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Response by the Swedish authorities to the European Commission´s public consultation on improving the EU's macroprudential framework for the banking sector

Joint response to the Commission's open consultation on improving the EU's macroprudential framework for the banking sector from the Swedish Ministry of Finance, the Swedish Financial Supervisory Authority (Finansinspektionen), Sveriges Riksbank (the Riksbank) and the Swedish National Debt Office – below called the Swedish authorities.

Introduction

We, the Swedish authorities, welcome the opportunity to comment on the EU Commission's open consultation on the future EU macroprudential framework for banks. Before addressing the questions posed in the consultation, we would like to put forward some more general comments. The EU macroprudential framework is an important component in the framework to safeguard financial stability and foster economic growth. In general, we find that the present macroprudential legal framework, introduced after the Global Financial Crisis, provides authorities with ample ability to contain macroprudential risks.

Ultimately, the purpose of the macroprudential framework is to build sufficient resilience in the banking sector towards two types of risks, the cyclical risks driven by business or financial cycle fluctuations, and the structural risks of contagion from one bank to another or from one bank to the wider economy. Adequately addressing both of these risks is highly important. As the financial sector is evolving, there is clearly a need to regularly assess if the framework needs to be adapted in order to ensure that all relevant authorities have the right tools to properly counter the risks. This EU consultation is therefore very timely.

As banks and financial markets in the EU are becoming increasingly integrated, it is likely that the financial and business cycles will become increasingly correlated. Furthermore, the pandemic has further underscored the need for structural reforms within the banking sector in the EU. Both of these developments are – in the short to medium term – likely to increase the need to focus more on common tools and measures to address the associated risks.

At the same time, many macroprudential risks are still primarily national. One example is that the residential real estate markets are still rather fragmented with very different set-ups across Member States. In our view, it is therefore important to retain the national decision-powers over the relevant policy measures, not only for efficiency reasons but also to ensure appropriate accountability.

Given both the European and national dimensions to macroprudential risks, and the risk of increasing spill-over effects between Member States, three features stand out as particularly important to develop further in the EU legislative review. First, there is a need to further develop and enhance the exchange of information among authorities about risks, vulnerabilities and potential macroprudential measures in order to foster cooperation and voluntary harmonisation of measures. Second, as spill-over effects are likely to increase, the need to ensure that all Member States have an adequate toolbox will be necessary. This includes among other things the ability to reciprocate different measures taken in other countries. Third, many authorities suffer from an inaction bias. The essence of macroprudential tools is to apply them sufficiently early, before problems arise. This inaction bias is therefore a genuine problem. Furthermore, measures to counter inaction bias will benefit us all by ensuring sufficient resilience in all Member States.

With this in mind and with the background that the present legal framework has been working largely adequately, we do have a number of suggestions for improvements in the EU legal framework.

In our view, the legal framework should – to a larger degree than today – encourage authorities to use the Countercyclical Capital Buffer (CCyB) more actively to build a higher degree of resilience in advance. This entails among other things a) enabling decisions about the CCyB to be more forward-

looking, b) removing the cap on CCyB reciprocity and c) encouraging authorities to use a positive neutral CCyB rate. At the same time, such changes should not come at the expense of making changes to the Capital Conservation Buffer (CCoB) which has a different purpose. We also support developing legal requirements at the EU level, implying that all Member States should legally have a common minimum toolbox for Borrower-Based Measures (BBMs) available. Finally, climate change represents a risk to the banking system and may become a source of systemic risk to the financial system. The Swedish authorities therefore consider that further analysis is warranted on what role macroprudential policy can play related to climate risk.

In addition, the enhanced importance of non-bank financial intermediation in the financial sector merits an analysis of new risks and the need for possible tools to address macroprudential risks in the broader financial system outside the banking sector. We would, therefore, welcome that the Commission would analyse these topics now or in a future review.

Our answers to the specific consultation questions below elaborate on these and a number of other issues.

1. Overall design and functioning of the buffer framework

1.1. Assessment of the buffer framework

Question 1 - Has the capital buffer framework been effective so far in providing sufficient resilience against all types of systemic risks in Member States and for different types of banks and exposures? Please explain your answer to question 1, considering not only overall resilience, but also the interactions of the individual components of the capital buffer framework (i.e. CCoB, CCyB, G-SII, O-SII and SyRB buffers); is it sufficiently clear which buffer is to be used to address which risk?

In our view, the present legal framework provides good opportunities to apply macroprudential tools. However, any evaluation of the efficiency of the capital buffer framework needs to factor in that it has not yet been fully tested. The potential impact from the Covid-19 pandemic on banks' capital buffers was limited through massive monetary and fiscal policy stimulus. Still, looking at the available evidence, capital buffers contributed to the relatively stable situation for many banks. In the Swedish case, we found the

availability of buffers, in particular the CCyB as a releasable component in the capital buffer framework, highly valuable during the crisis. Prior to the Covid-19 crisis, Finansinspektionen, the Swedish FSA, had set the CCyB at 2.5 per cent for Swedish banks, and at the onset of the crisis, Finansinspektionen decided to fully release it. The decision made it easier for the Swedish banks to continue contributing to the credit supply in the extremely uncertain economic and financial situation.

Taking an EU-wide perspective, a more active use of the instruments available in the capital buffer framework in order to build resilience towards systemic risks, would make a very positive contribution to financial stability. Hence, we support making the CCyB easier and more attractive to use. However, the key issue is not the design of the framework as such, but rather the willingness by authorities to use it. It is therefore important to improve the authorities' incentives to impose buffers. However, we oppose making the CCoB releasable. That would de facto risk lowering resilience and would, in addition, blur the clarity regarding how buffers are to be used. Furthermore, it would introduce a deviation from the Basel standard.

