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Updated Pillar 2 method for assessing flowback risk associated with securitisation

Summary

(This is a new version of the original memorandum. This version was published 2023-01-30 and contains clarifications on pages 15 and 16)

Finansinspektionen (FI) is updating its method for assessing flowback risks associated with securitisation for individual banks.[1] The aim is to decide on an additional own funds requirement, where applicable, for flowback risks associated with securitisation under Pillar 2. This will enable us to ensure that a bank is sufficiently able to cover the flowback risks to which it is exposed.

This memorandum replaces FI's memorandum from 2017, *"FI's Pillar 2 capital assessment method for systemic risk associated with securitisation"*,[2] where we reported on how securitisations can, under certain conditions, create systemic risks associated with securitisation that are not covered under the Pillar 1 framework.

Securitisations can be difficult to refinance, for example if the market is unstable or if there is less demand from investors. FI has identified two options that are open to a bank when credits can no longer be financed through securitisations and if the borrower still needs financing. The bank can choose to renew or extend the credits outside the securitisation; or it can choose not to do this.

Banks rarely have contractual obligations to extend or renew credits after they have matured, even if the borrower still has financing needs. However, FI's assessment is that in most cases a bank will offer financing, beyond its contractual obligations, to borrowers whose credits can no longer be financed through a securitisation. The banks do this to protect their brand, limit other reputational risks and minimise credit losses. If a bank takes this option, it can suffer a sudden and unexpected deterioration in its capital position, as the credits flow back to the bank while it no longer benefits from the reduction in its capital requirement associated with the securitisation. This flowback

[1] In this memorandum, the term *banks* is used for all institutions (banks, credit market companies and securities companies) that are subject to the capital adequacy rules.
[2] FI Ref. 16-17820.

therefore risks putting additional stress on the bank's capital position, making the bank more vulnerable.

This is how FI is going to apply the updated method for assessing flowback risks associated with securitisation:

- The method will be applied to banks that carry out traditional and synthetic securitisations, where the conditions for transferring significant credit risk to a third party are considered to have been met.
- The method will be applied to banks where the flowback risk is assessed as being significant, following a supervisory review and evaluation process. FI's assessment is that this will as a starting point apply to banks in Supervision Categories 1 and 2. In some exceptional cases, following a separate evaluation, the method may also apply to banks in Supervision Categories 3 and 4.
- FI intends to decide on an additional own funds requirement for flowback risks associated with securitisation if at least one of the following two conditions are met:
    - the bank's total capital ratio decreases by at least 50 basis points during a future 12-month period as a result of flowback.
    - the exposure value[3] for the bank's securitised credits exceeds 15% of the bank's total exposure value in the relevant exposure classes.[4]
- Securitisations that are assessed as having low flowback risks will be excluded from this method.

[3] 'Exposure value' refers to the amounts that, inter alia, are set out in Articles 111 and 166 of the Capital Requirements Regulation.
[4] 'Exposure class' refers to the exposure classes that are set out in Articles 112 and 147 of the Capital Requirements Regulation.

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1 Introduction and background

1.1 Background and purpose

On 1 December 2016, we published the consultation memorandum *"Pillar 2 capital assessment method for systemic risk associated with securitisation"* (FI Ref. 16-17820), where we described flowback risks associated with securitisation.

In the decision memorandum published on 29 June 2017, FI made the assessment that securitisation and its potential risks could primarily have a negative impact on the overall credit supply, as the banks are often free to decide whether or not to extend or renew credits. This decision memorandum was therefore updated to cover systemic risks associated with securitisation instead (*"Pillar 2 capital assessment method for systemic risk associated with securitisation"*, FI Ref. 16-17820).

However, in this current memorandum, FI's assessment is that in most cases banks will choose to extend or renew credits beyond their contractual obligations. The banks do this, for example, to minimise any potential reputational risks associated with the borrower. Offering support to borrowers by extending or renewing credits beyond contractual obligations causes flowback, which leads to a deterioration in the bank's capital position. We have established that support measures for borrowers that cause flowback risks are not covered by existing capital requirements. Consequently, FI believes that risks associated with securitisation for individual banks are not fully covered by existing capital requirements. This memorandum therefore describes an updated method for assessing the capital need for flowback risks associated with securitisation.

1.1.1 Economic incentives for securitisation

Risk-sensitive capital requirements require a bank to hold more capital, the riskier its exposures are. This gives banks an incentive to practise sound lending, while ensuring that they have sufficient capital to bear any losses.

In their efforts to improve their profitability, banks have incentives to find different ways of reducing their capital requirement. If banks can reduce their capital requirement by restructuring their balance sheets (or reducing their risks) without experiencing an equivalent reduction in their net income, their return on equity increases. It also increases the banks' capacity to pay dividends.

One method that the banks can use to reduce their capital requirement is to securitise credits. This transfers the credit risk of a credit portfolio to investors through securities, once it has been divided into different tranches. Securitisations enable banks to reduce their capital requirement, while retaining a significant part of the economic profitability in their operations. This can be achieved, for example, if an investor prices the risk lower than the current capital requirement or has a lower yield requirement than the bank. The fundamental economic driver behind securitisation for banks is therefore that it releases capital for other income-generating activities.

The regulations allow banks that have initiated the transaction to reduce their total capital requirement through securitisation, provided that significant credit risk has been transferred to an external investor. The capital requirement is reduced by a deduction being made from the risk-weighted exposure amounts. Securitisation therefore enables a bank to release capital to varying degrees. More capital is released when the capital requirements (expressed as a percentage) are high compared to when they are lower, as the requirements are based on risk-weighted exposure amounts for the securitised credits.

Although securitisation is common in most countries, it has so far been relatively rare in Sweden. Swedish banks have used covered bonds instead as a funding instrument, as well as guarantees and other measures for managing and reducing their credit risk. However, the banks' business models, the capital adequacy regulations, the investors' yield requirements and the pricing of risk can create major financial incentives to use securitisation.

1.1.2 Flowback risks associated with securitisation

FI is fundamentally supportive of developments that introduce more and broader capital and funding sources, as this improves risk diversification for Swedish banks. However, FI can see potential risks associated with securitisations. Extensive securitisation can present risks for the individual bank in times of financial stress, which are not covered by the regulatory requirements in Pillar 1.

The main cause of the risks associated with securitisation is that the effect that a securitisation can have on reducing the capital requirement of the bank is limited to the maturity of the securitisation. However, borrowers often need long-term financing. For example, if the market is unstable and securitisations cannot be refinanced (i.e. when credits that have to be renewed or extended cannot be transferred to new securitisation transactions), FI can see that a bank is faced with two main options, both of which are problematic.

The first option is for the bank to choose to renew or extend the credits in question, which will help meet the borrowers' (and, in certain , the bank's) expectations and needs. However, if outstanding securitisations cannot be refinanced, the capital requirement for the bank will increase, as the credits then flow back to the bank's risk exposure value with their full risk weighting. This type of risk is therefore referred to as a 'flowback risk' in this memorandum. A sudden and unexpected deterioration in the capital position can affect trust in the bank and create uncertainty about the bank's financial position.

The second option is for the bank to choose <u>not</u> to renew or extend the securitised credit, which will leave the borrower without financing. If the borrower's need for, and purpose of, the credits extend beyond the original contractual maturity, and if no alternative financing is available, this could have a severe impact on the borrower. As far as the bank is concerned, it could damage its reputation and its brand, and make it more difficult for the bank to maintain and establish new business relationships with borrowers. The bank may also suffer credit losses if it has other credit exposures with the same borrower in addition to the securitisation. This could all threaten the viability and sustainability of the bank's business model.

1.1.3 The purpose of FI's Pillar 2 method for assessing flowback risks associated with securitisation

FI believes it is essential to ensure that banks are able to manage flowback risks associated with securitisation. This memorandum describes the method that FI will apply as part of its supervisory review and evaluation process under Pillar 2 when assessing flowback risks resulting from securitisation. This method in itself does not restrict the bank's ability to carry out securitisations, but it does restrict the capital requirement incentives if banks decide to securitise significant amounts of their exposure and structure their transactions in a way that increases risks associated with flowback. This method therefore aims to ensure that a bank holds sufficient capital for the flowback risks to which it is exposed.

FI does not intend to calculate an additional own funds requirement for the risk of a leverage ratio being far too low as a result of flowback risks associated with securitisation.[5] FI may need to review this method in the future to take the leverage ratio requirement into consideration.

1.2 The securitisation market

Securitisation has been used for several decades, most notably in the USA, but also in European countries, such as the United Kingdom and France. At the beginning of the 2000s, it became much more complex and difficult to analyse. Some of the more complex techniques are considered to have been major contributors to the global financial crisis in 2008–2009 and to the speed at which the problems became widespread.[6]

In the wake of the global financial crisis, a number of changes were made to international frameworks. The Basel Committee revised, inter alia, its capital adequacy regulations for securitised exposures.[7] The Basel Committee also worked with the International Organization of Securities Commissions (IOSCO) to propose a framework for simple, transparent and standardised

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[5] See, for example, FI's memorandum: *"New capital requirements for Swedish banks"* (FI Ref. 20-20990), published on 20 November 2020.
[6] See, for example, Securitization: Lessons Learned and the Road Ahead, Segoviano, M., Jones, B., Lindner, P. and Blankenheim, J., IMF Staff Discussion Note, published in January 2015.
[7] Basel Committee on Banking Supervision, Revisions to the Securitisation Framework, published in December 2014 and amended in July 2016.

securitisation.[8] This framework enables, inter alia, lower capital requirements for securitisations, provided that certain conditions are met. The EU has also implemented frameworks through a new Securitisation Regulation[9] and amendments to the Capital Requirements Regulation. [10]

The purpose of these frameworks and amended EU regulations is to promote the development of relatively simpler, more transparent and more standardised securitisations. The frameworks and amended regulations also aim to increase trust in, and stability on, the securitisation market in order to enable more lending to the real economy, particularly through lending to small and medium-sized enterprises.

