Template for notifying intended measures to be taken under Article 458 of the Capital Requirements Regulation (CRR)

Please send this template to
- notifications@esrb.europa.eu when notifying the ESRB;
- macropru.notifications@ecb.europa.eu when notifying the ECB;
- notifications@eba.europa.eu when notifying the EBA.

Emailing this template to the above-mentioned addresses constitutes an official notification, no further official letter is required. In order to facilitate the work of the notified authorities, please send the notification template in a format that allows electronically copying the information.

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<tr>
<th>1. Notifying national authority and scope of the notification</th>
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<td><strong>1.1 Name of the notifying authority</strong></td>
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| **1.2 Categorisation of measures** | Finansinspektionen, in its capacity as the designated authority for the purpose of Article 458 of Regulation (EU) No 575/2013, intends to apply a stricter national measure for credit institutions using the Internal Ratings Based (IRB) Approach for calculating regulatory capital requirements applicable to retail exposures in Sweden collateralised by property. The stricter national measure concerns risk weights for targeting asset bubbles in the residential property sector (Article 458(2)(d)(vi) of Regulation (EU) No 575/2013). This national measure enables Finansinspektionen to change the method it currently uses to apply the current risk weight floor of 25% for Swedish mortgages for IRB banks through Pillar 2 by replacing it with a requirement within the framework of Article 458 of the CRR. More specifically, the measure is defined as: 

A credit institution-specific minimum level of 25% for the average risk weight on Swedish housing loans applicable to credit institutions that have adopted the Internal Ratings Based Approach.

For the purpose of this notification, the term “bank” has the same meaning as “credit institution” as defined in Article 4 of the CRR. |
| **1.3 Request to extend the period of application of existing measures for one additional year (Article 458(9) of the CRR)** | The proposed measure is a new macroprudential measure using Article 458 of the CRR. |
1.4 Notification of measures to which Article 458(10) of the CRR applies ('notification only procedure')

The proposed measure is not subject to the notification procedure as specified in Article 458(10) of the CRR. The measure implies an average risk weight floor of 25% on the Swedish mortgage exposure portfolios of the IRB banks. The concerned banks currently have average risk weights for their respective relevant portfolios that range from 3.4% to 12.5% in Pillar 1 based on their IRB models. The impact of the measure for the affected IRB banks is thus more than 25% of their respective risk weights that result from the use of the IRB models. Therefore, Article 458(10) of the CRR does not apply.

2. Description of the measure

2.1 Draft national measures (Article 458(2)(d) of the CRR)

The risk weight floor for Swedish mortgage exposures was first introduced in 2013[1] and then revised and recalibrated in 2014[2]. The floor constitutes today an important element of Finansinspektionen’s capital requirements. It applies to credit institutions that have permission to use the IRB approach. The floor was introduced as part of the supervisory capital assessment in Pillar 2.

Finansinspektionen made the assessment already when the floor was introduced that it was crucial for the stability of individual credit institutions as well as the Swedish financial sector for the credit institutions to hold own funds that fully cover the risks in the Swedish mortgage portfolios from a wider and more forward-looking perspective than was the result of the IRB model estimations. The level of the floor, defined as the average risk weight at the portfolio level, was initially set at 15% with the argument that there is a risk that the credit institutions’ IRB approaches do not fully capture the credit loss risk of Swedish mortgages in a severe downturn scenario.[4] Credit risk models on Swedish mortgage exposures often generate risk weights that from a broader perspective can be considered to be relatively low since credit losses in the mortgage portfolios have been virtually non-existent for a long period of time. In order to also account for the broader systemic risks that could arise from the Swedish mortgages of individual credit institutions, the floor was raised to 25% in 2014.

Finansinspektionen now intends to change the method it is currently using to apply the current risk weight floor for Swedish mortgages through Pillar 2 by replacing it with a requirement within the framework of Article 458 of

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3 Swedish mortgages in the standardised approach receive a higher average portfolio risk weight than 25% and therefore fall out of the scope of this measure.

4 The conclusion that risk weights for Swedish mortgages should be at least 15% was the result of an overall assessment of future loss levels in Swedish mortgages in a scenario with intense financial stress. The risk weights resulting from the IRB models range from 3.4% to 12.5%, with the average risk weight for the four largest banks being 4.2%.
CRR. The new requirement will be included in the Pillar 1 requirements. Thus, the proposed measure is the following:

- An average risk weight floor of 25% on the Swedish mortgage exposure portfolios of the IRB banks.

**Definition of average risk weight**

The proposed measure refers to the exposure-weighted average risk weight. It is calculated by the portfolio’s risk-weighted exposure amount divided by the exposure amount (EAD).

\[
\text{Additional risk exposure amount according to Article 458} = \text{EAD} \times (25 \% - \text{current RW})
\]

The measure constitutes an average risk weight floor on the portfolio level of the concerned IRB banks covered by the measure.

It should be noted that the proposed measure will affect the total risk exposure amount (TREA) and, therefore, the minimum Pillar 1 capital requirements that IRB banks have to meet at all times according to Article 92 of the CRR. The measure will thus increase the overall REA of the affected IRB banks. Finansinspektionen considers the impact on the total capital requirement to be limited in nominal terms, given that the measure is already applied in Pillar 2, and that the banks’ possibilities for meeting the total capital requirement are not affected.6

According to Chapter 1, section 6, second paragraph of the Special Supervision of Credit Institutions and Investment Firms Act (2014:968), Finansinspektionen is the competent authority in Sweden that decides on special macroprudential measures in accordance with Article 458 of the CRR.

Article 458(2)(d) (vi) of the CRR is the legal basis for the measure.

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### 2.2 Scope of the measure (Article 458(2)(d) of the CRR)

The scope of the measure, in terms of both exposures covered and credit institutions concerned, is the same as in the current implementation and treatment of the Swedish risk weight floor. More specifically, the measure applies to:

- Exposures in Sweden collateralised by immovable property within the exposure class ‘retail exposures’. This approach does not create burdensome additional work for the affected banks since it uses an already existing definition in the CRR.

In accordance with the current calculation of the risk weight floor in Pillar 2, the calculation will be based on reported data in the

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5 Risk-weighted exposure amount for retail exposures calculated in accordance with Article 154 and 154(3) of the CRR.