Although the capital buffer framework has become clearer with the first Banking package, it is still rather complex, and there is room for further clarifications. In particular, it could be better specified what risks the different buffer requirements are aimed at addressing. However, any effort to further clarify the purpose of different buffers must jeopardise neither the overall resilience nor the national flexibility in the macroprudential space.

Question 2 - Has the capital buffer framework been effective in dampening financial or economic cycles in Member States? Please explain your answer to question 2, considering in particular the experience to date with the calibration of buffers during phases of economic growth and rising vulnerabilities, and the use of buffers after an economic/financial shock; do you see any impediments to the intended use of buffers both during upswing and downswing phases?

In general, it should be noted that addressing cyclicality is complex and the CCyB is only one factor among others. Nevertheless, we believe that the CCyB and other macroprudential tools are relevant to address cyclical challenges, build resilience and thus facilitate addressing strong downturns in the financial cycle.

For countries that had a positive CCyB in place when the pandemic broke out, it was useful to have the opportunity to release this buffer. These buffer releases in March 2020 offered the first opportunity to assess the functionality of the macroprudential buffer framework in a crisis. Contrary to concerns prior to the pandemic, there were no problems releasing the buffer in the countries that had a positive CCyB prior to the pandemic.

We support a more flexible and preventive activation of the CCyB, including a broadening of the definitions for activation of the CCyB in order to further enable the build-up of releasable capital. We are also in favour of establishing a positive neutral CCyB. In addition, in order for the CCyB to be effective, reciprocity is important, and we support that the 2.5 per cent cap on mandatory reciprocity is abolished. Our experience from being in a region with highly integrated banking markets is that reciprocity is effective and necessary to mitigate systemic risks at national level in such banking markets.

Question 3 - How well is the systemic importance of banks addressed by G-SII and O-SII capital buffer requirements? Please explain your answer to question 3, considering in particular whether G-SII and O-SII buffer requirements are appropriate and coherent, also across countries, in view of their market shares, activities, market conditions, advances in setting up the Banking Union, and the risk their failure would pose to financial stability.

Overall, we find that the present system works well. Ensuring that systemically important banks are more resilient is of paramount importance for the overall financial stability. The current set-up of the G-SII and the O-SII buffer frameworks is largely appropriate and coherent.

A complete Banking Union will benefit financial stability in the whole EU and serve the Single market well. However, we do not support differentiating the application of the capital buffer framework between Member States inside the Banking Union and those outside it. In our view and at this stage, it is not appropriate to consider the Banking Union as one jurisdiction for the purpose of the G-SII framework. Doing so would put the level playing field within the EU at risk. Furthermore, it would reduce global resilience and be inconsistent with the Basel framework.

At the national level, the O-SII set-up works well. The current legal framework enables us to cover the relevant risks in the relevant Swedish banks.

However, we do see two challenges related to the O-SII-buffers, as discussed under question 4.5.

1.2. Possible improvements of the buffer framework

Question 4 - What changes would improve the current buffer framework and what would be, in your view, the pros and cons of these changes?

The CCyB is the macroprudential measure introduced to counter pro-cyclicality in the financial system by supporting credit supply during a downturn, and it is the only buffer explicitly designed to be released in a financial crisis. A preventive and forward-looking CCyB-increase in normal times enables macroprudential authorities to release capital during a crisis. An example is that the CCyB of 2.5 per cent in Sweden was entirely released at the onset of the Covid-19 crisis, to uphold credit supply.

However, the CCyB is designed to address excessive credit growth focusing on the credit-to-GDP-gap as main indicator, and not to cover any latent risks and external shocks. Thus, we support changes in the EU regulatory framework aimed at increasing the usability of the CCyB further, by making it more preventive and forward-looking. We support broadening the scope of the CCyB, through revising the definitions used for the activation and increases of the CCyB. We also support promoting the use of a positive neutral rate. These changes should over time result in an increase in the releasable part of the capital requirements. To ensure this development the current mandatory cap for reciprocity of 2.5 per cent for the CCyB needs to be abolished.

However, increasing releasable capital should not be introduced at the expense of structural buffers. A capital neutral rebalancing would risk lowering the level of resilience of the financial system, as structural buffers contribute to the overall resilience through the financial cycle. Thus, increased releasable capital should not be introduced in a so-called capital neutral way.

In addition, **the Riksbank** is of the opinion that the implementation period for the CCyB should be shortened, so that it – as a default – would be implemented 6 months after a decision, with the possibility for the authority to extend this to 12 months when necessary. In general, long implementation lags in cyclical measures are problematic. Shortening the

normal implementation period would enhance the effectiveness of the cyclical measures and reduce the risk that the CCyB is implemented too late. Furthermore, historically the effects of rising CCyB have not implied that banks have had to raise additional capital. The additional capital requirements have easily been met within the existing bank capital ratios. Moreover, given that major banks have exposures in many countries and that changes to the CCyB are not decided simultaneously, the effects of individual decisions to raise the CCyB should not be overstated for the requirement of individual banks.

In the Swedish FSA's, **Finansinspektionen's,** view the implementation period should not be shortened. **Finansinspektionen** do not consider the CCyB to be an effective measure for reducing build-up of cyclical risks. Rather the CCyB's primary function is to ensure sufficient releasable capital when risks materialise. This is also why a neutral rate of the CCyB has been set at 2 per cent. Shortening the implementation period for the CCyB would likely make banks less inclined to use freed up capital after a release and therefore risks reducing usability and the effectiveness of the buffer. Furthermore, **Finansinspektionen** has not seen any signs that the current phrasing of the regulation, where shorter implementation period is already possible has been problematic.

Question 4.1 - Enhanced clarity of the buffer framework: Consider whether there is scope for simplifying/streamlining the buffer framework or providing better guidance on how to use it.