Despite the amended frameworks and regulations, FI believes that the risk appetite and therefore market demand from investors for both traditional and synthetic securitisations may fall sharply during periods of widespread stress (see Appendix 1 and Appendix 2). This can have a varying impact on the ability of individual banks to refinance securitisation transactions; in the worst-case scenario it may be impossible to find investors that are willing to take on the risk in the underlying portfolio. FI therefore believes that the ability for an individual bank to refinance securitised credit exposures is sensitive to the economy as a whole, which could result in low market liquidity during periods of financial stress.

1.3 Feedback received

A total of eight bodies submitted responses as part of the consultation process. FI has considered all of the consultation responses that have been submitted, including those that it has not presented in this memorandum.

The Swedish Competition Authority, Kommuninvest and *the Swedish Investment Fund Association* did not submit any responses to the content of the consultation memorandum. *The Riksbank* supports FI's proposals. *The Swedish Bankers' Association, the Swedish Savings Banks Association* and *the Association of Swedish Finance Houses* reject FI's proposals.

Feedback is presented in the relevant sections. Any requests for additional clarification have been addressed directly in the text as far as possible.

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[8] Basel Committee on Banking Supervision, Capital treatment for short-term "simple, transparent and comparable" securitisations, published in May 2018.
[9] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.
[10] Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

2 Overarching legal basis

EU regulations on capital and liquidity have primarily been enacted through Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Capital Requirements Regulation) and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (Capital Requirements Directive).

The capital requirement comprises two main components: Pillar 1 and Pillar 2. The detailed capital requirement calculations that are set out in the Capital Requirements Regulation are often referred to as Pillar 1. Pillar 2 is the umbrella term used for the rules governing a company’s internal capital assessment and FI’s supervisory review and evaluation process. The supervisory review and evaluation process is the term used for FI’s assessment of an individual company’s risks and capital requirements. It takes into consideration both the risks that are covered by Pillar 1 and those that are not.

Any provisions of the Capital Requirements Directive that were not covered by the applicable Swedish legislation have been enacted through new acts, ordinances and government agency regulations or by making adjustments to existing regulations. Some constitutional amendments have also been made to supplement the provisions stipulated in the Capital Requirements Regulation.

Provisions on the supervisory review and evaluation process are set out in Articles 97–101 of the Capital Requirements Directive. In Section 9 of the Special Supervision and Capital Buffers Ordinance (2014:993), the Swedish Government has prescribed that FI must comply with these provisions in its supervisory activities. Article 97 of the Directive states, inter alia, that the competent authorities must determine whether the own funds held by the bank ensure the coverage of the bank’s risks on the basis of the supervisory review and evaluation process. This evaluation is based on a comprehensive analysis of the bank and covers all the requirements stipulated in the Capital Requirements Directive and the Capital Requirements Regulation.

Article 98 of the Capital Requirements Directive sets out the technical criteria for the supervisory review and evaluation process. It states, inter alia, that this review and evaluation must include information about the extent to which the own funds held by an institution in respect of assets which it has securitised are adequate having regard to the economic substance of the transaction.

The Capital Requirements Directive does not regulate the method that must be applied within the framework of the supervisory review and evaluation process. It therefore transfers the responsibility for the method to the relevant supervisory authorities. The European Banking Authority (EBA) has been authorised to issue guidelines for the national supervisory authorities to specify common procedures and methodologies for the supervisory review and evaluation process (Article 107(3)). The methods used by FI are consistent with the basic principles in the EBA's guidelines, i.e. that capital requirements for Pillar 2 risks are in addition to Pillar 1. The EBA guidelines are principle-based, as their purpose is not to regulate in detail the application of any specific methods.

According to the provision on an additional own funds requirement set out in Chapter 2 Section 1 of the Supervision Act, FI must decide on an own funds requirement in addition to the minimum level that otherwise applies, i.e. in addition to what is required under the Capital Requirements Regulation and the Capital Buffers Act (2014:966). A decision on an additional own funds requirement is made if FI finds that this is necessary to cover the risks that a company is or may be exposed to, following a supervisory review and evaluation process. A decision on an additional own funds requirement may also be made if the bank does not comply with, or if it is probable that it will no longer comply with within 12 months, the requirements set out in Chapter 6, Sections 1–3, 4a, 4b and 5 of the Banking and Financing Business Act (2004:297) or Chapter 8 Sections 3–8 of the Securities Market Act (2007:528).

According to Chapter 2 Section 1 of the Supervision Act, Finansinspektionen must decide on an additional own funds requirement that is specific to individual companies. This would mean that we are unable to provide general information about our risk assessment. However, it is the case that some risks that are not covered by Pillar 1 are shared by all companies with the kind of exposures that are detailed in this memorandum. By developing methods and general assessment practice for different risk types, FI is able to ensure that companies are treated equally. Section 3 of the Special Supervision and Capital Buffers Ordinance (2014:993) also states that FI must set out the general criteria and methods applied in its supervisory review and evaluation process on its website.

FI has to request and analyse data from individual companies for its risk assessment as part of the supervisory review and evaluation process. In addition, FI is able to request data from individual companies as part of its supervisory activities (see, inter alia, Chapter 13 Section 3 of the Banking and Financing Business Act and Chapter 6 Section 1 of the Supervision Act).

3 Description of flowback risk associated with securitisation

3.1 Maturity imbalances and refinancing risk associated with securitisation

Different credits are used for different purposes. They can be used, for example, by companies for the long-term financing of their business activities or real estate, or by consumers for smaller, unsecured loans. Different credit agreements also have different maturities. The contractual maturity specifies the date when the bank is entitled to demand repayment of the credit. However, in many instances the contractual maturity for a credit has very little to do with the actual and expected maturity. This is because both the borrowers and the bank often expect the credit to be extended or renewed when the original credit has contractually expired. The expected or actual maturity is largely determined by the purpose of the credit. The need and demand for credits will not necessarily disappear just because the contractual maturity has expired. For some credit types, the contractual maturity is longer than the actual and expected maturity, i.e. the credits are repaid or are expected to be repaid before the contractual maturity expires.

Just like credits, securitisations have a contractual maturity for the investor. It can be difficult to match the maturity of securities that have been issued with the repayments of the underlying credits. This causes a maturity imbalance between assets and liabilities. Maturity matching is made even more complicated by differences between the contractual maturity and the actual or expected maturity of the underlying credits, which is often much longer or shorter than the contractual maturity.

There is a risk that this maturity imbalance could cause problems for both the bank and the borrowers. These problems arise if the investors have less of an appetite (or if their appetite disappears completely) to take on the credit risk in the bank's underlying credit portfolios in its securitisations. This can, for example, be caused by financial turmoil on the securitisation market, by a deterioration in the bank's financial stability or by a sharp increase in the credit risk in underlying credit portfolios. In these situations, the bank may find it difficult to issue new securitisations, or extend or replenish (in cases where 'replenishment periods' appear in the contract) existing securitisation transactions. This creates an inherent refinancing risk for banks that carry out securitisations.

If a bank is not able to issue new securitisation transactions, or extend or refill securitisation transactions, the bank will no longer be able to transfer credits (the credit risk, if it is a synthetic transaction) to securitisations. Existing credits or credits that have to be renewed or extended will then need to be financed (or the credit risk managed, for synthetic transactions) in another way.

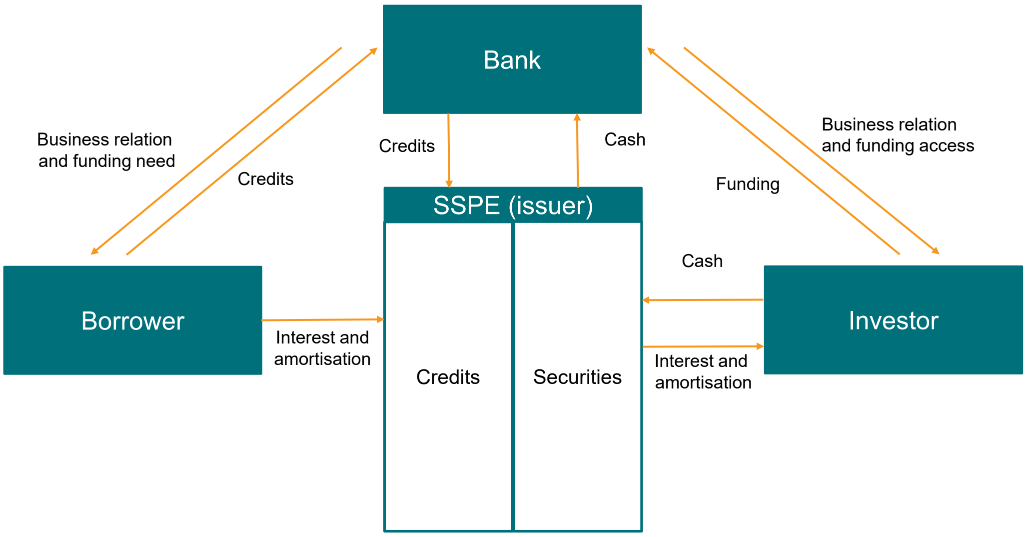
Refinancing risk can occur both for securitisations and for other kinds of financial transactions that have a fixed maturity. Various requirements in the regulations take into consideration the risk that this will make it difficult for banks to raise financing, for example, in order to satisfy the Liquidity Coverage Ratio (LCR) requirement and the Net Stable Funding Ratio Requirement (NSFR). The bank's need for capital will increase as a result of the scenarios described above if the bank chooses to take back the credit risk for credits that are not yet due, have been replaced or are being refinanced by another actor. Weaker market demand for a bank's securitisation transactions can therefore have a serious impact on the bank's capital need as well. The Capital Requirements Regulation currently does not limit the scope of the refinancing risks associated with securitisations or the reductions of capital requirements that a bank may take.