6 The change in the method of applying the risk weight floor for Swedish mortgages from Pillar 2 to Pillar 1 implies an increase in the total capital requirements in nominal terms of about SEK 1.4 billion (as per Q4 2017) due to calculation reasons. Swedish banks have more than enough capital to cover this amount. The four major Swedish banks alone earned a total of SEK 105 billion in profits in 2017.

7 Article 154(3) of the CRR.

8 Article 147(2)(d) of the CRR.
COREP template based on the following cells:

- C 09.02 – Geographical breakdown of exposures by residence of the obligor: IRB exposures (CR GB 2), Sweden.
  - Row 070, columns 105 and 125.

For institutions that are subject to the measure but do not report in accordance with C 09.02, the following is proposed:

- C 08.01 – Credit and counterparty credit risks and free deliveries: IRB approach to own funds requirements (CR IBR 1)
  - Row 010, column 260.

- Credit institutions that have permission to use the IRB approach and have an exposure to Swedish mortgages. The measure focuses on IRB banks as their model-implied risk weights are relatively low, compared to those implied by the standardised approach. These are also typically the credit institutions with the largest share of mortgage exposures in their portfolio in Sweden. Their total combined amount of mortgages accounts for 95 % of the total mortgage market in Sweden.

- The measure applies to the individual banks as well as the consolidated situation. This implies that 20 banks will currently fall within the scope of the measure, including Danske Bank’s Swedish subsidiary (Danske Hypotek AB). Danske Bank operates in the Swedish mortgage market through its Swedish branch as well.

### 2.3 Calibration of the measure

The calibrated level of the proposed measure is the same as in the current implementation and treatment of the risk weight floor for Swedish mortgages. Thus, the calibration of the minimum level for the average risk weight floor is set so it securely covers both future loss levels in Swedish residential mortgages in a severe scenario with high financial stress and takes into account the broader systemic risks that could arise. A risk weight floor of 25 % is assessed to be adequate for this purpose. For more information on the calibration of the measure and assessments related thereto, see *Risk Weight Floor for Swedish Mortgages*, May 2013, FI (in particular pp. 14-19) and *Increase to the Risk Weight Floor for Swedish Mortgages*, Chapter 4 (in particular pp. 62-63) of *Capital Requirements for Swedish Banks*, September 2014, FI.10

The capital requirement, in nominal terms, corresponding to a 25 % risk weight floor for Swedish mortgages, is SEK 111 billion at the consolidated

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9 Swedish banks applying the standardised approach assign risk weights of 35 % to their exposures fully and completely secured by mortgage on residential property in Sweden. Their total share of the Swedish mortgage market is about 5 %.

10 Links to the two decisions on introducing and revising the Swedish risk weight floor in 2013 and 2014, respectively, are found in section 6.2.
The measure increases the implied risk weights on Swedish mortgage exposures from 4.5% on average (volume-weighted) to 25%. Thus, the risk weight floor has increased the capital levels and created an added loss-absorbing capacity in the affected banks. The impact of the measure, in nominal terms, on the total capital levels of the IRB banks is relatively minor, as the measure has been in place since 2013 under Pillar 2. However, the total capital requirement expressed as a per cent of the risk-weighted assets will decrease as a result of the proposed measure. This decrease is primarily an effect of removing the risk weight floor for mortgages from Pillar 2 and instead increasing the risk-weighted exposure amount, i.e. the denominator in the capital ratio. The size of the effect for each credit institution is dependent on the percentage of Swedish mortgages in the balance sheet. The credit institutions that have a relatively high percentage of Swedish mortgages will experience a more tangible decrease than credit institutions with more diversified operations. It is, however, important to note in this context that the banks’ possibilities for meeting the total capital requirement are not affected. For more information on the impact assessment of the measure, see the published consultation memorandum Changed method for the application of the risk weight floor for Swedish mortgages, March 2018, FI, which is attached as appendix A.

Finansinspektionen considers the proposed measure to be necessary, suitable, effective and proportionate on the basis of a number of considerations.

First, the proposed measure is intended to ensure that important residential mortgage banks are fully resilient and can withstand a potentially severe downturn in the housing market without restricting the supply of credit. This can be achieved by imposing a sufficiently high capital requirement for residential real estate exposures. The necessity of this is stressed by the elevated household indebtedness in Sweden, mainly consisting of mortgage loans, which has increased rapidly and continuously for a long time. This development has occurred hand-in-hand with substantial increases in house prices over the past 20 years. Studies by international bodies such as the International Monetary Fund (IMF), the ESRB and the European Commission indicate overvaluation in the Swedish residential real estate market. These international bodies have continuously highlighted the systemic risks posed by Swedish mortgages and the developments on the Swedish housing market. The need for additional capital buffers also arises from the low model-implied risk weights for mortgage exposure, which stand in contrast to the increased vulnerabilities at the macro level. Given the IRB-modelling of credit risks and the fact that Sweden has not experienced a real estate crises of a major magnitude since the early 1990s (and even then the credit losses were not that high in the retail segment), it is assessed that the current IRB risk weights do not and cannot reflect the full impact of a potential crisis at the macro level in an

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11 Capital requirements for the Swedish banks, fourth quarter 2017, February 2018, FI.
https://www.fi.se/contentassets/b2daaf0c7da74f18705974ea77f121a4/kapital_pm_2017q4_eng_rev180309.pdf.
accurate way. Therefore, there is a need to target the risks associated with high household indebtedness and high house prices through a sufficiently strong capital buffer for mortgage exposures.

**Second, the measure is effective and proportionate in that it targets the very exposures that give rise to the identified systemic risks linked to Swedish mortgages and residential real estate.** The design of the measures is such that it ensures good precision in targeting the mortgage exposures of IRB banks without spilling over to other parts of the banks’ lending. This minimises any potential negative side-effects.