Although recent changes in the regulation have somewhat enhanced clarity of the buffer framework, there is still room to further disentangle the roles between the different buffer requirements in terms of addressing risks. It is in this context also important not to propose changes in the macroprudential framework that could lead to an increasing overlap in the use of different buffer requirements as this could be counterproductive and reduce clarity. For instance, making other buffer requirements releasable besides the CCyB would reduce the clarity of the buffer framework.

It would be useful to simplify notification and approval procedures for some instruments. In relation to Article 458 the condition for activating the measure should also consider situations where the intensity of macroprudential or systemic risk is unchanged but still high. The application

period of Article 458 and any subsequent extension could be extended by two additional years. Moreover, we suggest that recognised SyRB rates do not count towards the authorisation thresholds in CRD V. Also, the sectoral SyRB rate should be exposure weighted to avoid authorisation at overall relatively low levels. In general, the legal framework should facilitate activation of different macroprudential instruments in order to counter inaction bias.

Question 4.2 - Releasable buffers: Consider in particular whether an increase of releasable buffers could be achieved in a capital-neutral way over the cycle, the circumstances and conditions under which buffers should be released and what coordination/governance arrangements should be in place.

We support enhancing authorities' incentives to use releasable buffers. Two advantages of the CCyB are that there is a clear legal framework and that the CCyB has mandatory reciprocity. Enhancing the use of the CCyB will facilitate for authorities to set appropriate buffers to mitigate macroprudential risks. However, we strongly oppose increasing releasable capital in a so-called capital neutral way, through for example making the CCoB releasable. The CCoB is structural in nature and has a different purpose. Furthermore, the CCoB has no mandatory reciprocity, which is problematic for time-varying buffers in a situation with large and increasing cross-border activities. Moreover, making the CCoB releasable would de facto increase the risk of lower overall capital requirements, and hence reduced resilience. It would also be inconsistent with the Basel III agreement. Implementing international agreements are important to ensure resilience and a global level playing field.

Buffers should be released in particular following a) a severe financial shock to the banking system or b) certain types of macroeconomic shocks that temporarily increase the demand for credit.

As regards coordination/governance arrangements, possible coordination of measures that may provide for a more effective response to a shock may be warranted in situations where all EU countries are affected in a similar way. ESRB provides an effective forum for sharing of information and discussion of any potential need for coordination. However, the decisions to impose or release buffers should be left to national discretion. In most situations, EU Member States will not be equally affected by a crisis, which for example was

the case during the Covid-19 crisis, and the usability of buffers should depend on the specific situation in each respective EU country. In other words, we see no need for changing the present coordination/governance arrangements.

Question 4.3 - Buffer management after a capital depletion: How can capital buffers be restored/replenished after an adverse shock in such a way that banks will provide sufficient lending in the recovery? In that regard, is there scope for optimising the MDA restrictions and capital conservation rules as laid down in Articles 141 to 142 CRD?

We do not see any need for changes, as at present we have no indications that there is a need to change the MDA restrictions or capital conservation rules.

Question 4.4 - Overlap between capital buffers and minimum requirements: How important is it to reduce the overlap between capital buffers and other requirements, and how could this be achieved without unduly raising overall capital requirements and having to re-open the composition of the leverage-ratio based "capital stack" and the calibration of the MREL based on the total exposure measure and the MREL subordination requirement?

A cornerstone in the global revisions of the regulatory framework after the Global Financial Crisis was the introduction of a multi-restrictive framework whereby banks would be subject not only to a risk-based capital requirement, but also to the leverage ratio, the LCR, the NSFR, as well as the FSB:s recovery and resolution framework. Another cornerstone of the Basel-III agreement was the introduction of capital buffers, whereby banks would need to conserve capital before getting close to breaching minimum requirements. This multi-restrictive framework, by construction and intent, creates overlaps between different requirements. We support enhancing buffer usability by banks, but this should not come at the expense of reducing the overall resilience, resolvability and benefits that the multi-restrictive framework creates.

More specifically regarding MREL, a particular aspect is that current rules to some extent create a conflict between capital usability and resolvability needs. On the one hand, the usability of capital (buffers, P2G and other capital in excess of capital requirements) may be limited if banks – due to losses and/or incapacity to refinance eligible liabilities – breach MREL but do not breach any part of its capital requirements. One the other hand, the existence of such limitations in current rules is needed to ensure that

sufficient recapitalisation capacity is maintained and to avoid undue depletion of MREL-resources (including capital). While acknowledging that measures that would fully address this issue most likely lie beyond the scope of this consultation, the Swedish authorities would like to highlight that any forthcoming legislative review needs to take into account the full dynamics and interplay between MREL, buffer requirements and capital requirements.[1]

Question 4.5 - Consistent treatment of G-SIIs and O-SIIs within and across countries: Should there be more EU-level guidance or binding rules on the identification of O-SIIs and the calibration of O-SII buffers? Should the leverage ratio buffer requirement for G-SIIs also apply to O-SIIs?

The O-SII buffers play an important role in ensuring financial stability in an EU-wide context and we largely support the present framework.

However, we see two challenges related to the O-SII-buffers. The first is a broader issue that warrants attention and adjustments in the short run. Several regulations, including but not limited to the O-SII-buffer framework, are based on year-end values of banks. The banks respond by window-dressing their financial reporting which in turn amplifies unwarranted swings in a number of market prices and market activity around year-ends. This problem also leads to underestimates of the size of the banks at year-ends. To a certain degree, and although this is on a shorter time horizon, this is similar to procyclicality in that the construction of the regulations amplifies the natural market swings. We would therefore support using within-year averages instead of year-end values to reduce this window-dressing problem. This is relevant for the frameworks for systemically important institutions, but also for other frameworks, including the fees to the resolution funds.