3.2 Flowback risks associated with securitisation

Article 247(1) of the Capital Requirements Regulation states that if a bank has transferred significant credit risk associated with the underlying exposures of the securitisation to external investors, the bank may exclude these exposures from the calculation of risk-weighted exposure amounts. Article 247(2) states that the bank in this case should instead calculate the risk-weighted exposure amounts for the positions that it holds in the securitisation. Articles 244 and 245 of the Capital Requirements Regulation and the EBA's guidelines[11] establish the conditions that apply when significant credit risk transfer is considered to have been met. The credit risk that is transferred to investors on the capital market during the maturity of the transaction can contribute to reducing the bank's total risk level and therefore its total capital requirement over a certain period of time.

A bank's relationship with its borrowers and investors in a traditional securitisation is shown in Figure 1. In both traditional and synthetic securitisations, the bank's business relationship with borrowers is based firstly on meeting the borrowers' financing needs with credits. In a traditional securitisation, investors primarily offer the bank financing. In a synthetic securitisation, the bank is instead offered means to manage credit risk.

Figure 1: Example structure and a bank's relationships in a traditional securitisation



[11] Guidelines on Significant Credit Risk Transfer relating to Articles 243 and Article 244 of Regulation (EU) No 575/2013, EBA/GL/2014/05.

Note: SSPE stands for Securitisation Special Purpose Entity.

During the financial crisis in 2008–2009, it was common for banks to offer support, beyond their contractual obligations, to investors in securitisation transactions in order to protect their own brand and minimise other reputational risks.[12] Reputational risks can result in banks choosing to offer support measures beyond their contractual obligations to investors, which is what happened during the global financial crisis. The banks do this to ensure continued access to funding and credit risk management on the capital markets, to protect their brand and to maintain good relationships with investors.

Article 250 of the Capital Requirements Regulation uses the term *implicit support* for support measures beyond contractual obligations in a securitisation. This is not permitted if the bank has applied Article 247(1) and 247(2) when calculating risk-weighted exposure amounts. Implicit support is when banks offer support beyond their contractual obligations for a securitisation in order to reduce potential or actual losses for investors. However, the Capital Requirements Regulation states that implicit support does not cover borrowers.

There are several reasons why a bank would provide support beyond its contractual obligations to borrowers. One reason is reputational risks. It is normal for the business relationship with the borrowers to be maintained at the bank for the credits that are included in a securitisation. With synthetic securitisations, the credit does not even leave the bank's balance sheet. It is therefore possible for the bank's borrowers not to be aware that their credits have been securitised. In a securitisation, the bank often continues to be responsible for the administration of the credits and the customer contact for the borrowers that are included in the securitisation. This means that the borrower will probably continue to view themselves as a customer of the bank. If a bank chooses not to offer an extension or refinancing of a credit, this could have a negative impact on the borrowers' perception of the bank. This could in turn damage the bank's brand and impair the bank's ability to maintain existing business relationships or establish new ones with its borrowers. This gives rise to a reputational risk, which can incentivise support measures for borrowers.

Another reason why a bank might offer support measures is to minimise credit losses. In addition to the securitised credits, the bank can continue to sell other credits or financial services to the same borrower. If a borrower is no longer in a financial position to repay the credit as set out in the agreement, or if the credit risk has increased in another way to such an extent that it is difficult to refinance the credit with another actor, this can lead to acute liquidity problems

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[12] BCBS, Enhancements to the Basel II Framework, July 2009, section 47. Reputational risk is the negative impact on the bank's access to funding sources and its ability to maintain existing business relationships or establish new ones as a result of a negative perception from customers, counterparties, shareholders, investors, holders of debt instruments, market analysts, supervisory authorities or other relevant parties.

for borrowers that are not receiving financing. In a worst-case scenario, this could result in liquidation. If a bank has other credit exposures with the borrowers, in addition to the securitised credits, the bank may experience credit losses. This means that a bank may also offer support measures to minimise potential credit losses.

FI's assessment is that in most cases a bank will offer support measures, beyond its contractual obligations, to borrowers in order to, inter alia, protect its brand, limit other reputational risks and minimise credit losses. Although it is not negative in itself for a bank to offer support measures to borrowers, the credit risks will flow back to the bank's balance sheet if it chooses to extend or renew the credits outside the securitisation. This is because the credit risks through the securitisation are no longer transferred to external investors. Consequently, the positive impact that the securitisation has on the capital requirement is removed, and the bank's capital position becomes weaker. It is therefore important for banks to have the capacity to manage the flowback.

Against this background, FI defines flowback risk in the following way:

Flowback risk is the risk that credit risks or other risks associated with credits will flow back to the bank. Flowback occurs when the bank gives support, beyond its contractual obligations, to borrowers in order to minimise other potential risks.

4 Method for assessing an additional own funds requirement for flowback risks associated with securitisation and other forms of risk transfers that can give rise to material flowback risks like those associated with securitisation

4.1 Scope

4.1.1 Finansinspektionen's position

FI will apply the method for assessing flowback risks associated with securitisation in its calculation of an additional own funds requirement. This method covers banks that carry out traditional and synthetic securitisations, where the conditions for the transfer of significant credit risk to a third party are considered to have been met.

FI will apply this method to banks where the flowback risk is assessed as being significant in a supervisory review and evaluation process. FI's assessment is that this will as a starting point apply to banks in Supervision Categories 1 and 2. In some exceptional cases, it may also apply to banks in Supervision Categories 3 and 4, where the method will be applied following a separate evaluation process.

In terms of the banks' capital needs for flowback risks associated with securitisation, FI will start by assessing this at a group level, based on the bank's consolidated situation. In its supervisory review and evaluation process at an individual level for the legal units within the group, the starting point will therefore be the additional own funds requirement for flowback risks associated with securitisation at a group level. Based on this, an assessment will be made of the extent to which the additional own funds requirement at group level will be distributed to each legal entity in the group.

If FI believes that it is justified from a risk perspective, FI may expand the scope to include other forms of risk transfers similar to securitisation, which could result in significant flowback risks. The method is applicable, for example, to some peribank[13] structures with alternative investment funds (AIF).

4.1.2 Feedback received

The Swedish Bankers' Association and *the Association of Swedish Finance Houses* state that FI should not expand the scope to include other forms of risk transfers that could result in a flowback risk similar to securitisation. These consultation bodies believe that it has to be very clear what is covered by the capital assessment method to enable informed business decisions.

The Swedish Bankers' Association states that it has to be very clear when this method will be applied and for which banks. The Swedish Bankers' Association also raises the question as to why not all banks are covered by this proposal, regardless of their supervision category. It believes that the materiality criteria should apply to all supervision categories.

The Association of Swedish Finance Houses believes that the proposal in the consultation memorandum would lead to greater uncertainty for institutions in Supervision Categories 3 and 4 in terms of whether or not they need to meet any requirements.

The Swedish National Debt Office states that FI has to make it clear what is means by "transactions that are fundamentally similar to securitisation" so that companies and other stakeholders can better predict the consequences of this proposal.

4.1.3 Grounds for Finansinspektionen's position

The method for flowback risks associated with securitisation covers securitisations where the conditions for the transfer of significant credit risk to a third party are considered to have been met in accordance with the Capital Requirements Regulation. FI's supervisory activities include assessing whether securitisations, which according to the banks result in significant credit risk

[13] *Peribank structures* refers here to a structure that a bank establishes outside of its Group structure and that is not subject to consolidation in the consolidated situation.

transfer, meet the conditions set out in the Capital Requirements Regulation and the EBA's guidelines. This assessment takes into account, inter alia, the structure of the transaction, the credit risk of the underlying credits and other factors that affect the transfer of credit risks.

The reason why it is only securitisations that are considered to meet the conditions for significant credit risk transfer covered by this method is because it is only in these situations that securitisations have the effect of reducing the capital requirement. If the conditions for significant credit risk transfer are not met, the underlying credits in a securitisation need to be treated, in terms of capital requirements, as if they had not been securitised. This means that it is only if significant credit risk transfer is considered to have taken place that credit risks and other risks can flow back to the bank.

The Swedish Bankers' Association and *the Association of Swedish Finance Houses* state that it should be made clear which companies are covered by the method. The Swedish Bankers' Association also raises the question as to why not all banks are covered by this proposal, regardless of their supervision category. FI has made it clear that the method applies if the flowback risk is assessed as being significant. However, FI's assessment is that this will as a starting point apply to banks in Supervision Categories 1 and 2. In some exceptional cases, it may also apply to banks in Supervision Categories 3 and 4, where the method will be applied following a separate evaluation process.

FI believes that flowback risk may also be relevant for certain specific transactions that are fundamentally similar to securitisation, but are not included in the definition of securitisation in the Capital Requirements Regulation. Against this background, FI (in cases where it can be particularly justified from a risk perspective) intends also to apply the method to other forms of credit risk transfers that cause the same kind of flowback risks. Examples of transactions and structures that could, in specific instances, cause the same kind of flowback risks are 'sub participation transactions' and peribank financing structures, for example some peribank[14] structures with alternative investment funds (AIF) that handle lending. Lending refers to both direct and indirect lending.[15]

In peribank AIF structures, credit risk transfers can occur that give rise to the same type of flowback risks as in securitisations. Therefore, from a risk perspective, it can be specifically justified to apply the method in a corresponding manner to manage these flowback risks. For an AIF that is closely associated with a bank, transactions are assessed based on the same criteria as for securitisation. In part, the financial substance, the refinancing

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[14] Peribank structures refers here to a structure that a bank establishes outside the Group structure and that does not entail consolidation in the consolidated situation.
[15] https://www.fi.se/sv/publicerat/sarskilda-pm-beslut/2023/konsolidering-av-aifer-och-andra-liknande-alternativa-strukturer--fortydligande-av-begreppet-utlaning-i-kapitaltackningsdirektivet/

risk and the reputation risk are assessed; in other words, the risks that are already described in this memorandum.