**Third, the measure is suitable and effective as it intends to ensure a level-playing field for all banks that operate in the Swedish residential mortgage market and, in turn, also upholds resilience and safeguards financial stability.** This is especially important given the current structural changes that are occurring in the Swedish banking market. Currently, all material lenders in the Swedish mortgage market are consolidated in Sweden, except for the Swedish branch of Danske Bank, for which Finanstilsynet reciprocates the current Pillar 2 measure. However, Nordea Bank AB (Nordea) decided on 15 March 2018 to move its legal domicile from Sweden to Finland. Nordea is today the largest Swedish bank with total assets amounting to 120 % of the Swedish GDP. Nordea is established and systemically important in all Nordic countries with the exception of Iceland. Due to Nordea’s size, range and complexity of provided financial services, cross-border activities and interconnectedness with other financial actors and counterparties, Finansinspektionen has identified the bank as both G-SII and O-SII.\(^\text{12}\) Nordea is also one of the major actors in the Swedish mortgage market, holding a 14 % share. The scope of Nordea’s business operations in Sweden will not change as a consequence of the planned move. It is assumed that, after the move, Nordea’s operations in Sweden will consist of a significant branch\(^\text{13}\) and a number of subsidiaries, including Nordea Hypotek AB, which is classified as a credit institution. The capital adequacy regulations offer the possibility, on a voluntary basis, to request and achieve reciprocity of capital requirements in Pillar 2 within the framework of the Joint Decision on capital taken in the supervisory colleges. However, Finansinspektionen makes the assessment that the supervision practice applied by SSM/ECB makes it highly unlikely that the authority will be able to apply the Swedish risk weight floor in Pillar 2, as it is designed today. If the risk weight floor is kept as a Pillar 2 measure, Finansinspektionen assesses that Nordea, by re-domiciling to Finland, will be subject to lower capital requirements for its Swedish mortgage exposures than it is today.

Article 458 of the CRR contains a more structured pre-defined process for requesting reciprocity by the designated authorities in the EU Member

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\(^{12}\) Nordea is currently subject to a G-SII buffer of 1 % and an O-SII buffer of 2 %.

\(^{13}\) According to the forthcoming guidelines from the EBA regarding supervision of significant branches (EBA/GL/2017/14), which have been adopted in Sweden, and given the size of Nordea Bank AB and the significant role it currently holds on the Swedish market, Nordea’s Swedish branch is most likely expected to also be classified as a “significant-plus branch”.
States. Therefore, due to Nordea’s planned move there is a need to change the manner in which the risk weight floor is currently applied. Given the elevated and increasing macroprudential risks identified in the mortgage and housing markets, there is a risk that if a major player in the mortgage market will get significantly lower capital requirement for mortgages, this will not only impair resilience and harm financial stability, but also distort competition and the functioning of the market. Thus, this change is necessary and suitable to maintain a level playing field in the Swedish mortgage market and ensure the resilience of the banking sector and thereby financial stability.

Finally, the measure ensures that capital levels are upheld and contribute to mitigating the risks highlighted in the ESRB Warning from November 2016. In its warning, the ESRB identified the main vulnerabilities for Sweden by explicitly referring to:

- “… the rapidly growing residential real estate prices that appear to be overvalued, and high and increasing indebtedness especially among some groups of households. In addition, if risks were to materialise, there could be potential cross-border spill-over effects to other countries in the Nordic-Baltic region.”

- “Adverse dynamics in residential real estate prices and household consumption may also pose a threat to the banking system. Downside risk could be amplified by the high reliance of Swedish banks on market and foreign currency funding.”

- “… vulnerabilities in the residential real estate sector of Sweden as a source of systemic risk to financial stability which may have the potential for serious negative consequences for the real economy.”

In summary, Finansinspektionen considers the proposed measure, an average risk weight floor of 25% for mortgage exposures for IRB banks, as necessary, suitable, effective and proportionate. The measure is necessary to ensure a sufficient capital buffer and thus resilience in the Swedish banking sector. This capital buffer is necessary to have in place in the event of a severe downturn scenario in the Swedish housing market, thereby supporting the banks in maintaining the flow and supply of credit to the real economy.

The measure targets residential mortgage exposures and has been in place since 2013. No negative spill-overs to other sectors, credit extensions in general or the real economy have been observed during this time. Nor are they expected once the measure is implemented in Pillar 1 instead of in Pillar 2.

The measure ensures that the capital buffers, which have been built since the implementation of the measure in 2013, remain virtually the same in nominal terms. The requirement constitutes today on average 15% of the nominal total capital requirement for the ten largest Swedish IRB banks at the consolidated level, which confirms the effectiveness of the measure in increasing resilience. At the same time, the measure seems not to have restricted households’ access to mortgages since the average growth rate of mortgages has ranged from 5% to 9% on an annual basis since the introduction of the risk-weight floor.
Proportionality of the measure is ensured given its scope. It targets residential mortgage exposures, thereby avoiding any detrimental impact on other types of lending, such as credit to the non-financial corporate sector. It applies to IRB banks, thus not affecting banks that have opted for the standardised approach and therefore already apply higher risk weights on mortgage exposures.

Finansinspektionen will monitor the effectiveness of the measure on the basis of the requirement’s overall ability in achieving its core macroprudential objective, namely to strengthen and ensure the resilience of IRB banks exposed to Swedish mortgages. Such assessment will, therefore, be based on the capital adequacy of these banks, especially in terms of the amount of own funds, risk-weighted capital ratios and overall exposure to the Swedish mortgage and residential real estate markets. Part of this assessment is also the monitoring of any potential unintended consequences on bank lending and sustainable profitability.

<table>
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<tr>
<th>2.5 Other relevant information</th>
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<tr>
<td>Finansinspektionen has taken measures over time to mitigate the vulnerabilities posed by high household debt. Thus, in addition to supply-side measures, i.e. introducing a risk weight floor for mortgages to strengthen the resilience of banks, Finansinspektionen has also taken a number of borrower-based measures with the objective of increasing the resilience of households. In 2010, Finansinspektionen introduced a mortgage cap, according to which new loans collateralised by a home should not exceed 85 % of the market value of the home. In June 2016, Finansinspektionen introduced an amortisation requirement. According to this requirement, households borrowing more than 50 % of the residential property’s value must amortise at least 1 % of their mortgage a year, while households borrowing more than 70 % must amortise at least 2 %. In March 2018, Finansinspektionen introduced a stricter amortisation requirement following approval by the Government. According to this stricter requirement, households borrowing more than 4.5 times their annual income before tax must amortise an additional 1 % of their mortgage a year. These measures have been deemed necessary and appropriate to strengthen the resilience of households and possibly curb household indebtedness. Nevertheless, household credit growth has remained high.</td>
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14 It is possible to be granted an unsecured loan to finance the purchase of a home. For more information about the mortgage cap, see Finansinspektionen’s general guidelines (FFFS 2010:2) regarding limitations to the size of loans collateralised by homes.