The second challenge is more specific to the O-SII framework. With the backdrop of an increasing financial integration within the EU, there may be a case for taking cross-border activities more into account in the O-SII-buffer framework. This would address some of the potential risks that such further integration may create. Thus, the purpose would be to enhance the consideration of cross-border spill-over effects in order to further foster EU-wide resilience. There are several ways to achieve this. One way is to

[1] For an in depth description on the overlap between capital buffers and MREL and possible policy options to address the issue see [ESRB - Report of the Analytical Task Force on the overlap between capital buffers and minimum requirements]() (December 2021).

incorporate the flows of payments and other infrastructure services, also across borders, in the EBA scoring method for the O-SII buffers, but there are other alternatives as well.

However, we oppose more binding rules at EU-level both for the identification of O-SIIs and for the calibration of O-SII buffers. It is important that Member States have the possibility to set buffers that sufficiently cover the identified risks. Steps to simplify the framework regarding notification and coordination would be warranted, though.

The **Riksbank** supports the introduction of a leverage ratio buffer requirement also for O-SII banks. There are several reasons. First, the buffer concept is important in order to tackle macroprudential risks and foster resilience. The leverage ratio is a complement and supplement to the risk based framework, not only a backstop. As such, there are good reasons to apply the buffer concept also in the leverage ratio space. Second, applying buffers in the leverage ratio space would guarantee that at least part of the combined buffer is usable in a crisis. In theory, the overlapping requirements could potentially imply that the risk-based buffers are "consumed" by the leverage ratio. A leverage ratio buffer would ensure that there is a buffer on top of that, thus safeguarding the ability of the bank to use a buffer at all times. Third, a leverage ratio buffer for O-SII banks could enlarge the macroprudential space in particular for the banks that are most important for macroprudential policies. Fourth, in stressed environments, the leverage ratio becomes more important and as the purpose of the buffers is to be available in stressed scenarios, it is highly relevant to apply a buffer on top of the leverage ratio requirement. Having said that, the calibration of the O-SII leverage ratio buffer needs to be carefully considered. One straightforward possibility would be to apply the leverage ratio buffer to O-SII-banks, and for these banks convert the risk based O-SII buffer with a conversion factor of 50 per cent. This would have the benefit of being simple and consistent with the G-SII framework. It would also solve the problem for banks that are both G-SII and O-SII, by aligning the two frameworks.

Finansinspektionen is against the proposed introduction of a leverage ratio buffer requirement for other banks than G-SII banks, i.e. also including O-SII banks, although we think that buffers are important to ensure resilience in the banking system. However, after the introduction of the Banking package, it is already possible according to CRD to set a buffer on top of the

leverage ratio in the form of a Pillar 2 Guidance. The main reason for not supporting such a proposal is that the leverage ratio buffer replicating all risk-weight measures would be binding for many banks. This would result in significant shortfalls in banks T1 capital and would reduce risk sensitivity where banks could increase their risks without it leading to higher capital requirements. It would also limit the potential use of the CCyB, which could reduce the releasable capital. In turn this risks decreasing resilience in the banking system. A leverage ratio buffer requirement would become the binding requirement for many banks, but the impact varies significantly between banks in the EU. The introduction of a leverage ratio buffer would thus require differentiation of the conversion rates, which risks creating a complicated system that would not be consistent with the aim of the review to simplify the macroprudential framework.

Question 4.6 - Application of the SyRB to sectoral exposures: Are the thresholds for opinions and authorisations appropriate for sectoral SyRB rates (and for the sum of G/O-SII and SyRB rates)? Should the combined SyRB rate be calculated as a percentage of total risk exposure amounts and not sectoral risk exposure amounts? How should sectoral risk exposure amounts be calculated after the introduction of the output floor?

The thresholds for opinions and authorisations for the sectoral SyRB are in general too low, especially when not calculated as an average to the total portfolio.

In our view, it is important that opinions or authorisations should not be required when reciprocating measures. This is proposed to be clarified in the Commission proposal on implementing the final parts of Basel III in the EU and is a welcomed change.

For simplicity, and to reduce the burden for banks, when carrying out the calculations we see an advantage of applying the same methodology, for instance if buffers should apply on REA after output floor the thresholds should also be set on REA after output floor. This issue depends on how the output floor will be implemented on banking groups.

Transparency is very important in order to see the capital requirement created by each (reciprocated) buffer. It is therefore important that the impact of the different reciprocated buffers is clearly visible within reporting and disclosure. Should reporting requirements be revised in this way, the possible capital relief from a removal of a buffer would be clear.

2. Missing or obsolete instruments, reducing complexity

2.1. Assessment of the current macroprudential toolkit and its use

Question 5 - Based on the experience so far, have you observed any major gaps in the EU macroprudential toolkit (also beyond the buffer framework)? Please explain your answer to question 5, indicating which gaps you perceived and what consequences these gaps have or might have had.

Borrower-based measures (BBMs): Dampening an upswing in the RRE sector is extremely difficult, but BBMs seem to be promising tools (they of course also build resilience). Availability of BBMs vary between EU countries, and it would be good with legal requirements at EU level for a common minimum toolbox. See answer to questions 8.1 below for further comments.

Non-banks: There are inconsistencies and gaps in the macroprudential framework relating to non-banks. We are interested in increasing the use of activity-based tools, and would like to see continued work in this area going forward.

Question 6 - Has the experience with the macroprudential toolkit so far revealed any redundant instruments or instruments that need to be redesigned to make them fit for purpose?