In the same manner as for securitisation, the method does not limit the banks' possibilities for setting up peribank AIF structures, but it does limit the capital requirement-related incentives in cases where the bank would choose to structure the transactions in a way that increases the risks associated with flowback. The method is applied in cases where there is no consolidation of the AIF according to the regular consolidation rules within Pillar I, which is clarified through the memorandum "Konsolidering av AIF:er och andra liknande alternativa strukturer – förtydligande av begreppet utlåning i kapitaltäckningsdirektivet"[16].

The Swedish Bankers' Association, the Association of Swedish Finance Houses and *the Swedish National Debt Office* state that it should be made very clear which kinds of transactions and structures are covered by this method. There are several possible kinds of transactions and structures that could cause flowback risks, which makes it difficult to specify every possible scenario. The bank needs to analyse potential flowback risks on a case-by-case basis. In this context, FI would also like to point out that our ambition is to use method memorandums to give these banks as much insight as possible into the considerations we apply when determining an additional own funds requirement, but that these methods will never cover every single risk and risk element that have to be assessed. FI will therefore sometimes assess an additional capital increase that is not the direct result of a method. The banks are always given the opportunity to comment on FI's deliberations on a decision, before a decision is made.

4.2 Fundamental assumptions for the assessment

4.2.1 Finansinspektionen's position

FI will apply the following assumptions when assessing the bank's additional own funds requirement under Pillar 2:

a) No new securitisation transactions can be issued by the bank.

b) The credits that have been securitised will be renewed in most cases once the contract has expired, with some specific exceptions.

[16] https://www.fi.se/sv/publicerat/sarskilda-pm-beslut/2023/konsolidering-av-aifer-och-andra-liknande-alternativa-strukturer--fortydligande-av-begreppet-utlaning-i-kapitaltacksningsdirektivet/. Available only in Swedish.

4.2.2 Feedback received

The Swedish Bankers' Association states that it is not reasonable for the proposal in the consultation memorandum to be based on assumptions of credits being extended beyond the contract, that securitisations cannot be structured to manage refinancing risk and the securitisation market's functionality under stress. The method should be based on reasonable assumptions and not on worst-case scenarios. The Swedish Bankers' Association believes that FI has used an unusual argument that is based on a bank whose capital ratios are so stressed that it would breach its own requirements in the event of flowback, and would even choose to do this under stress.

The Association of Swedish Finance Houses states that the proposal is conceptually wrong and is in violation of the fundamental principles for sound risk and capital assessment; an institution being free to choose whether or not to renew exposures cannot be viewed as a risk. Furthermore, the Association of Swedish Finance Houses believes that the proposal is based on the incorrect assumption that the securitisation structure does not have any mitigating impact on refinancing risk and incorrect assumptions about how the securitisation market functions under stress.

The Swedish Savings Banks Association states that the proposal is based on the assumption of extending credits beyond the contract. It believes that a bank's ability to act to protect its reputation and brand within the framework of what its capitalisation allows does not mean that a capital requirement will be triggered. The Swedish Savings Banks Association also states that the proposal is not institution-specific and that the risk may therefore not be covered under Pillar 2.

4.2.3 Grounds for Finansinspektionen's position

Financial stress at a bank can be institution-specific or originate from widespread stress on the financial markets and from the economy as a whole. If there is widespread stress on the financial markets and the economy as a whole, a number of events normally happen simultaneously. This means that turmoil spreads rapidly to other actors and financial markets. Experiences from the global financial crisis in 2008–2009 show that volumes of issued European securitisations decreased sharply. A similar effect, if not as severe, has been identified in the wake of the current coronavirus crisis. Consequently, FI believes that market liquidity for securitisations under stressed situations can deteriorate quickly and sharply, and can remain under stress for a long period of time.

The Swedish Bankers' Association, the Swedish Savings Banks Association and the Association of Swedish Finance Houses state that the method is based on incorrect assumptions about how the securitisation market functions under stress. They therefore believe that the method is not institution-specific.

FI would therefore like to clarify that even if it is still possible for some actors to issue new securitisations during periods of widespread financial stress, it does not mean that all banks are able to do this. The ability to refinance securitisation transactions could even be much more difficult for an individual bank than for the market as a whole. The bank would find it difficult to issue new securitisations or it would be much more expensive to do this if investors demand higher yields for their risk-taking.

We are aware that the assumption of the bank not being able to carry out any transactions reflects the risk in a worst-case scenario. The Swedish Bankers' Association states that the method should be based on reasonable assumptions and not on worst-case scenarios. However, FI believes that this assumption is justified given the experiences from the global financial crisis. We also want to highlight the fact that the financial stress that the method refers to is a situation that occurs when the issue volumes and their impact on the bank's total capital ratio exceed the thresholds for the conditions set out in this memorandum. Flowback and volumes below these thresholds do not result in an additional own funds requirement.

FI also assumes that the credits that have been securitised will be renewed in most cases once the contract has expired, with some specific exceptions. The specific exceptions we are referring to are credits or securitisation transactions that are assessed as having a low flowback risk. *The Swedish Bankers' Association* and *the Association of Swedish Finance Houses* believe that FI does not take into consideration any effects that a securitisation structure may have on the refinancing risk in terms of the flowback risk. The exceptions we refer to include the kinds of transactions where the structure results in a low flowback risk. In other words, there are opportunities to structure a transaction in such a way that the flowback risk is assessed as being low.

The Swedish Bankers' Association, the Swedish Savings Banks Association and *the Association of Swedish Finance Houses* believe that it is not reasonable for the method to be based on the assumption of extending credits beyond the contract. However, FI's assessment is that the assumption that in most cases banks renew credits that have been securitised at the end of their maturity is justified. During the financial crisis in 2008–2009, individual banks offered support, beyond their contractual obligations, to investors in securitisation transactions in order to, inter alia, minimise reputational risks. Since the introduction of the Capital Requirements Regulation, implicit support has not been allowed. In this consultation memorandum, FI assesses that in most cases individual banks will offer support measures, beyond their contractual obligations, to borrowers who have a continued need for financing once the securitisation has expired. The banks do this, inter alia, to protect their brand, minimise other reputational risks and limit credit losses.

The Swedish Bankers' Association also states that it is not reasonable to assume that a bank's capital ratios would be so stressed that it would breach its requirements in the event of flowback, and would still choose to do this under stress. FI would like to clarify that the assumption that a bank renews credits beyond its contract is not based on a bank acting in this way if it knows in advance that the capital ratios would fall below the requirements that apply at any given time. However, capital ratios can be strained in the event of flowback, which increases the bank's vulnerability. FI's method limits this vulnerability.

4.3 Thresholds for significant flowback risks

4.3.1 Finansinspektionen's position

As part of its supervisory review and evaluation process, FI will decide on an additional own funds requirement for flowback risk associated with securitisation if a minimum of one of the following conditions is met.

A decision on an additional own funds requirement will be made if:

1. the bank's total capital ratio falls by at least 50 basis points over a future 12-month period due to the flowback of securitised credits, and/or

2. the exposure value for the bank's securitised credits exceeds 15% of the bank's total exposure value for the relevant exposure classes.

A future 12-month period refers to a calendar year. This means that the first and last period can be shorter than 12 months. Flowback has to be calculated for all future 12-month periods across the life of all transactions. The calculation must be made using up-to-date and relevant data for all securitisation transactions at any time.

The exposure value in condition 2 for securitised credits in the relevant exposure classes must be calculated as if they had not been securitised. The total exposure value for relevant exposure classes must include the securitised credits as if they had not been securitised.

If a bank meets both conditions 1 and 2, the condition that entails the highest additional own funds requirement will be applied.

4.3.2 Feedback received

The Riksbank states that flowback can lead to a sudden increase in the capital need, which can have a negative impact on a bank's financial position. Against this background, the Riksbank shares FI's assessment that banks will continue to cover the flowback risks that they are exposed to through their securitisations. However, the Riksbank notes that the proposal potentially reduces the current capital requirement for flowback risks. As the risks associated with this kind of activity have not diminished, the Riksbank believes that the capital requirement should at least be maintained.

The Association of Swedish Finance Houses states that a securitisation transaction that meets all the rules for credit risk transfer must result in a reduction in the capital requirement in accordance with the Capital Requirements Regulation. As this proposal neutralises this effect and does not result in a reduction in the capital requirement, the Association of Swedish Finance Houses believes it is not consistent with the Capital Requirements Regulation.

The Swedish Savings Banks Association states that the method set out in the memorandum is a national restriction on the securitisation rules in the Capital Requirements Regulation, which allows for capital adequacy relief in the event of significant credit risk transfer. It questions whether this kind of national restriction is permitted. It also believes that the proposal is not institution-specific, as the conditions are similar to tariffs.

The Swedish Bankers' Association believes that this proposal is not compatible with the Capital Requirements Regulation, the EBA's Guidelines on Significant Credit Risk Transfer and therefore the primacy of EU law. A securitisation that meets all the conditions for credit risk transfer must result in a reduction in capital requirements pursuant to the Capital Requirements Regulation. The Swedish Bankers' Association believes that FI's proposal is contrary to the Capital Requirements Regulation and the EBA's guidelines because, both in terms of its purpose and its design, it neutralises the effect of the regulation by proposing restrictive thresholds.

The Swedish Bankers' Association believes that condition 1 will result in highly capitalised banks being hit harder. This is because a highly capitalised bank will meet this condition more quickly, and thus will be more restricted by this proposal. The Swedish Bankers' Association further states that it is better to relate the condition to the impact that a securitisation has on a bank's risk-weighted exposure amounts and to express the condition as a percentage of its own funds.

The Swedish Bankers' Association believes that condition 2 must be removed. This condition is not considered to be appropriate as flowback would have a minimal impact on the bank's capitalisation and financial stability. Furthermore, the Swedish Bankers' Association believes that this condition hits banks with a diversified portfolio harder. According to the Swedish Bankers' Association, it means that smaller banks will be excluded from the securitisation market and that it could cause problems when credits change exposure class.