15 Finansinspektionen’s regulations regarding amortisation of loans collateralised by residential property (FFFS 2016:16).

16 Regulations amending Finansinspektionen’s regulations (FFFS 2016:16) regarding amortisation of loans collateralised by residential property (FFFS 2017:23).

17 Both amortisation requirements apply to new mortgages.
### 3. Timing of the measure

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<th>3.1 Timing of the Decision</th>
<th>August 2018</th>
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<tr>
<td>3.2 Timing of the Publication</td>
<td>The final decision will be taken by Finansinspektionen’s Board of Directors in August 2018 and subsequently published. Note, however, that Finansinspektionen announced its intention to use the notified measure already in March 2018 through the publication of a consultation memorandum.</td>
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<tr>
<td>3.3 Disclosure</td>
<td>Finansinspektionen published a consultation memorandum in March 2018 announcing its intention to change the method it currently uses to apply the current risk weight floor for Swedish mortgages through Pillar 2 by replacing it with a requirement within the framework of Article 458 of CRR. The memorandum also included the motivation for the measure and the impact assessment. The consultation period ended on 30 April 2018.(^{18}) Before the publication of the consultation memorandum, Finansinspektionen pursued a dialogue with the Swedish Bankers’ Association and the Swedish Savings Banks Association. Finansinspektionen has, in addition, held bilateral meetings with most of the credit institutions affected by the measure, both large banks and medium-sized credit institutions, in order to capture their views on the proposed action at an early stage. Finansinspektionen has also been in contact with the rating agencies and held a meeting with one of them in order to clearly communicate the measure and its impact on bank capital requirements. The proposed measure has also been presented at the meetings of the supervisory colleges of the major Swedish banks. Moreover, Finansinspektionen conferred with the Swedish National Debt Office (the resolution authority in Sweden) to assure the quality of the calculation of the impact of the measure on the banks’ requirements on bail-inable debt (so-called MREL requirements) as well as the impact analysis in general in order to take into consideration other effects that may result from the measure. Finally, Finansinspektionen informed the members of the Swedish Financial Stability Council about the work on the proposal.(^{19})</td>
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<tr>
<td>3.4 Timing of Application (Article 458(4) of the CRR)</td>
<td>31 December 2018</td>
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\(^{18}\) A summary of the feedback from the consultation bodies can be found in Appendix B along with direct links to the referral responses.

\(^{19}\) The Swedish Financial Stability Council is a forum for representatives from the Government, Finansinspektionen, the Swedish National Debt Office and the Riksbank. The Council discusses matters related to financial stability and how to counteract financial imbalances.
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<th>3.5 Phasing in</th>
<th>No phasing-in is planned. The measure enters into force immediately on 31 December 2018.</th>
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<tr>
<td>3.6 Term of the measure (Article 458(4) of the CRR)</td>
<td>The measure is intended to be implemented for a minimum of two years and possibly renewed afterwards. Finansinspektionen will monitor the measure regularly on the basis of its overall macroprudential (mitigating) impact on the observed build-up of systemic risks in the Swedish mortgage and residential real estate markets. In line with Art 458(4) of the CRR, Finansinspektionen will consider the withdrawal of the measure if risks were to materialise. Such assessment will be based on guided discretion, taking account of the overall developments in the residential real estate market and prices, developments in household indebtedness and in particular the growth rate of mortgages, mortgage-linked indicators such as LTV and LTI (as also followed in the annual mortgage survey conducted by Finansinspektionen) and the resilience of the IRB banks in terms of both capital strength, credit quality indicators and observed credit losses directly or indirectly linked to Swedish mortgages.</td>
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<tr>
<td>3.7 Review (Article 458(9) of the CRR)</td>
<td>The necessity and appropriateness of the measure will be reviewed in line with the requirements in Article 458 of the CRR, with possible amendments of the measure implemented at renewal. The review and assessment process would be in the same lines as described in section 3.6.</td>
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| 4. Reason for the activation of the stricter national measure | **Sweden has experienced a significant and prolonged build up and intensification of systemic risk related to the housing market.**

**Swedish banks are increasingly exposed to the residential property sector.** Today, the banking sector supplies essentially all residential mortgage loans in Sweden. IRB banks constitute 95 % of the total mortgage market, making them fundamental for the supply of mortgages to households. Mortgages account for 82 % of monetary financial institutions’ total lending to households and about 68 % of the Swedish GDP. For the four major banks, mortgage loans to households constitute 50 % of their total lending, making them sensitive to a negative development in the housing market.

**Residential real estate prices have increased substantially for two decades now.** House prices were more or less unaffected by the 2008 financial crisis, and the upswing has continued virtually uninterrupted. Thus, **house prices have doubled over the past ten years,** and several international bodies have made the assessment that residential properties in Sweden may be overvalued. For example, the European Commission (2018) pointed out that the price-to-income ratio is about 40 % above the historical average.\(^{20}\) ESRB’s valuation model also indicates that homes in Sweden are overvalued by 40–60 %.\(^{21}\) Estimates of overvaluation have, |

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\(^{21}\) *ESRB Risk Dash Board*, March 2018.
moreover, increased over the last couple of years. In light of this, Finansinspektionen makes the assessment that there is an increased risk for a substantial price correction in the housing market.

The increase in house prices has been supported by good access to mortgages (but not driven by any material watering down of origination lending standards, according to Finansinspektionen’s mortgage supervision) and the low interest rate environment. As a direct consequence, household debt has increased much faster than both household disposable income and GDP for a prolonged period. Household debt has increased on average by 8.2 % in annual terms over the period 1997-2017. By contrast, average disposable income has only increased by 4.3 % in the same period. Household credit growth remained high at an annual growth rate of 7 % in March 2018. Mortgages are the primary driver behind the development in household debt with an annual growth of 7.2 % in March 2018.22

Swedish households are thus borrowing more in relation to their income. The aggregate DTI ratio has been rising for a long period of time. Household aggregate debt accounted for more than 180 % of disposable income at the end of 2017, up from around 90 % in 1997, thus doubling in 20 years. Among all mortgage borrowers, the share of households with high DTI ratios, which is defined as a DTI ratio greater than 450 %, continued to increase in 2017. Even without a further increase in house prices, the aggregate DTI ratio is expected to keep rising since households that are moving must do so in a market with substantially higher prices. Thus, despite already being high in a both historical and international perspective, the DTI ratio of Swedish households is expected to climb even higher.