We do not see any redundant instruments. Neither do we see that any instruments should be redesigned to make them fit for purpose, apart from the changes to the CCyB we suggested and discussed in the answers to questions 2 and 8. However, it would be useful to simplify some activation, notification and approval procedures. Furthermore, it is important that the simplification is carefully balanced with retaining the possibility of national authorities to activate measures that can mitigate different risks in the respective Member States. Thus, the situations and areas in which the authorities can take measures, should be maintained, whereas we see room for simplifying mainly the notification and approval process of these measures. This would help counteracting the inaction bias in implementing macroprudential measures.

Question 7 - How effective has the macroprudential toolkit and EU governance framework been in managing a crisis? Please explain your answer to question 7, notably in light of the experience gained during the Covid-19 crisis

The regulatory framework introduced after the Global Financial Crisis has put banks and regulators in a much better position to address economic shocks like the one following the pandemic. Most importantly, banks have both more and better capital as well as more liquidity and better crisis management preparations. Also, the sheer existence of the macroprudential framework has provided benefits during the pandemic, not least in fostering market confidence.

At the same time, the framework has not been fully tested yet, due to major fiscal and monetary policy interventions in the recent Covid-19 crisis. Thus, it is not possible to draw far-reaching conclusions regarding the effectiveness and sufficiency of the macroprudential toolkit for possible future crises. However, we would argue that overall the toolkit has worked and been beneficial. Particularly the CCyB has proved useful at the onset of the Covid-19 crisis for those countries that had built it up prior to the pandemic.

2.2. Possible improvements of the buffer framework

Question 8 - What changes to the current set of instruments would improve the macroprudential toolkit and what would be, in your view, the pros and cons of these changes?

CCyB: We support a) making it more preventive and forward-looking, b) removing the ceiling for mandatory reciprocity, and c) promoting (but not legally enforcing) a positive neutral rate. (See answer to question 4 for further details.)

BBMs: We support introducing a requirement in EU legislation for a common minimum toolbox. (See answer to question 8.1 for further details.)

Question 8.1 - Borrower-based measures: Should all Member States have a common minimum set of borrower-based measures to target more directly potentially unsustainable borrowing by households and corporates, particularly in a low interest-rate environment? Which tools should Member States have and what role should EU bodies play in fostering their effective use?

We support introducing a common minimum toolbox of Borrower-Based Measures (BBM). We believe that the main reason for introducing BBMs, is to ensure sound lending standards and higher resilience of borrowers. Such measures are useful complements to capital-based measures. Resilience in the financing of the real estate markets is particularly important given these markets' importance for financial stability. Introducing a common minimum toolbox of BBM:s would ensure that a basic set of instruments is available in all Member States to mitigate risks related to RRE markets at the national as well as EU level effectively.

It should however be recognised, that there are great challenges with this type of measures. Requirements for an extensive harmonization of definitions for these measures would be challenging due to the vastly differing regulatory frameworks affecting the real estate markets in different Member States. Thus, in order to enable the effective use of such tools, flexibility when defining for instance debt, value and income is key. There may be merit in having harmonized definitions for statistical and analytical purposes, while for the above mentioned reasons Member States should have flexibility in how to define the measures as such.

The macroprudential policy should, in general, be left to national authorities so that they are able to build up sufficient resilience against possible systemic risks. This holds true also for policy development of Borrower-Based Measures. While supporting enhanced cooperation regarding these measure, potential regulation should maintain national decision-making powers to ensure flexibility to address national specificities and accountability when designing and implementing such measures. Further, many existing Borrower-Based Measures have been designed with such national specificities in mind. Thus, the introduction of an EU-wide toolbox for Borrower-Based Measures needs to be sufficiently flexible to accommodate the varying national specificities and leave it up to national authorities to keep or activate legally binding instruments.

Question 8.2 - System-wide distributions restrictions: Should EU and/or national authorities have the power to restrict distributions for the entire banking system to conserve capital in a severe crisis situation? Under which conditions and how should such system-wide restrictions be used, taking also into account the role of European bodies?

No, we do not see a need for a system-wide pay out restriction and particularly not if it would be centralised to EU authorities. There are many reasons for our view, but the main reason is that we do not see this as a necessary change in the regulatory framework. We note that even in the severe crisis situation at the onset of Covid-19, the existing framework where recommendations were issued by European and national authorities to restrict pay-outs in financial institutions worked well. The coordinating role of pay-out restrictions that the ESRB had also mitigated the risk of heterogeneous responses, which would otherwise have risked hampering the level playing-field across the EU.

Furthermore, introducing system-wide distribution restrictions in the legal framework would be very intrusive in a market based economy. It should therefore be reserved for microprudential rather than macroprudential purposes and then for specifically identified risks and when requirements are not met, as in the existing legal framework. A centralised macroprudential power which imposes system wide pay-out restrictions could also promote inaction bias leading to lower than optimal capital requirements ex ante. Measures aimed at establishing sufficiently large usable capital buffers are a preferable way to increase resilience as they are transparent, and affect institutions based on their individual financial position. Such buffers can be released rather than imposed in times of crisis, and this can limit the negative shock to the system in stressed times.

Furthermore, the ability to introduce such EU-wide restrictions may decrease investors' confidence in the EU banking sector as a whole, i.e. even for healthy institutions. In a crisis it can also make healthy banks less prone to uphold credit supply and reduce unhealthy banks' ability to recapitalise, based on the deteriorating confidence.

Question 8.3 - Temporary relaxation of prudential requirements to support the recovery after a shock: Should EU and/or national authorities have more powers to relax prudential requirements after banks have suffered a shock, to avoid procyclical behaviour and enhance banks' capacity to support the recovery? What elements of the prudential framework could be addressed using such powers (e.g. unwarranted risk weight hikes after a shock)? Could Art. 459 CRR be adapted for this purpose?