The Swedish Bankers' Association believes that FI's proposal means that an important recovery measure will be taken off the table. It is important for banks to have access to several recovery measures to enable them to strengthen their capital situation. This is not only important for an individual bank, but also for financial stability.

4.3.3 Grounds for Finansinspektionen's position

The Association of Swedish Finance Houses, the Swedish Savings Banks Association and the Swedish Bankers' Association believe that FI's Pillar 2 method for assessing flowback risk associated with securitisation is not compatible with the Capital Requirements Regulation, the EBA's Guidelines on Significant Credit Risk Transfer and therefore EU law.

FI does not believe that this method could be considered to contravene EU law. The method does not affect the banks' application of the rules on significant credit risk transfer, which means that it does not affect the capital requirement for credit risk. The neutralising effect referred to by the Association of Swedish Finance Houses, the Swedish Bankers' Association and the Swedish Savings Banks Association probably relates to the overall capital requirement that FI believes is justified to cover the additional flowback risks. FI's assessment is that these flowback risks are not covered under Pillar 1. We would also like to make reference in this context to the provisions in the Supervision Act and the Capital Requirements Directive, as well as FI's description of flowback risks associated with securitisation.

However, FI believes, just like *the Swedish Bankers' Association*, *the Swedish Savings Banks Association* and *the Association of Swedish Finance Houses*, that the proposed calculation method for determining the level of the additional own funds requirement could have certain unwanted consequences that do not reflect the flowback risks that an individual bank is exposed to. FI has therefore adjusted its calculation (see Section 4.4). The updated calculation means that the capital requirement for the flowback risks will never exceed the capital requirement for the credits in Pillar 1, as if they had not been securitised. As a result of this, FI believes that the banks are able to carry out securitisation transactions, while taking into consideration the flowback risks.

This method aims to include flowback risks as part of FI's supervisory review and evaluation process of a bank and ensures that a bank covers the flowback risks that it is exposed to. *The Riksbank* shares FI's assessment that flowbacks can cause a sudden increase in capital needs and can therefore have a negative impact on a bank's financial position. Just like FI, the Riksbank believes that a bank must cover these risks.

The Swedish Bankers' Association states that condition 1 would result in highly capitalised banks being hit harder. It therefore believes that it would be better instead to relate this condition to the impact that a securitisation has on a bank's risk-weighted exposure amounts.

FI agrees that the technical design of the condition, all things being equal, would result in highly capitalised banks being affected more quickly by the condition. FI has considered the Swedish Bankers' Association's proposal to relate this condition to the impact on the risk-weighted exposure amounts instead, but assesses that this kind of condition risks missing the direct impact that a securitisation can have on own funds. Furthermore, FI's assessment is that it is important to relate the condition to the purpose of the method, i.e. to ensure that an individual bank has the capacity to manage the impact that flowback can have on its capital situation.

Against this background, FI believes that a suitable threshold for flowback across a future 12-month period remains an impact of 50 basis points on the total capital ratio. In addition, the purpose of having the threshold at 50 basis points is to give banks the incentive to structure transactions in such a way that spreads the flowback risk across the life of the securitisation.

FI's assessment is that banks that carry out transactions where the flowback falls below 50 basis points across a future 12-month period can be expected to hold sufficient capital or manage the flowback risk in another way. FI also assesses that if a bank meets condition 1 and holds sufficient capital according to the adjusted calculation, it will be able to manage flowback risks. FI also assesses that the adjusted calculation will result in highly capitalised banks not being hit significantly harder by condition 1.

Under the Pillar 2 method for systemic risk associated with securitisation from 2017, there were two thresholds in condition 1. A threshold of 25 basis points for banks in Supervisory Category 1 and a threshold of 50 basis points for banks in Supervisory Category 2. These two different thresholds were based on the fact that the systemic risk of feedback associated with securitisation was assessed as being higher for banks in Supervisory Category 1. As systemic risk is not included in Pillar 2, there is no longer any reason to have two different thresholds in the updated Pillar 2 method for flowback risk associated with securitisation.

The Swedish Bankers' Association also states that it believes that condition 2 should be removed. FI still thinks that there is reason for a bank to consider the consequences of an unstable market over a long period of time, where the bank's flowback across a 12-month period would not exceed the method's threshold in condition 1, but where the overall flowback risk would be significant for the bank's operations. FI therefore believes that there is a need to ensure that a bank has the capacity to manage its total flowback risk. We estimate that an appropriate limit for condition 2 is 15% of the bank's total exposure value in the relevant exposure classes.

FI agrees that banks with a diversified credit portfolio, all things being equal, will be hit by condition 2 more quickly than banks with a concentrated credit portfolio. Having adjusted the calculation, FI believes that banks with a diversified credit portfolio will not be hit much harder by condition 2.

The Swedish Bankers' Association states that the proposal would result in smaller banks being excluded from the securitisation market and that FI's proposal means that an important recovery measure will be taken off the table. FI believes that a bank, regardless of size, will not be prevented from issuing securitisations that exceed the method's thresholds and therefore achieve the volumes that the Swedish Bankers' Association believes are normally required to attract institutional investors. Similarly, a bank is also not prevented from using securitisations as a recovery alternative. However, in this situation FI believes that a bank must hold sufficient capital to have the capacity to manage any additional significant flowback risks. Having adjusted the calculation, FI believes that banks, regardless of their size, will be able to use securitisation as part of their risk management and as a recovery alternative, while taking into consideration the flowback risks.

In the capital assessment method for systemic risk associated with securitisation from 2017, FI believed that there was a need to ensure that lending to an individual geographic market did not exceed a significant proportion of the total lending to the geographic market. This was based on the fact that FI believed that significant flowbacks for individual geographic markets could have major negative consequences on the credit supply for these geographic areas. As the updated method is no longer based on systemic risk, there is no longer any reason to take individual geographic markets into considerations.

If banks carry out securitisations below the thresholds, a capital requirement will not normally be calculated. However, FI expects banks, even in these situations, to evaluate and analyse their exposure to flowback risks as part of their internal capital adequacy assessment.

4.4 Calculation of additional own funds requirement

4.4.1 Finansinspektionen's position

The additional own funds requirement for flowback risks associated with securitisation under Pillar 2 will be calculated as follows:

$$\mathrm{P2R}_{\text{flowback risk}} = \mathrm{REA}_{flowback} * \mathrm{CR} * \mathrm{F}_{\mathrm{rf}}$$

Variable	**Explanation**
$\mathrm{REA}_{\mathrm{flowback}}$	Risk-weighted exposure amount from the flowback to the bank's own balance sheet (above the applicable condition) across all future 12-month periods.
F_{rf}	Flowback risk factor, amounts to 75%.
CR	Applicable capital requirement as a percentage for the bank, as if the underlying capital exposures had not been securitised, excluding countercyclical capital buffer and capital conservation buffer. Including any asset-specific capital requirements for underlying credit exposures in securitised credit portfolios.

When calculating the additional own funds requirement, FI intends to apply an even risk distribution in securitised credit portfolios.[17]

4.4.2 Feedback received

The Riksbank states that this proposal potentially reduces current capital requirements. As the risks associated with this kind of activity have not diminished, the Riksbank believes that the capital requirement should at least be maintained.

The *Swedish Bankers' Association* states that the level of the proposed additional own funds requirement (for those carrying out securitisations where the method's thresholds are exceeded) is larger for banks with a higher total capital ratio, all things being equal. The Swedish Bankers' Association believes that this creates distorted incentives for banks.

In addition, the Swedish Bankers' Association states that FI's proposed calculation, under certain conditions, may result in a bank's capital requirement increasing when carrying out a securitisation, as the calculation is based on a bank's total capital ratio. The Swedish Bankers' Association believes that it is not reasonable for the capital requirement to increase as a result of securitisations. This is because securitisations that meet the conditions for significant credit risk transfer in the Capital Requirements Regulation and the EBA's guidelines reduce the credit risk, according to the Capital Requirements Regulation.

The Swedish Bankers' Association proposes an alternative calculation of the level for the additional own funds requirement that is based on the impact that a securitisation has on a bank's risk-weighted exposure amounts. The risk-weighted exposure amounts on which the calculation is based must be lower than the reduction in risk-weighted exposure amounts caused by a securitisation that meets the conditions for significant credit risk transfer. This recognises the reduction in credit risk caused by a securitisation, according to the Capital Requirements Regulation. An additional own funds requirement should then be translated using a capital ratio of 10.5% in order to exclude systemic risk, according to the Swedish Bankers' Association's proposal.

4.4.3 Grounds for Finansinspektionen's position

FI agrees with the *Swedish Bankers' Association* that the technical design of the calculation to determine the level of the additional own funds requirement for flowback risks associated with securitisation could result in unwanted incentives. FI also agrees that the own funds requirement should fall as a result of a securitisation if the conditions for significant credit risk transfer are met,

[17] An even risk distribution refers to the same average risk weighting for the securitised credit portfolio as a whole.

but that flowback risks should still be taken into consideration. Consequently, FI has adjusted the calculation of the additional own funds requirement.

However, FI does not agree with the Swedish Bankers' Association that the level for the additional own funds requirement should be translated using a capital ratio of 10.5%. The method aims to ensure that an individual bank has the capacity to manage significant flowbacks. A bank will have to cover credits that flow back with the applicable capital requirement. FI therefore believes that the capital requirement that is most appropriate to use when calculating an additional own funds requirement for flowback risk is the one that applies to each bank. For systemically important institutions, this means that the systemic risk buffer and the O-SII buffer should be included in the calculation.