The majority of mortgages (70 %) have floating interest rates. In combination with the rise in DTI, this makes Swedish households sensitive to sudden interest rate shocks that could arise as a result of turbulence in financial markets or a contraction in the supply of credit.

In addition, many Swedish households are also relatively highly leveraged in relation to the value of the home. Approximately 60 % of outstanding mortgage volumes stem from households with LTV ratios greater than 50 %. Mortgages make up the bulk of Swedish households’ total debt, and incentives to amortise have long been weak due to both low interest rates and rather generous interest rate deductions, leaving many households highly indebted over time after the purchase of a new home.

Construction of new housing, which has been suppressed for a long time and thereby contributed to the rising house prices, has picked up in recent years. Although an increased supply of housing may dampen house price growth, it may also exacerbate the problem. The greater supply of new residential properties may contribute to the increase in household mortgages since ownership of new homes is largely financed through loans to households. It also contributes to an increase in the aggregate DTI ratio in the short term. This leads to a higher intensity in the systemic risks linked to the Swedish mortgages.

22 More than 80 % of household lending consists of mortgages.
The Swedish mortgage market is also facing structural changes in that new financial actors (with new business/finance models) are entering the market and supplying mortgages to households in direct competition with the traditional banks. While there may be positive effects from such changes, a more competitive environment in terms of a greater supply of mortgages and cheaper interest rates may further increase household indebtedness, thus intensifying the systemic risk linked to Swedish mortgages and the potential negative repercussions for the stability of the financial system in Sweden.

In summary, a combination of structural and cyclical vulnerabilities are giving rise to elevated and increasing systemic risks in Sweden. The structural vulnerabilities consist of a large and concentrated banking sector that is highly exposed to the residential real estate market. IRB banks, in particular, play a fundamental role in the supply of residential mortgages and are heavily exposed to both the mortgage and the housing markets. They are, at the same time, vulnerable to funding risks that are directly affected by the developments in these markets. The cyclical vulnerabilities reflected in the high housing prices and high and still rising household indebtedness exacerbate and intensify the identified systemic risk. There is therefore a need for resilience in the system in the form of high loss-bearing capital for the banks in order to protect against a potential crisis scenario that cannot be fully captured in bank credit risk models. The risk weight floor for Swedish mortgages is a measure that targets and contributes to the mitigation of the cyclical systemic risk.

### 4.2 Analysis of the serious negative consequences or threat to financial stability (Article 458(2)(b) of the CRR)

Swedish mortgages constitute an important and large portion of the balance sheet of Swedish banks, and developments in the housing market have a considerable effect on household finances. In the event of a severe downturn in the Swedish economy or turbulence in the financial system, a negative dynamic may arise between the residential real estate market, the macroeconomic situation and bank behaviour in Sweden. This could have negative repercussions for the Swedish real economy and in the long run pose a threat to the stability of the banking system.

IRB banks are crucial for the supply of mortgages to Swedish households and could react strongly to adverse events that put strain on their business models or balance sheets, for example an initial negative shock in the housing market or increased financial stress either globally or domestically that affects the banks’ funding costs or reduces their appetite for risk. Another example could be a more general macroeconomic downturn that leads to an increase in credit losses. If banks deleverage and reduce their supply of credit by raising interest rates or imposing substantially stricter lending standards, this could have a strong impact on both household demand for housing and household consumption, which would most likely amplify the negative scenario. A self-reinforcing negative cycle could be triggered, which would have the potential of developing into a full blown systemic crisis, even though the initial shock was not systemic.

Due to the rapid increase in house prices and household indebtedness over the past decade, Finansinspektionen makes the assessment that households and the housing market are more sensitive to adverse shocks in the supply of credit. The high percentage of variable rate mortgages
means that potential transmission effects will spread swiftly. In addition, the magnitude of the potential corrections on the housing market as well as the potential reaction of households to such scenarios are considered to have increased since both house prices and household debt are at historically high levels.

If house prices fall, household wealth would decrease, thus leaving some households with particularly weak balance sheets. These households would experience a reduction in their ability or willingness to consume. Consumption, therefore, may be adversely affected by a fall in house prices, and highly indebted households in particular may react strongly and reduce their consumption during an economic downturn. Since the indebtedness of Swedish households has increased substantially, so has the potential impact of this indebtedness on economic development. Because household consumption constitutes almost 50% of Swedish GDP, any adjustments in household spending would have a material impact on the economy at large.

Falling house prices and reduced consumption would also likely lead to a decrease in investments, particularly in the construction sector, as uncertainty about house prices and the economic development increases. A severe downturn in the Swedish residential real estate market could thus rapidly spill over to the commercial real estate market and be further propagated through a negative impact on the solvency of banks and reduced macroeconomic confidence, which would further exacerbate the economic downturn.

Swedish mortgages also make up the majority of the cover pool that serves as a basis for one of the banks’ most important funding sources - covered bonds. A substantial price correction associated with a loss of confidence in the housing market could potentially lead to a dynamic with reduced risk appetite among banks and increased caution from investors with regard to the banks’ covered bonds, further amplifying the reduction in credit supply and by extension the severity of the downturn.

Last but not least, Swedish banks are heavily interlinked with Nordic and Baltic counterparts, indirectly leaving the region vulnerable and highly exposed to the risks associated with the Swedish housing market.

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<th>4.3 Indicators prompting use of the measure</th>
<th>The main indicators are:[23]</th>
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<tr>
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<td>• Assessment of banks’ exposures to real estate risks</td>
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<td></td>
<td>• Development of household indebtedness, in levels and growth rates</td>
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<td>• Development of house prices</td>
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<td>• Developments of risk profiles, i.e. LTV, DTI/LTI, DSTI, total risk weights, banks’ margins on mortgages, variable vs fixed interest rates etc.</td>
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23 Data are available upon request.
The objective of the measure is to increase and strengthen resilience in the Swedish banking sector given the prolonged and elevated risks in the household debt sector as well as the housing sector in Sweden.