We do not see a need to introduce more powers to EU or national authorities to relax prudential requirements after banks have suffered a shock. Specifically, we do not support adapting Article 459 CRR in that way.

If the Commission would be empowered to, for instance, release the CCyB, such a change risks increasing uncertainty around the use of the CCyB for the banks, for the market participants as well as for the NCAs. Our view is that increased coordination of a possible synchronized action, for example, releasing the CCyB in a situation with EU-wide unknown unknowns should be sufficient. Furthermore, we believe that it should not be standard procedure to release or disregard capital regulation in any crisis as this creates risks of eroding the trust in the capital requirement regulation. Concerns of pro-cyclical effects (e.g. risk weight hikes) should be handled ex ante through the addition of releasable capital requirements or through improvements of the models. In this context, it should be noted that the introduction of the output-floor will mitigate model risk. We also note that current rules, which give banks time to rebuild MREL-resources after being subject to resolution, are satisfactory and should in principle help limiting the risk that banks exiting resolution will act pro-cyclically with too restrictive lending.

Question 8.4 - Instruments targeting risk weights and internal model parameters: How will the forthcoming application of the input and output floors under the Basel III agreements affect the need for tools that adjust risk weights or the parameters of internal models (Art. 124, 164 and 458 CRR)? Are such tools still necessary and, if yes, how should they be adapted to the new regulatory environment?

We do not see that the output floor – once in place – is an alternative to Article 124, 164 or the use of Article 458 CRR. The output floor is microprudential in nature and is not constructed to address systemic risks. While the output floor and macroprudential measures targeting risk weights can complement each other, the floor does not directly target certain exposures and might not be sufficient on its own to handle identified risks.

3. Internal market considerations

3.1. Assessment of the current macroprudential framework's functioning in the internal market

Question 9 - Are macroprudential measures as used by national authorities generally commensurate with systemic risks in a given country, or do you consider that there are unjustified disparities across countries? Please explain your answer to question 9, providing supportive evidence on possible disparities and their likely impact on the internal market

There are quite substantial disparities across countries in the use of macroprudential measures, which do not always reflect differences in risk levels between the countries. One area where disparities can be seen is in the handling of RRE-related risks (see for example ESRB warnings and recommendations in this field). Besides issues such as inaction bias and information deficiencies, one reason for such disparities may be that some countries lack the macroprudential tools that are most efficient in addressing these types of risk, in particular BBMs. We also note that there are quite large differences in the use and application of other macroprudential tools, such as the CCyB and the SyRB.

Furthermore, parts of the banking system in the EU is in need of reform. So far, there has not been sufficient measures to instigate warranted changes. This problem relates to structural, micro- and macroprudential policy. Not handling these problems, increases systemic risks in the EU. At the same time, when addressing these warranted changes it is important not to increase other problems and challenges, such as the Too-Big-To-Fail problem.

Question 10 - Has the oversight of national macroprudential policies through notification, assessment and authorisation procedures been proportionate and effective in preventing an excessive use of macroprudential tools and undue market fragmentation?

Given the single market and the high degree of cross-border banking, some coordination on an EU-level is warranted and we see merit in the notification, assessment and authorisation procedures. However, there is room for streamlining and reducing the complexity in this type of procedures. See also answer to question 4.1. As highlighted above this could also contribute to limiting the inaction bias of Member States in implementing macroprudential measures.

Question 11 - Have the provisions on reciprocation been effective in maintaining a level playing field in the banking sector and preventing the circumvention of national macroprudential measures through regulatory arbitrage?

The current reciprocity framework has worked reasonably well, but the procedures are sometimes quite cumbersome, which risks contributing to inaction bias. We, therefore, suggest reducing the requirements for opinions or authorisations when reciprocating measures (relating to different macroprudential measures, for example to the SyRB).

We also support extending the mandatory part of the reciprocation framework. In particular, we strongly support removing the ceiling for mandatory reciprocity for the CCyB. It would increase efficiency when applying the CCyB and enhance the releasable buffer framework. This would also increase authorities' incentives to use the CCyB. One of the original reasons to limit reciprocity was the risk that the CCyB would be used too extensively. The experience so far is rather the contrary, i.e. that the inaction bias is substantial.

We are generally positive towards reciprocity of macroprudential measures as this would enhance the efficiency of the measures, in particular in further integrating the banking market. In our own case, we aim to reciprocate all measures where Swedish banks' activities are above the thresholds. However, this is provided that the implementation is within the limits of the legal framework. The latter does not allow the implementation of two measures covering the same risk. One somewhat complex area regarding reciprocation is the SyRB and particularly the recently introduced sectoral SyRB. We would like to highlight the importance of not letting recognised SyRB rates count towards the thresholds defined in CRD V. A clearer legislation in this area is of essence.

Question 12 - Has the current allocation of responsibilities for macroprudential policy between the national and European level been effective in ensuring that sufficient and appropriate action is taken to limit systemic risks and manage crises? Please explain your answer to question 12, taking notably into account the roles of the ESRB, the ECB and the Commission (which may impose stricter prudential requirements in accordance with Article 459)

The structure of the financial sector differs quite a lot between EU countries. It is therefore important that substantial decision powers remain at the national level so that systemic risks can be adequately addressed and enough flexibility is available to build up sufficient

resilience against such risks while also ensuring accountability. At the same time, if systemic risks are not addressed in an appropriate way at national level, they may spread to other countries and cause financial instability in more countries. Hence, the different types of risks need to be balanced against each other. When doing so, we find the current allocation of responsibilities between national and EU level appropriate, and do not see any need for change.