However, FI believes that the capital requirement level for flowback risks should be adjusted for the countercyclical capital buffer and the capital conservation buffer. This is because these buffers are intended in various ways to cover losses that may occur under financial stress. The flowback risk associated with securitisation can occur during critical periods, when it can be assumed that these buffers will be used. FI therefore believes that the level for the additional own funds requirement for flowback risks should be reduced by both the countercyclical capital buffer and the capital conservation buffer. The countercyclical capital buffer and capital conservation buffer are therefore excluded from the applicable capital requirement in their calculation. Asset-specific capital requirements[18] for exposures in the underlying securitised portfolio must be included in the calculation for the additional own funds requirement for flowback risks.

The adjusted calculation of the additional own funds requirement is based on the risk-weighted exposure amounts that flow back (above the relevant threshold) to the bank. The risk-weighted exposure amounts from flowbacks above the relevant threshold are multiplied by the applicable capital requirement and flowback risk factor. See Section 4.6 for calculation examples.

As FI has mentioned previously, securitisations can be difficult to refinance under certain circumstances. FI's assessment is that in most cases a bank will offer financing, beyond its contractual obligations, to borrowers outside the securitisation if the borrower still has financing needs and new securitisations can no longer be issued. The banks do this, inter alia, to protect their brand, limit other reputational risks and minimise credit losses. Against this background, FI's assessment is that a flowback risk factor of 75% is appropriate.

The Riksbank believes that the risks associated with securitisations have not diminished and that the level of capital requirements must be maintained. FI

[18] Examples of asset-specific capital requirements are the risk weight floors for mortgages (FI no. 20-20493) and loans for commercial real estate (FI no. 19-14171).

agrees with the Riksbank that the risks associated with securitisations have not diminished. FI believes that if a bank holds sufficient capital in accordance with the adjusted calculation described above, it should been in a good position to manage flowback risks in a satisfactory way, and that a bank, regardless of its capital situation, can use this to reduce its credit risk.

4.5 Exclusions from the scope

4.5.1 Finansinspektionen's position

FI will exclude the following credit types from the additional own funds requirement for flowback risks associated with securitisation:

1. loans for the following three specific purposes:

   a) specific financing for exports of goods and services (export credit),

   b) bridge financing with a contractual maturity of a maximum of 12 months

   c) non-revolving loans secured against receivables.

2. bank guarantees that have a final expiry date within 2.5 years of the date of issue with no possibility for restructuring or extension

3. construction loans

4. documentary credits.

If FI assesses that other credit types have a low flowback risk, they will also be excluded from the calculation of additional own funds requirements.

If FI assesses that the structure of a securitisation involves a low flowback risk, this securitisation will be excluded from the calculation of the additional own funds requirement.

4.5.2 Feedback received

The *Swedish Bankers' Association* requests clarification of which other kinds of credit and which kinds of securitisation structures may be covered by the kind of assessment that would lead to them being excluded from the additional own funds requirement. The Swedish Bankers' Association believes that STS securitisations[19] should be excluded as they protect investors and create a more stable market that is more resilient to shocks, which reduces the risk of investors leaving the market under stress.

4.5.3 Grounds for Finansinspektionen's position

[19] STS securitisations are securitisations that meet the requirements for 'simple, transparent and standardised' (STS) securitisation in accordance with the Securitisation Regulation.

The flowback risk can be considered to be low if a bank chooses to securitise credits where the borrower does not expect to extend their credits upon maturity, or credits where the borrower no longer has a financing need after the credits reach maturity. This could in turn justify exclusion from the capital assessment method for flowback risks associated with securitisation.

The securitised portfolio may, for example, contain credits for which the borrowers have neither a need for, nor an expectation of, the financing continuing after maturity. As neither the borrowers nor the bank in these cases expect the credits to be extended or renewed at the maturity of the securitisation transactions, the flowback risk can be assessed as being low. The expectations for refinancing could also be linked to the brand. For example, flowback risk can be assessed to be low when the borrowers do not associate their credits with a bank in any way. In these cases, there is less incentive for a bank to protect its brand by taking over the credit risk in the event of refinancing. Consequently, FI does not intend to set an additional own funds requirement for credits with a low flowback risk.

Securitisation transactions may also be structured in such a way as to manage or limit the flowback risk. This may include, for example, securitisations that guarantee a certain number of extensions to the transaction, under all circumstances. These transactions result in no flowback risk or that flowbacks will materialise later if there are flowback risks at the end of the final extension to the transaction. Against this background, FI intends not to establish an additional own funds requirement for securitisation transactions whose structure has a low flowback risk.

The Swedish Bankers' Association has stated that STS securitisations should be excluded from this method. FI agrees with the Swedish Bankers' Association that the STS framework was set up to create a more stable market. However, in principle, an STS securitisation for individual banks is still associated with the same flowback risks as other securitisation transactions. FI's assessment is therefore that STS securitisations should not be excluded from the scope of this method.

4.6 Calculation examples

Calculation example A

Bank A's total securitisation transactions for corporate credits comprise 10% of its total exposure value in exposure class corporates. Bank A therefore does not meet condition 2. Bank A is a systemically important bank, which means that it is covered by the systemic risk buffer and the O-SII buffer in its capital requirement.

The applicable capital requirement for calculating an additional own funds requirement for flowback risks associated with securitisations is assumed to amount to 14.5%. This capital requirement comprises 8% minimum requirement, 3% systemic risk buffer, 1% O-SII buffer and 2.5% Pillar 2 requirements, of which 1% is asset-specific Pillar 2 requirements associated with credits that have commercial real estate as collateral. The securitised credit portfolio consists entirely of credits that are met by the asset-specific Pillar 2 requirement.

Example calculation A	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Exposure value$_{securitisation}$	60,0	60,0	60,0	60,0	60,0	60,0
Exposure value$_{relevant\ exposure\ class}$	600,0	600,0	600,0	600,0	600,0	600,0
REA$_{pre\text{-}securitisation}$	100,0	100,0	100,0	100,0	100,0	100,0
REA$_{post\text{-}securitisation\ excl.\ flowback}$	90,0	90,0	90,0	90,0	90,0	90,0
REA$_{accumulated\ flowback}$	0,0	0,0	0,0	3,3	6,7	10,0
Own funds	20,0	20,0	20,0	20,0	20,0	20,0
Total capital ratio$_{pre\text{-}securitisation}$	20,00%	20,00%	20,00%	20,00%	20,00%	20,00%
Total capital ratio$_{post\text{-}securitisation}$	22,22%	22,22%	22,22%	21,43%	20,69%	20,00%
Flowback effect on total capital ratio	2,22%	0,00%	0,00%	-0,79%	-0,74%	-0,69%
Condition 1 (0.50%)	Yes	No	No	Yes	Yes	Yes
Condition 2 (15%)	No	No	No	No	No	No
P2R$_{flowback\ risk\ condition\ 1}$	0,35	0,00	0,00	0,13	0,12	0,10
CR$_{pre\text{-}securitisation}$	17,00					
CR$_{post\text{-}securitisation}$	15,65					

The calculation of the additional own funds requirement for flowback risks associated with securitisation for Bank A across five future 12-month periods is illustrated above. Amounts are in SEK million.

Bank A meets condition 1 for three 12-month periods (years 3, 4 and 5). A capital requirement for flowback risk associated with securitisation is therefore calculated.

The additional own funds requirement for flowback amounts to:

- year 3 SEK 0.13 million (3.3 * [29/79] * 75% * 14.5%)
- year 4 SEK 0.12 million (3.3 * [24/74] * 75% * 14.5%)
- year 5 SEK 0.10 million (3.3 * [19/69] * 75% * 14.5%).

The additional own funds requirements is therefore a total of SEK 0.35 million.

We assume that the total capital requirement is 17%. After the securitisation, the total capital requirement, including the additional own funds requirement for flowback risks, will therefore be SEK 15.65 million (90 million * 17% + SEK 0.35 million).

Calculation example B

Bank B's total securitisation transactions for corporate credits are 24% of its exposure value in exposure class corporates. Bank B is a non-systemically important bank.

The applicable capital requirement for calculating the additional own funds requirement for flowback risks associated with securitisation is assumed to be 9% (8% + 2% - 1%). The capital requirement comprises 8% minimum requirement and 2% Pillar 2 requirements, of which 1% is asset-specific Pillar 2 requirements. There are no credits that meet an asset-specific Pillar 2 requirement in the securitised credit portfolio.

The calculation of the additional own funds requirement for flowback risks associated with securitisation for Bank B across five future 12-month periods is illustrated below. Amounts are in SEK million.

Example calculation B	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Exposure value$_{\text{securitisation}}$	120,0	120,0	120,0	120,0	120,0	120,0
Exposure value$_{\text{relevant exposure class}}$	500,0	500,0	500,0	500,0	500,0	500,0
REA$_{\text{pre-securitisation}}$	100,0	100,0	100,0	100,0	100,0	100,0
REA$_{\text{post-securitisation excl. flowback}}$	88,0	88,0	88,0	88,0	88,0	88,0
REA$_{\text{accumulated flowback}}$	0,0	2,4	4,8	7,2	9,6	12,0
Own funds	16,0	16,0	16,0	16,0	16,0	16,0
Total capital ratio$_{\text{pre-securitisation}}$	16,0%	16,0%	16,0%	16,0%	16,0%	16,0%
Total capital ratio$_{\text{post-securitisation}}$	18,18%	17,70%	17,24%	16,81%	16,39%	16,00%
Flowback effect on total capital ratio	2,18%	-0,48%	-0,46%	-0,43%	-0,41%	-0,39%
Condition 1 (0.50%)	No	No	No	No	No	No
Condition 2 (15%)	Yes					
P2R$_{\text{flowback risk condition 2}}$	0,30					
CR$_{\text{pre-securitisation}}$	12,50					
CR$_{\text{post-securitisation}}$	11,30					

Bank B meets condition 2, but not condition 1. A capital requirement for flowback risk associated with securitisation is therefore calculated.

Total remaining accumulated flowbacks increase the risk-weighted exposure amount by SEK 12 million. The additional own funds requirement in Pillar 2 for flowback risk associated with securitisation therefore corresponds to SEK 0.30 million (SEK 12 million * [9/24] * 75% * 9%).