Today, the capital buffer in the banking system due to the risk weight floor for Swedish mortgages amounts to SEK 111 billion or 15% of the total capital requirement for the ten largest IRB banks at the consolidated level. Needless to say, if this stricter measure were to be removed, risks would increase further since an important and sizable capital buffer would be removed, leaving the banking sector exposed and vulnerable to any negative developments in the housing market or shocks to the macroeconomy at large. Thus, the absence of the measure would weaken and harm the resilience of the Swedish banking sector and affect financial stability in Sweden in an undesirable way.

By implementing the current risk weight floor within the framework of Article 458 of the CRR, the measure makes it possible for the capital requirement with regard to mortgage exposures and thereby the capital buffers built up to address and manage future credit losses in the face of a downturn in the housing market or financial crisis in general to be maintained at the current level. This is crucial given that the vulnerabilities and systemic risk that Swedish mortgages and the developments in the housing market give rise to remain elevated and are still intensifying. The proposed measure ensures that the resilience of the Swedish banking system is kept intact despite the structural changes in the market due to Nordea’s decision to re-domicile its parent company from Sweden to Finland.

Moreover, the implementation of the measure through Article 458 aims to ensure a level playing field and, thereby, uphold resilience and safeguard financial stability, given Nordea’s decision to move its headquarters. Provided that the relevant authorities approve the decision, it is expected that Nordea will be operating in Sweden as a significant branch and a number of subsidiaries, including Nordea Hypotek AB. This implies that while the risk weight floor will be applicable for the subsidiaries, it will not automatically apply to the branch and therefore in this part not to the Nordea Group, either. Reciprocity of the measure is therefore crucial to ensure that the measure also applies to Swedish branches and thereby at the consolidated level of foreign banks. Finansinspektionen makes the assessment that the use of Article 458 of the CRR facilitates the reciprocation of the measure. Unlike a macroprudential measure taken within the framework of Pillar 2, where a process for requesting reciprocity is not as clearly defined, Article 458 of the CRR allows a more transparent, clear and structured way for voluntary reciprocity of the measure either directly by the Member States in Article 458(5) or through the ESRB in Article 458(8).

High capital buffers that address risks linked to high household indebtedness and high house prices in Sweden are also crucial to maintain the market’s confidence in the ability of the Swedish banks to withstand a severe downturn in the housing market in particular or the Swedish real economy in general. Bank operating in the Swedish mortgage market rely quite extensively on market financing by issuing covered bonds as a way to
finance mortgage lending. Any deterioration in the capital buffers or decreased capital requirements could lead to diminished market confidence and thus have negative consequences for households, banks and the entire Swedish economy.

Last, but not least, the measure is important from the perspective of the Nordic-Baltic region. The Swedish financial system is characterised by a high degree of interconnectedness with the financial systems of other Nordic and Baltic countries. Swedish banks operate in all countries in the region and hold large market shares in many of them. This is particularly the case in the Baltic countries, where most of the Swedish banks are identified as O-SIs. Thus, measures that ensure the resilience of credit institutions and strengthen the stability of the financial system in Sweden also act to ensure the financial stability in the Nordic-Baltic countries and thereby the stability of a substantial part of the EU financial system.

Why other measures or legal bases are still not adequate

Article 124 of the CRR

Article 124 enables the competent authority, on the basis of financial stability considerations, to increase the risk weights of banks that apply the standardised approach to their mortgage exposures. About 5% of the relevant Swedish residential mortgage market exposures are held by banks applying the standardised approach, whereas exposures that are risk-weighted according to the IRB approach constitute 95% of the total mortgage market. Article 124 of the CRR would therefore not be effective in meeting the objectives of the measure.

Swedish banks applying the standardised approach assign risk weights of 35% to their residential mortgage exposures in Sweden, which is considered to be sufficient. This level stands in contrast to the average (exposure-weighted) risk weight of around 4.5% for IRB banks. Given the elevated and increasing macroprudential risks that have been identified, the measure therefore targets the IRB banks since they display relatively low IRB risk weights as a consequence of historically low credit losses on their domestic residential real estate credit portfolio. Because Article 124 of the CRR does not apply to credit institutions using the IRB approach, it is thus not relevant for achieving the aimed objective of the measure.

Article 164 of the CRR

Article 164 enables the competent authority to increase, on financial stability considerations, the exposure-weighted average LGD floor applied by IRB banks on their mortgage exposures. This measure has been considered as an option, but the assessment is that it would not adequately and effectively address the identified systemic risk. Finansinspektionen makes the assessment that the objective is currently more effectively achieved by implementing a risk weight floor – the same for all banks – rather than increasing LGD.

Increasing the LGD floor for mortgages would widen the differences in risk weights between IRB banks and result in a disproportionate increase in risk weights for some banks. As the IRB risk weight formula is a linear function of the LGD parameter, increasing the latter implies a bigger
unwanted effect on the banks with the highest initial PDs. Thus, applying an average risk weight floor is assessed to be a more effective way to address the issue of low IRB risk weights in view of the high and increasing systemic risk while at the same time avoiding increasing the differences in risk weights between IRB banks.

Moreover, in order to have the same impact as the proposed measure of a risk weight floor of 25%, the minimum LGD would need to be raised by more than a multiple of 5, i.e. to more than 50% in comparison to today’s 10%. This implies that any current differences in PDs and corresponding IRB risk weights between the banks would more than five-fold.

In addition, the proposed measure will not affect banks’ internal models, as would be the case if Article 164 were used. An increase in the average LGD floor under Article 164 would have implications beyond the calculation of risk-weighted exposure amounts and would, for example, also apply to the calculation of expected loss amounts as per Articles 158-159 of the CRR.

Last, but not least, the use of Article 164 would add further complexity to the determination of capital requirements and could reduce the transparency of IRB risk weights for market participants.

**Article 101 of the CRD**

With reference to Article 101 of the CRD, Finansinspektionen makes the assessment that Swedish banks using IRB models are on the whole not in breach of the requirements of the CRR when modelling their Swedish mortgage portfolios. The banks have modelled their estimates using long time series of internal historical data from their Swedish mortgage portfolios. The low risk weights are a result of the extremely low credit losses from Swedish mortgages that the banks have experienced ever since the financial crisis in the beginning of the 1990s. Losses in the mortgage portfolios were not very high during the recent financial crisis, either.