The ESRB has made a very positive contribution as a link between national authorities and other EU institutions, and by providing an EU perspective while also taking account of individual national developments. It has used its soft powers through warnings, recommendations and other communications, and has served as a forum for exchange of information and common development of analysis and policy as well as for discussions between national and EU authorities. We support the role that the ESRB is playing in making assessments and issuing recommendations. The use of soft tools has helped stimulate appropriate and sufficient actions in Member States. We would find it useful if the ESRB would apply the type of country based assessment conducted in connection with warnings and recommendations on risks related to residential real estate also in other areas.

As regards the Commission's mandate to impose stricter prudential requirements in accordance with Article 459, this possibility has not been tested yet, and can therefore not be evaluated. However, we do not see any need for revisions of Article 459, as outlined in the response to question 8.3.

3.2. Possible improvements relating to the functioning of the macroprudential framework in the internal market

Question 13 - What changes to the current governance arrangements and oversight procedures would improve the compatibility of macroprudential policy making with the internal market, and how could the complexity of procedures be reduced?

Monitoring of the macroprudential stance: We support that some body, i.e. ESRB, makes regular assessments of the relevant macroprudential risks and of the macroprudential stance in different countries. However, in the application of macroprudential measures, we do not see any need for change

in the current allocation of responsibilities between EU and national level. (See answer to question 13.1 for further details.)

Reciprocation of national macroprudential measures: We generally support mandatory reciprocity. However, if mandatory reciprocity were to be introduced more broadly, the risk of double-counting of the same risk when reciprocating would need to be addressed. Furthermore, we find it important to abolish the current cap of 2.5 per cent on mandatory reciprocity for the CCyB, in order to support the aim of building releasable buffers.

Question 13.1 - Monitoring of the macroprudential stance: Should there be regular overall assessments of the macroprudential requirements (or stance) in each Member State in addition to, or as a substitute of, the EU-level monitoring and vetting of individual macroprudential measures? What measures should be available to which bodies in case the national macroprudential stance is deemed disproportionate to the level of risk (too low or too high)?

We see the inaction bias as a problem in the EU context. One way to address this would be for some body, i.e. ESRB, to make regular assessments of the macroprudential stance in different countries. The ESRB has played an important role in developing the framework for analysing and monitoring the macroprudential stance. However, given the current state of knowledge and availability of models/methods in this area, the assessments of stance would have to be qualitative (rather than quantitative). Before deciding whether to use the stance assessments as more than complementary information when making assessments of macroprudential policy in EU countries, we will need to allow quite some time to assess how well the assessment models/methods work in practice, as well as to refine the models/methods.

In the application of macroprudential measures, we do not see any need for change in the current allocation of responsibilities between EU and national level, as mentioned in our reply to question 12. In other words, we do not favour any move of power over decisions regarding macroprudential policy or any power to alter the macroprudential stance to any centralised body.

Question 13.2 - Reciprocation of national macroprudential measures: Should there be mandatory reciprocation for a wider range of macroprudential measures and how could this be implemented (role of the ESRB, materiality thresholds, etc.)?

We generally support mandatory reciprocity as an important aspect to build resilience in the internal market. To support the aim to build releasable buffers, abolishing the current cap of 2.5 per cent for mandatory reciprocity of the CCyB is important. Increased releasable buffers is supportive of resilience.

However, if mandatory reciprocity were to be introduced more broadly, while the macroprudential framework retains a level of flexibility in the application of different macroprudential measures to the same risk, there is a risk for double-counting of the same risk when reciprocating. Thus, if mandatory reciprocity were to be expanded, it is important that provisions for cases where the risk is already covered by another macroprudential tool in the reciprocating jurisdiction are included in the macroprudential framework. This risk for overlap also means that banks in a reciprocating jurisdiction would still need guidance from its macroprudential authority if to recognize the measure or not. It is also important to keep the materiality thresholds to ensure that banks with smaller relevant amounts do not have to apply the reciprocated measure. Otherwise it might lead to an increased burden and complexity for smaller banks.

Another aspect is that changes have recently been made to the regulatory framework for instance concerning the SyRB with the introduction of the Sectoral Systemic Risk Buffer. Decisions to introduce a Sectoral Systemic Risk Buffer has recently been taken in some countries, and the reciprocity process is on-going but experience is so far limited. Thus, before considering to expand the mandatory reciprocity to include the SyRB, further experience should preferably be gained on the use of this macroprudential instruments, and reciprocity of these measures.

4. Global and emerging risks

4.1. Assessment of the current macroprudential framework's suitability for addressing cross-border and cross-sectoral risks

Question 14 - Have macroprudential tools been appropriate and sufficient to limit the systemic risk arising from EU banks' exposures to third countries? Please explain your answer to question 14, also in light of the experience gathered so far, considering in particular whether the EU's existing macroprudential tools and capital requirements (notably Articles

138 and 139 CRD) are sufficient to limit systemic risks emanating from EU banks' third country exposures:

The Swedish authorities currently do not see any need for revisions regarding this aspect.

Question 15 - Is the EU macroprudential toolkit adequate for monitoring and mitigating banks' systemic risks related to global market-based finance, securities and derivatives trading as well as exposures to other financial institutions?

There are issues that need further analysis in this review or in another context. In particular, today's framework is, to a large degree, incomplete regarding the non-banking sector. This situation warrants further consideration, taking into account the work being done in this area in other EU contexts.

4.2. Possible enhancements of the capacity of the macroprudential framework to respond to new global challenges

Question 16 - How do you expect systemic risks to evolve over the coming years and what enhancements of the EU macroprudential monitoring framework and toolkit (notably capital buffers, rules on risk weights and exposure limits), would be necessary to address global threats to financial stability?

The Swedish authorities support further analysis on the capacity of the macroprudential framework to respond to the increasing global and in particular EU-wide interconnectedness of banks, as well as of banks and the non-banking sector. In this context, the need to ensure that macroprudential tools can be applied at the relevant level in a banking group will likely increase over time.