We assume that the total capital requirement amounts to 12.5%. After the securitisation, the total capital requirement, including the additional own funds requirement for flowback risks, will therefore be SEK 11.30 million (88 million * 12.5% + SEK 0.30 million).

Calculation example C

Bank C’s total securitisation transactions for corporate credits comprise 35% of its total lending in exposure class corporates. Bank C is a systemically important bank.

The applicable capital requirement for calculating the additional own funds requirement for flowback risks associated with securitisation is assumed to be 14.1% (8% + 3% + 1% + 2% + [0.5% * 20%]). The capital requirement comprises 8% minimum requirement, 3% systemic risk buffer, 1% O-SII buffer and 2% Pillar 2 requirements, of which 0.5% is asset-specific Pillar 2 requirements. The securitised portfolio consists of 20% credits that are met by the asset-specific Pillar 2 requirement.

The calculation of the additional own funds requirement for flowback risks associated with securitisation for Bank C across five future 12-month periods is illustrated below. Amounts are in SEK million.

Example calculation C	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Exposure value$_{\text{securitisation}}$	140,0	140,0	140,0	140,0	140,0	140,0
Exposure value$_{\text{relevant exposure class}}$	400,0	400,0	400,0	400,0	400,0	400,0
REA$_{\text{pre-securitisation}}$	100,0	100,0	100,0	100,0	100,0	100,0
REA$_{\text{post-securitisation excl. flowback}}$	85,0	85,0	85,0	85,0	85,0	85,0
REA$_{\text{accumulated flowback}}$	0,0	0,0	1,5	6,0	13,0	15,0
Own funds	22,0	22,0	22,0	22,0	22,0	22,0
Total capital ratio$_{\text{pre-securitisation}}$	22,00%	22,00%	22,00%	22,00%	22,00%	22,00%
Total capital ratio$_{\text{post-securitisation}}$	25,88%	25,88%	25,43%	24,18%	22,45%	22,00%
Flowback effect on total capital ratio	3,88%	0,00%	-0,45%	-1,26%	-1,73%	-0,45%
Condition 1 (0.50%)	Yes	No	No	Yes	Yes	No
Condition 2 (15%)	Yes					
P2R$_{\text{flowback risk condition 1}}$	0,81	0,00	0,00	0,29	0,53	0,00
P2R$_{\text{flowback risk condition 2}}$	0,91					
CR$_{\text{pre-securitisation}}$	16,50					
CR$_{\text{post-securitisation}}$	14,93					

The bank meets condition 1 for two 12-month periods (years 3 and 4). The bank also meets condition 2. In this case, an additional own funds requirement is calculated for condition 2, since this is the condition that results in the highest additional own funds requirement.

Total remaining accumulated flowbacks increase the risk-weighted exposure amount by SEK 15 million. The additional own funds requirement in Pillar 2 for flowback risk associated with securitisation therefore corresponds to SEK 0.91 million (SEK 15 million * [20/35] * 75% * 14.1%).

We assume that the total capital requirement amounts to 16.5%. After the securitisation, the total capital requirement, including the additional own funds requirement for flowback risks, will therefore be SEK 14.93 million (85 million * 16.5 percent + SEK 0.91 million).

5 Data collection

When assessing flowback risk associated with securitisation, FI will request data about all of the bank’s total securitisations in the form of an additional request for information as set out in Appendix 3. This is carried out as part of FI's supervisory review and evaluation process. The assessment of flowback risk associated with securitisation must always be based on updated and relevant information.

When collecting data, the bank should assume a static balance sheet across the forecast period, apart from the impact of the flowback from the securitisation transactions. This means, inter alia, that credits that expire are assumed either to be extended or supplemented with new identical credits.

The bank should also clarify whether it has made any other assumptions during the forecast period. These can include, for example, assumptions about amortisation rate, credit losses and known regulatory changes.

6 Impact assessment

6.1 Impact on society and consumers

An additional own funds requirement for flowback risk associated with securitisation can result in the bank's funding costs rising, as capital is normally a more expensive kind of funding than loans. However, the impact depends on the size of the additional own funds requirement, i.e. how much of the securitisation exceeds FI's thresholds for flowback risk associated with securitisation. If the additional own funds requirement results in higher funding costs for the banks, this may impact households and non-financial companies through lower lending volumes or higher lending rates. This can in turn lead to lower consumption and lower investments.

However, the proposal is expected to contribute to the banks' financial stability. Stable banks are important to ensure that the banking system has good resilience. A stable banking system reduces the yield requirements for investors. This leads to lower funding costs for the banks, which benefits society and consumers.

6.2 Implications for the banks

There are currently few Swedish banks that have carried out securitisation transactions and strived to meet the criteria for significant credit risk transfer. The effects of this updated method are therefore assessed to be very similar in all material respects to the effects of FI's existing method for systemic risk associated with securitisation. This means that the method primarily has an impact on the banks' future choices and not on their current situation.

The Pillar 2 method does not prohibit securitisation, but means that banks have to cover any additional flowback risks associated with securitisation above the thresholds set by FI. This applies to securitisations whose underlying credits and structure are assessed as having flowback risks. As the Pillar 2 method reduces the effects related to capital requirements above the thresholds set by FI, banks should be able to choose to refrain from securitisations that involve significant flowback risks. This can have both wanted and unwanted consequences.

For example, the banks may avoid risk management measures that could be positive for stability. The banks' access to alternative funding sources may also be limited. This may to some extent impair the Swedish banks' competitiveness, both in relation to international actors and unregulated actors on the Swedish market.

Several initiatives have been introduced at the international level, within Basel, IOSCO and the EBA, to stimulate the securitisation market and lending to the real economy (primarily lending to SMEs). FI's Pillar 2 method for assessing flowback risks associated with securitisation may appear not to be fully consistent with these international initiatives.

However, FI would like to emphasise that this method intends to manage the significant flowback risks that extensive securitisations can have on an individual bank. The adjusted calculation in the decision memorandum means that banks are able to use securitisations as part of their risk management and as a recovery alternative, while taking into consideration the flowback risks. The Capital Requirements Directive stipulates that banks must be able to manage risks associated with securitisations that are not covered by existing capital requirements. On the whole, FI's assessment is that flowback risks associated with securitisation above a certain level are so significant as to justify the method.

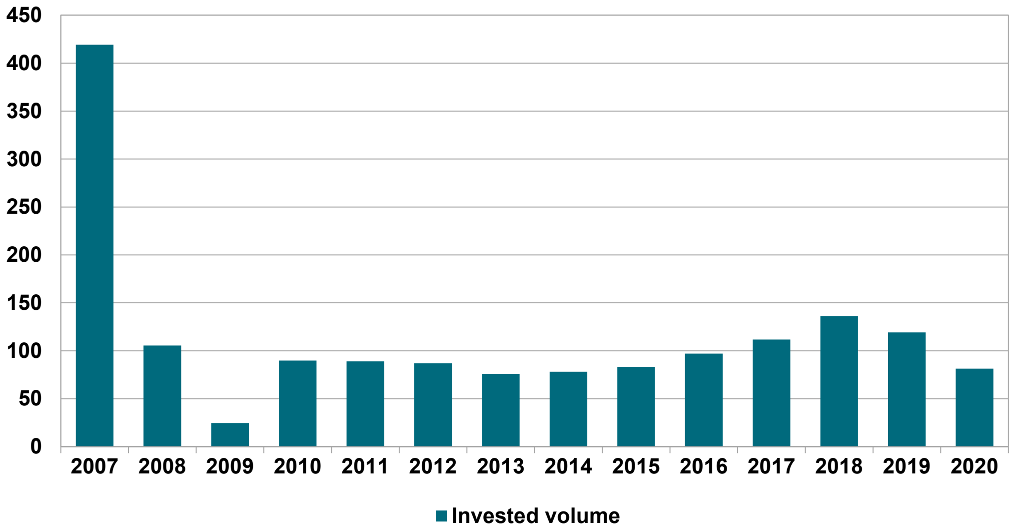
6.3 Implications for Finansinspektionen

FI already assesses the banks' institution-specific risks within the framework of the supervisory review and evaluation process under Pillar 2. Updating the method to include a calculation for an additional own funds requirement for flowback risks associated with securitisation will therefore not result in any major changes to FI's duties. However, our workload will increase to some extent as a result of gathering information, performing analyses and assessing flowback risks associated with securitisations. Although we assess that any additional costs fall within the existing frameworks, the use of resources at FI may change depending on future activity on the Swedish securitisation market.

Appendix 1: Development of the European market for traditional securitisation

Activity on the European market for traditional securitisations is shown in Diagram 1. Invested volumes fell during the global financial crisis from approximately EUR 420 billion in 2007 to EUR 25 billion in 2009. This change represents a reduction of 94%. In 2010–2016, market activity was stable, albeit at relatively low volumes compared with the period before the global financial crisis. In 2017–2019, the market saw a slight recovery, with invested volumes rising compared with the years following the global financial crisis.