Finansinspektionen intends, nevertheless, to review the IRB models for the Swedish mortgages to ensure, among other things, that the cycle and downturn adjustment used in the calibration of PD and LGD are sufficient. These “bottom-up repair” measures, however, are not expected to increase the risk weights to anywhere near the 25% level of the floor. Moreover, these kinds of measures should be seen as long-term efforts that could possibly gradually push risk weights upward over a number of years, but will not realistically come into effect in the near future. By implementing the higher risk weights through a floor, any increase in risk weights in the IRB models would not lead to any double counting. Rather, the impact of the floor decreases to the benefit of the modelled risk weights.

In summary, it is not possible to achieve the same effect through Article 101 of the CRR as through Article 458. At the same time, there is no contradiction between a continuous review and improvement of IRB models and the implementation of a risk weight floor through Article 458.

**Articles 103, 104 and 105 of the CRD**

The risk weight floor for Swedish mortgages on the IRB banks is currently applied within the framework of Pillar 2. At present, all material lenders in the Swedish mortgage market are consolidated in Sweden, except for the Swedish branch of Danske Bank, for which the Danish Supervisory
Authority, Finanstilsynet, reciprocates the current Pillar 2 measure. However, Nordea’s decision to move its head office from Sweden to Finland implies significant changes to the current situation.

The re-domiciliation will have a major impact on the distribution of responsibility for supervision and crisis management between the authorities in the affected countries. Supervision responsibility for Nordea with regards to capital, liquidity and risk management will lie with the Banking Union’s central supervisory body, Single Supervisory Mechanism (SSM)/ECB, while Finland’s supervisory authority will be the responsible authority for macroprudential policy.

The capital adequacy regulations offer the possibility, on a voluntary basis, to request and achieve reciprocity of capital requirements in Pillar 2 within the framework of the Joint Decision process in supervisory colleges. However, Finansinspektionen makes the assessment that the supervision practice applied by SSM/ECB makes it highly unlikely that the authority will be able to apply the Swedish risk weight floor in Pillar 2 as it is designed today. If the risk weight floor is kept as a Pillar 2 measure, we assess that Nordea, by moving its head office to Finland, will be subject to lower capital requirements for its Swedish mortgage exposures than it is today.

Currently, the capital adequacy regulations do not clearly define reciprocity for Pillar 2 requirements, whereas Article 458 of the CRR contains a pre-defined process for requesting reciprocity by the designated authorities in the EU Member States. Therefore, due to Nordea’s planned move and in order to uphold resilience and safeguard financial stability as well as counteract a distortion in the competition on the market, there is a need to change the manner in which the risk weight floor is currently applied.

As for Article 105 of the CRD, the focus is on specific liquidity requirements, which is not relevant for the purposes of the proposed measure. As such it is outside the scope of the assessment.

**Article 133 and 136 of Directive 2013/36/EU**

Pursuant to Article 133, the systemic risk buffer is used with the objective of preventing and mitigating long-term, non-cyclical systemic or macroprudential risk not covered by the CRR. While the Swedish mortgage market and the residential real estate sector in Sweden also display vulnerabilities of a structural character, the aim of the risk weight floor for mortgages focuses on limiting the risk of a potential severe cyclical downturn in the housing market. It is thus a measure taken in response to the elevated and increasing cyclical risks in the residential real estate market.

In this context, it is also worth mentioning that Finansinspektionen already applies a systemic risk buffer of 3 %, applicable to the four major banks\(^{24}\), which addresses the structural risks associated with the large, concentrated and interconnected banking sector in Sweden.

Moreover, the systemic risk buffer is designed so as to apply to all exposures of a credit institution. A narrower application is possible only for exposures located in the Member State and exposures located in third

\(^{24}\) Nordea, SEB, Handelsbanken and Swedbank.
countries. Thus, the systemic risk buffer is not designed to apply to specific exposures, such as residential mortgage credit exposures within a Member State. Applying this instrument, therefore, risks penalising other types of exposures, including the corporate ones, which do not give rise to the systemic risk linked to Swedish mortgages and residential real estate market. This would be neither effective nor appropriate in addressing the systemic risk concerned. In addition, if the systemic risk buffer could be set on residential mortgage credit exposures within a Member State, the applicable buffer rate would have to be set at around 500 % for those exposures in order to achieve a corresponding capital requirement as a risk weight floor of 25 %.

As for Article 136 of the CRD, it enables the use of a countercyclical capital buffer to address cyclical systemic risks. The buffer is a time-varying capital requirement and applies to all credit exposures to the non-financial private sector located in the concerned Member State. The countercyclical buffer rate in Sweden is currently set at 2.0 %. It addresses the overall prolonged excessiveness in the credit growth in the Swedish economy and thereby the financial imbalances that have built up over time. In an ensuing recession or in the event of major losses in the banks, the buffer requirement may be reduced to counteract more restrictive lending and thereby alleviate the economic downturn.

The countercyclical buffer applies to all Swedish credit exposures and not just the mortgage exposures. In much the same way as the systemic risk buffer, applying the countercyclical buffer to target systemic risks linked to the Swedish mortgage and housing markets penalises credits and other exposures to SMEs and corporates, which are not the target of the measure. Moreover, it penalises the most banks with the lowest share of relevant exposures in mortgage loans. Therefore, further increasing the countercyclical capital buffer would not adequately address the identified risk in an effective and proportionate way.

5. Cross-border and cross-sector impact of the measure

5.1 Assessment of cross-border effects and the likely impact on the internal market (Article 458(2)(f) of the CRR and Recommendation ESRB/2015/2)

The proposed measure will secure the resilience of the Swedish banking sector and, through a stable financial environment, support continuous economic growth. Finansinspektionen does not expect the measure to have a negative impact on the internal market that would outweigh the financial stability benefits resulting from a reduction of the identified macroprudential or systemic risk.