Question 16.1 - Financial innovation: What risks to financial stability could result from banks' new competitors (FinTech and BigTech) and the arrival of new products (notably crypto-based)? Is there a need to enhance banks' resilience in view of such changes? If so, how could this be achieved while maintaining a level playing field?

The financial sector is dynamic and new innovation and actors arise all the time. To detect possible systemic risks stemming from financial innovation in general, Fintech and BigTech in particular, it is key to monitor

developments and interconnections between these players as well as between them and both the traditional banking system and the financial system as a whole. Risks related to the new competitors to existing financial institutions need to be analysed and identified, although this is a difficult task.

Also, new instruments such as crypto assets will pose additional challenges and risks to banks, but also possibly opportunities. Some of these new products are also developing fast and can move swiftly across borders. This clearly warrants greater international cooperation to mitigate the risks.

The Swedish authorities recognise that in these areas much work is already being done in other EU-fora. At this junction, it is not apparent, if the risks from financial innovation, new actors and crypto assets can be sufficiently addressed through appropriate prudential regulation and supervision or whether an explicit macroprudential perspective is also needed. Consequently, the Swedish authorities support further analysis and discussion on this topic.

Question 16.2 - Cybersecurity: Is there a need to enhance the macroprudential framework to deal with systemic cybersecurity threats? If not, how should the existing tools be used to mitigate threats and/or build resilience?

Cyber risks are – at least – partly operational in nature. Supervision and cooperation are therefore crucial to address such risks. Furthermore, cyber risks may become systemic risks if they affect systemic actors, e.g., financial market infrastructures, or if the correlation of cyber risks across banks increases. It is important to analyse the systemic risks that may arise from cyber risks.

However, systemic risks stemming from cyber risks may be relevant and dealt with in a prudential, and to some extent sectoral, approach. In the Swedish authorities' view, including cyber risks in the macroprudential framework, or developing specific macroprudential tools, is not called for at present. We also recognise that important work is being done at the EU-level regarding regulation of cyber risks.

Question 16.3 - Climate risks: Should the macroprudential toolkit evolve to ensure its effectiveness in limiting systemic risks arising from climate transition and from physical climate change, also considering the current degree of methodological and data uncertainty? And if so, how?

Transition and physical risks arising from climate change represent a material risk to the banking system and they may become a source of systemic risk to the financial system. Hence, climate related risk may affect not only individual banks, but also sectors and regions.

From a microprudential perspective, it is therefore important that banks already today properly measure, assess, and incorporate climate related risks into their risk assessments. These risks include the "political risk" that in the future some CO_2 intensive activities may become outlawed, subject to higher taxes or other requirements and that this creates credit risk for banks.

However, appropriate quantification of climate risks to banks' balance sheets is a major challenge and, in addition, there are feedback loops between the financial sector and the real economy that may be hard to assess. Macroprudential policy can therefore be an important complement to microprudential policy. The Swedish authorities consider that further analysis is warranted on what role macroprudential policy can play in this respect. In particular, we should consider how currently available macroprudential tools, such as for example the Sectoral Systemic Risk Buffer, possibly with some minor revisions, may be used to help limit climate related systemic risks.

We would like to stress, though, that we would find it inappropriate to use the capital regulation framework to subsidize "green" activities. The credit risk of financing "green" activities will not be reduced just because the activity is "green". The capital framework should focus on the credit risk, market risk and operational risks that banks encounter. Potential subsidies should be tackled through budgetary subsidies, not through banking regulation. If, despite these arguments, the capital framework would be used to influence the allocation of resources in a climate related way, it should be done through penalizing "brown" activities, instead of subsidizing "green" ones. Penalising "brown" activities would not dilute the resilience of the banking sector and it is likely to be easier to define what is "brown" than what is "green".

Finally, the Swedish authorities support the steps taken in sectoral legislation e.g., the Banking Package 2021 and the Solvency II-proposal to introduce climate risk in risk management. In addition, we support further work by ESAs to analyse how climate risk and sustainability can be reflected in the

financial regulation. In the Swedish authorities' view, further analysis on systemic risks arising from climate transition and from physical climate change, as well as the development of possible policy instruments to mitigate the risks, can be informed by this work.

Question 16.4 - Other ESG risks: Should the macroprudential toolkit further evolve to address financial stability risks stemming from unsustainable developments in the broader environmental, social and governance spheres? How could macroprudential tools be designed and used for this purpose?

The Swedish authorities maintain that regulators and supervisors should be monitoring how banks and other financial institutions manage other ESG risks. Further analysis is warranted on how to assess such ESG risks as well as how these risks can affect individual actors and whether such risks can possibly pose a threat to financial stability. Other ESG risks should be, and to an increasing extent are, dealt with in sectoral prudential regulation and supervision. In the Swedish authorities view, it is not presently called for including other ESG risks in the macroprudential framework or developing specific macroprudential tools.

Other observations

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Question 17 - Do you have any general observations or specific observations on issues not covered in the previous sections?

We would like to stress the importance of keeping a review clause in the CRR/CRD, as macroprudential policy is a rather new and evolving policy area. First, we continuously gain more knowledge of the effectiveness of different macroprudential instruments. This new knowledge should be reviewed with regular intervals, with a view to refining the instruments. Secondly, financial market actors develop their businesses over time and new actors evolve. If macroprudential policy is to remain effective, it must be able to mitigate systemic risks wherever they arise. An area where we already today see a need for a review is the non-banking sector. Thirdly, also new risks – which may in some cases become systemic – emerge over time. We should regularly reflect on what instruments we need to effectively mitigate such emerging risks. For all the reasons above, we find it important to include a review clause also in the future regulation.