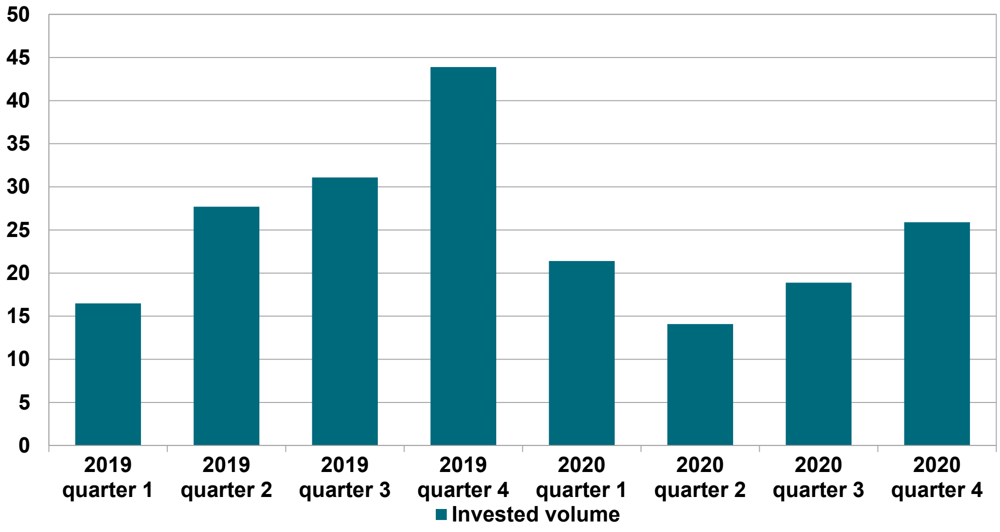
Diagram 1: Invested volumes in traditional securitisations issued in Europe since 2007 (EUR billion)



Source: The Association for Financial Markets in Europe (AFME)

As a result of the coronavirus crisis, the market has experienced a slowdown once again. Diagram 2 shows that invested volumes in traditional securitisations from Q2 to Q4 in 2020 fell by 40% and 50% compared with the same periods in 2019. The downturn during the coronavirus crisis has so far been milder than during the global financial crisis. One explanation for this is that this crisis is mostly driven by the real economy rather than by the financial markets. The fact that the regulations have been amended, and that governments and central banks initiated extensive and quick support measures on the financial markets (compared with the period during the global financial crisis) has probably contributed to the milder downturn.

Diagram 2: Invested volumes in traditional securitisations issued in Europe between Q1 2019 and Q4 2020 (EUR billion)



Source: The Association for Financial Markets in Europe (AFME)

Appendix 2: Development of the European market for synthetic securitisations

Synthetic transactions are usually carried out bilaterally or with a small number of counterparties, and there is not much standardisation in their contracts. This makes it more difficult to get a clear picture of the scope of the synthetic securitisation market compared with traditional securitisations. In its Report on STS Framework for Synthetic Securitisations,[20] the EBA collected data from the multinational commercial bank, Bank of America,[21] and the International Association of Credit Portfolio Managers (IACPM)[22] in order to shed light on the European market for synthetic securitisations. The Commission forwarded the EBA's report to the European Parliament and the European Council in July 2020.[23]

Synthetic securitisations can be carried out for different purposes. They can be divided into arbitrage synthetic securitisations and balance-sheet synthetic securitisations. Arbitrage synthetic securitisations are when the bank securitises financial guarantees and credit derivatives for credit exposures that the bank does not own. Instead of using synthetic securitisation in its credit risk management, the bank aims to find arbitrage opportunities between earnings from financial guarantees and credit derivatives and the cost of issued synthetic securities.

Balance-sheet synthetic securitisations are securitisations carried out in order to manage and reduce the credit risk that the bank is exposed to. In order to reduce the credit risk, the bank uses financial guarantees or credit derivatives to transfer credit risk to external investors for specific credits that the bank owns and maintains on its own balance sheet. In many cases, the bank is also the credit originator.

The investigation carried out by the EBA in its report states that arbitrage synthetic securitisations have mostly disappeared from the European securitisations market, see Diagram 3. Instead, balance-sheet synthetic securitisations have become the dominant type in the EU. Diagrams 3 and 4 also show that the market volumes for synthetic securitisations decreased during the global financial crisis, both for issued and invested volumes among

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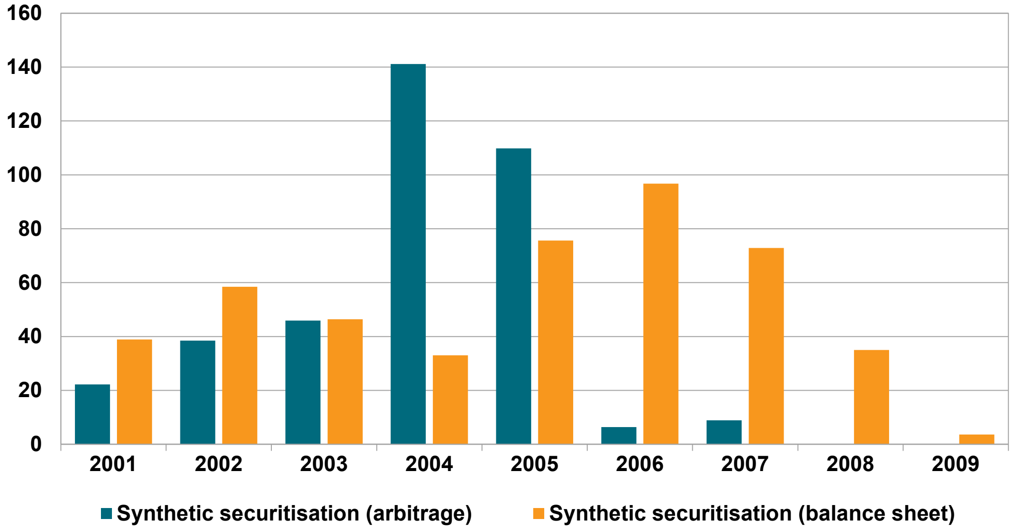
[20] EBA/OP/2020/07, Report on STS Framework for Synthetic Securitisations under Article 45 of Regulation (EU) 2017/2402, published in May 2020.
[21] Data from Bank of America relates to market volumes for both arbitrage synthetic securitisations and balance-sheet synthetic securitisations. The data refers to the period 2001–2009.
[22] Data from IACPM refers to the market volumes for synthetic securitisations with assets from banks' own balance sheets between 2008 and 2018. Data from IACPM is based on the 22 banks that are most active on the European market for synthetic securitisations.
[23] Report from the Commission to the European Parliament and the Council on the creation of a specific framework for simple, transparent and standardised synthetic securitisation, limited to balance-sheet synthetic securitisation, published in July 2020.

investors. The market for both issued and invested volumes remained at a low level until 2014 before it started to increase again.

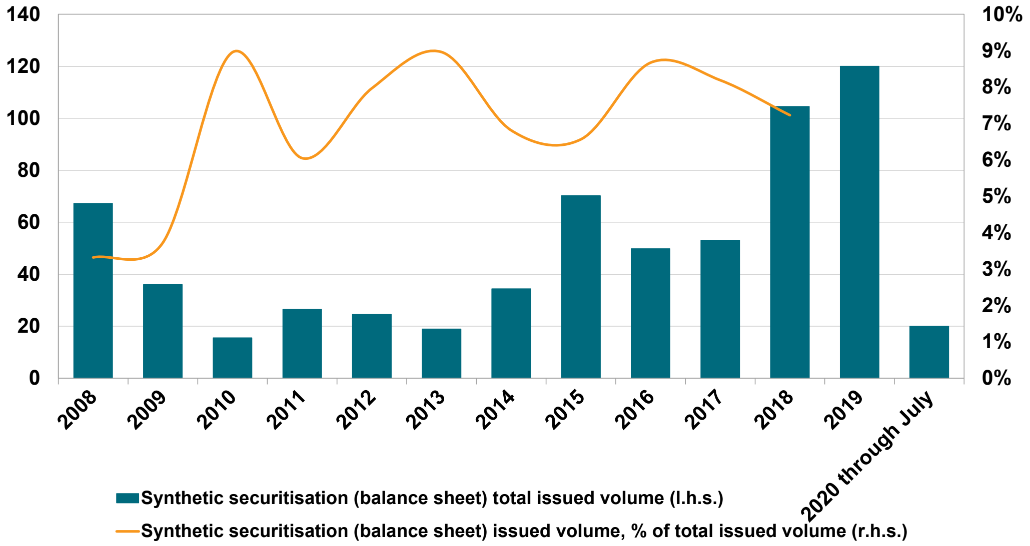
In 2018 and 2019, there was a significant growth in synthetic securitisations on the European market. Although the data for 2020 is still incomplete, the volumes indicate a decline as a result of the coronavirus crisis. Market data on the credit spreads for securitisations indicates a lower risk appetite from investors. The credit spreads increased sharply and rapidly at the start of the coronavirus crisis. Consequently, it has probably become much more difficult and much more expensive for banks to issue new synthetic securitisations on the market.

Diagram 3: European synthetic securitisations issued before the global financial crisis in 2008–2009, broken down by 'arbitrage' and 'balance sheet'. Amounts in EUR billion.



Source: Bank of America

Diagram 4: European synthetic securitisations issued after the global financial crisis of 2008–2009, classified as 'balance sheet'. Amounts in EUR billion.



Source: International Association of Credit Portfolio Managers and EBA.

Appendix 3: Information for the assessment of flowback risks associated with securitisation

FI will gather data about the banks' total securitisation activities in order to assess the flowback risks associated with securitisation. In addition to the data specified below, FI may request additional information if needed to assess the flowback risk associated with securitisation in accordance with the method in this memorandum.

1. Data about flowback for the bank's total securitisation activities, broken down by transactions and future 12-month periods.[24]

	Year 0	Year 1	Year 2	etc.
Nominal value of the credit portfolio of which, retained risk Exposure value of credit portfolio Credit maturity Replenished exposures Clean-up call option REA for credit portfolio pre-securitisation REA for retained risk post-securitisation REA released Total capital ratio pre-securitisation				

[24] A future 12-month period refers to a calendar year.

Total capital ratio post-securitisation				
Total capital requirement for the portfolio pre-securitisation				
Total capital requirement for retained risk post-securitisation				
Total capital reduction after securitisation				
Exposure value for exposures whose credit risk is taken back				
REA for exposures whose credit risk is taken back				
Total capital requirement for exposures whose credit risk is taken back				
Total capital ratio post-extension of maturing exposures whose credit risk is taken back				

2. Data about the bank's total securitisation activities, broken down by exposure classes[25] and future 12-month periods.

[25] The exposure classes referred to here are defined in Articles 112 and 147 of the Capital Requirements Regulation.