These liabilities should also be subordinated to other liabilities issued by the subsidiary and be capable of being written down or converted without causing the subsidiary to be put in resolution.*

FI has no objections to the position statement as FI sees considerable advantages when internal eligible liabilities are subordinated. However, FI believes further analysis is required about the consequences, including the impact of potential

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the MREL buffer becoming pro-cyclical – the MREL buffer requirement would increase during periods of refinancing difficulties. This could be problematic and should therefore be avoided.

changes to tax deductibility pursuant to the Swedish Government's proposal that interest on certain subordinated debt obligations shall no longer be tax deductible (see Fi2016/01229/S1).

**Position statement 12: Subordination of eligible liabilities**

*The Debt Office proposes that liabilities which are used to meet the minimum requirement should be subordinated to other liabilities and that, as a consequence, a subordination requirement should be eventually introduced. The Debt Office intends to provide further information about the form, extent and timing of the introduction of such a requirement in the beginning of 2017.*

FI shares the Debt Office's view that subordinated liabilities, in principle, have considerable advantages from a resolvability point of view, compared to non-subordinated liabilities. Subordination also ensures that the risk in such instruments becomes more transparent for investors. The upcoming requirements for Total Loss Absorbing Capacity (TLAC), which should be introduced at least for globally systemically important banks as of 2019, also require that MREL-eligible liabilities are formally subordinated. [11]

Since capital instruments such as Tier 2 have stronger loss-absorbing capacity than other liabilities (under certain conditions Tier 2 instruments can be converted into equity capital outside of resolution), in FI's view the Debt Office should clarify that such instruments can be used to meet a the debt component of MREL, if the Debt Office elects to introduce such a requirement.

Even though FI sees considerable advantages with subordinated liabilities from a resolvability point of view, FI believes subordination requirements can exacerbate the already significant refinancing risks described above. FI notes that it is not clear whether Swedish banks are even capable of issuing formally subordinated liabilities which meet the TLAC criteria, other than capital instruments, at present, even if market demand for such instruments is available.[12] Since the market for subordinated debt instruments at present is limited, banks' ability to issue such liabilities can also be expected to be lower and more uncertain compared to non-subordinated instruments. As mentioned above, FSB's market survey also suggests strongly cyclical demand, and significant challenges (to the extent the possibility exists at all) for banks to issue subordinated debt instruments during periods of economic downturn.

FI shares the Debt Office's assessment that any subordination requirement requires an extensive impact assessment. Such an assessment specifically needs

[11] See http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

[12] This is due to the fact that Swedish banks do not have ultimate holding companies, which means so-called structural subordination is unavailable, and there is no statutory regime in place which ensures subordination of otherwise senior bonds. Finally, there are restrictions in existing funding programmes which limit, or prohibit, the issuance of contractually subordinated debt instruments which rank senior to existing tier 2 liabilities.

to cover the banks' ability to issue such instruments, generally and across full business cycles. Given that the experience of such instruments is limited, FI proposes that the Debt Office in its upcoming assessment of whether subordination requirements should be introduced considers both the possibility of not enforcing such a requirement as part of the formal minimum requirements, and the possibility of requiring that only parts of the overall MREL-eligible liabilities be in the form of subordinated debt instruments (for example, this proportion could be set at the level envisaged in the global TLAC requirement). In the future, when the market for subordinated debt hopefully has matured and broadened, and when more experience exists as regards the issuability of such instruments across cycles, such requirements could be formalized and increased.

**Position statement 13: Restrictions relating to risks resulting from cross ownership**

*The Debt Office proposes that the risks related to the companies' holdings of other companies' eligible liabilities should be reduced. However the Debt Office will await further impact assessments as well as international regulatory developments before it introduces such risk reducing measures.*

FI principally supports the introduction of restrictions of cross ownership but believes that such restrictions, at least at the outset, should not go beyond the restrictions which are being developed by the Basel Committee. This also applies to any transition period to be proposed by the Committee. A significant share of banks' eligible liabilities is held by other banks. Even though it is principally desirable to reduce such cross ownership, such new restrictions will further increase the risks associated with the implementation of the new gone-concern rules given that significant amounts of debt instruments will need to be recirculated to new owners. FI notes that holdings of other banks' debt instruments are subject to capital requirements already today and that such capital requirements will increase significantly with expected application of the standardized approach to interbank exposures, as proposed by the Basel Committee[13]. This createds effective incentives for banks, and to some extent addresses the same risks which are intended to be minimized with limits on holdings of other banks' MREL-eligible liabilities.

[13] See the Basel Committee's consultation document Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches, March 2016 (http://www.bis.org/bcbs/publ/d362.pdf)

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