The measure applies today to all IRB banks with Swedish mortgage exposures. As mentioned earlier, all material lenders in the Swedish mortgage market are consolidated in Sweden, except for the Swedish branch of Danske Bank, for which Finanstilsynet already reciprocates the current Pillar 2 measure. Nordea’s planned re-domiciliation to Finland necessitates the reciprocation of the measure in order to ensure that Nordea continues to hold capital for the Swedish mortgages after its move. Thus, reciprocity is key in order to avoid leakages and regulatory arbitrage. In this context, Finansinspektionen emphasises that a Memorandum of
Understanding (MoU) on prudential supervision of significant branches applies to the Nordic-Baltic macroprudential network. The competent authorities in the region acknowledge the importance of reciprocity of macroprudential measures in general, and in particular as a means to prevent banks from circumventing the measures by transferring operations to other countries. The authorities, thereby, recognise the importance of reciprocity as a means of ensuring a level playing field and a well-functioning internal market. The authorities also acknowledge Recommendation ESRB/2015/2 as a minimum standard for reciprocity in macroprudential matters. Note also that an additional MoU on cooperation and coordination on cross-border financial stability was recently signed by the ministries of finance, financial supervisory authorities, central banks and resolution authorities of the Nordic Baltic countries.

The Nordic and Baltic countries have common financial stability interests stemming from inter-linkages in the financial system in the region. This has resulted in a close cooperation between the countries to facilitate and support the measures taken by reciprocating them even long before there was a MoU in place. Examples include the reciprocation in 2014 of the Swedish 25% risk weight floor on Swedish mortgages by the Danish Finanstilsynet, the reciprocation in 2014 of the Norwegian stricter IRB model restriction for estimation of PD and LGD and a 20% LGD floor on Norwegian mortgages by Finansinspektionen and the Danish Finanstilsynet, and more recently the reciprocation in 2017 of the Finnish 15% risk weight floor for IRB banks’ mortgage portfolios by Finansinspektionen as the home authority of two major foreign branches affected by the Finnish measure. Naturally, the reciprocation for the Swedish measure at hand has also been discussed with other relevant authorities, including Finland, Denmark and the ECB. This will ensure the prevention of inward spill-overs and regulatory arbitrage.

Finansinspektionen assesses that the proposed measure will have a positive impact on the Internal Market. This is also supported by the experience so far with the use of the measure in Pillar 2. The positive consequences are the direct result of the financial stability benefits in terms of reducing and mitigating the macroprudential or systemic risk identified. This is increasingly important in the context of the financial interlinkages in the Nordic-Baltic region and the enhanced cross-border dimension of the Swedish financial sector.

5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State

Finansinspektionen will monitor closely the impact of the measure on other sectors of the Swedish financial system. As mentioned earlier, the mortgage market in Sweden has begun to change recently. These changes concern both the traditional financing model and the players involved in the mortgage lending chain. Insurance companies and pension funds have, for instance, shown interest in investing directly in mortgages through mortgage funds alongside their traditional role as investors for the covered


bonds issued by banks. Such a shift in the value chain in the Swedish mortgage market could mean that non-bank companies could take on a larger role. Thus, there is a need to monitor these developments closely in order to continuously assess the effectiveness of the measure.

Finansinspektionen will request that the ESRB recommends that other Member States reciprocate the measure, as their banking sector may be exposed directly or indirectly (through their branches) to the risk related to the residential real estate market in Sweden. A reciprocity request will also be sent directly to the relevant macroprudential authorities of the most affected Member States. In conjunction with the request for reciprocity, Finansinspektionen will also propose an institution-level maximum materiality threshold in order to avoid any disproportionate implementation costs for reciprocating Member States. This threshold will be set and calibrated in accordance with the principles in the reciprocity framework as established by the ESRB, taking into account the guiding principles on the calibration of the threshold level. Reciprocation will ensure the effectiveness of the measure in achieving the macroprudential goal of safeguarding the resilience of the Swedish banking sector with regard to risks in the residential real estate and mortgage markets.

In this context, it is important to note that a risk weight floor in the form of a Pillar 1 requirement under Article 458 of the CRR will apply directly to foreign banks’ subsidiaries that are credit institutions in Sweden. The measure will thus affect their exposures also at the consolidated level. It is therefore not necessary to ask for reciprocity of the measure for these banks’ exposures to the Swedish mortgage market. However, reciprocity of the risk weight floor from other Member States is necessary in order for the measure to apply also to Swedish mortgage exposures in foreign banks’ branches in Sweden and thereby also at the consolidated level.

As described above, reciprocation of the proposed measure is imperative to avoid any potential leakages or regulatory arbitrage. This is especially the case given the decision by Nordea to re-domicile its parent company from Sweden to Finland. Nordea is currently the largest bank in Sweden, with total assets amounting to 120 % of the Swedish GDP. It is also one of the major actors in the Swedish mortgage market holding a 14 % share of this market. The scope of Nordea’s business operations in Sweden will not change as a consequence of the planned move, and the planned branch of Nordea will be the third largest credit institution in Sweden.

With regard to Nordea’s move, Finansinspektionen further notes that there is a slight time discrepancy between the planned move on 1 October 2018 and the entry into force of the proposed measure on 31 December 2018. Given that Finansinspektionen has made its intention to apply the measure public well in advance, it does not expect Nordea to run down its built-up capital buffer for the Swedish mortgages during the period in-between. First, it is expected that the Finish authorities will reciprocate the measure. Second, the entry into force of the measure on 31 December 2018 implies that Nordea’s Q4 2018 figures will be affected. Finally, Finansinspektionen makes the assessment that market and investor pressures to keep up the capital levels will also contribute.
### 6. Miscellaneous

<table>
<thead>
<tr>
<th>6.1 Contact person(s) at notifying authority</th>
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<tbody>
<tr>
<td>Matilda Gjirja</td>
</tr>
<tr>
<td>+46 8 4089 8395</td>
</tr>
<tr>
<td><a href="mailto:matilda.gjirja@fi.se">matilda.gjirja@fi.se</a></td>
</tr>
<tr>
<td>Maria Blomberg</td>
</tr>
<tr>
<td>+46 8 4089 8179</td>
</tr>
<tr>
<td><a href="mailto:maria.blomberg@fi.se">maria.blomberg@fi.se</a></td>
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<td>Consultation memorandum: <em>Changed method for the application of the risk weight floor for Swedish mortgages</em>, March 2018, FI.</td>
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<td><strong>Appendix B</strong></td>
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<td>Summary of referral responses on Finansinspektionen's consultation memorandum.</td>
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**Links to other relevant documents**

*Risk Weight Floor for Swedish Mortgages, May 2013, FI.*

*Capital Requirements for Swedish Banks, September 2014, FI.*