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ESRB
European Systemic Risk Board
European System of Financial Supervision

Assessment Team on national macroprudential measures

Assessment of the Swedish notification in accordance with Article 458 of Regulation (EU) No 575/2013 concerning the extension of a stricter national measure for retail mortgage exposures

Background note

Introduction

On 12 September 2023 Sweden's Finansinspektionen (FI) officially notified the European Systemic Risk Board (ESRB) in accordance with Article 458(2)(d)(iv) of the Capital Requirements Regulation (CRR)[1] of its intention to extend a national measure limiting risks stemming from Swedish retail mortgage loans. FI is the designated authority responsible for the application of Article 458 of the CRR in Sweden.[2] Pursuant to Article 458(4) read in conjunction with Article 458(9) of the CRR, the ESRB must provide the Council of the European Union, the European Commission and Sweden with an opinion within one month of receiving the notification. The opinion must be accompanied by an assessment of the national measure in terms of the points specified in Article 458(2) of the CRR.

The ESRB's assessment focuses on the net benefits of the national measure for maintaining financial stability. The procedural framework for the provision of opinions under Article 458 of the CRR is clarified in Decision ESRB/2015/4[3]. In particular, the ESRB has assessed the rationale and merit of the measure against the following criteria.

- **Justification:** Has there been a change in the intensity of systemic risk and does it pose a threat to financial stability at the national level? Could alternative instruments provided for in the Capital Requirements Directive (CRD)[4] and in the CRR adequately address the risk, taking into account their relative effectiveness?
- **Effectiveness:** Is the measure likely to achieve its intended objective?
- **Efficiency and suitability:** Will the measure achieve its objective in a cost-efficient way, i.e. are the instrument and calibration appropriate?

1 See Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

2 In accordance with Chapter 1, Section 6, second paragraph, of the Swedish Special Supervision of Credit Institutions and Investment Firms Act (2014:968), FI has the power to take measures related to Article 458 of the CRR.

3 Decision of the European Systemic Risk Board of 16 December 2015 on a coordination framework for the notification of national macroprudential policy measures by relevant authorities, the issuing of opinions and recommendations by the ESRB, and repealing Decision ESRB/2014/2 (ESRB/2015/4), as amended by Decision ESRB/2021/7.

4 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

- **Proportionality and impact on the internal market:** Is there an appropriate balance between the costs resulting from the measure and the problem it aims to address, taking into account any potential cross-border spillover effects? Where appropriate, the ESRB may suggest amendments to the measure to mitigate potential negative spillover effects.

The ESRB's assessment draws extensively on information provided by, and discussions held with, FI and its staff. The ESRB has also relied on the assessments it carried out at the time of the introduction and previous extensions of the measure[5], as well as its assessments of medium-term vulnerabilities in the residential real estate (RRE) sectors of the EEA countries.[6]

Section 1: Description of and background to the measure

1.1 Description of the measure

The draft measure is an extension of the current measure under Article 458 of the CRR, which has been in place since 31 December 2018. It consists of a 25% risk weight floor for Swedish retail mortgage loans which is applied to credit institutions that use the internal ratings-based (IRB) approach. The draft measure targets credit institutions authorised in Sweden[7], or a subset of those institutions, and falls under Article 458(2)(d)(iv) of the CRR. The measure is intended to continue mitigating the changes in the intensity of risk and concerns risk weights targeting asset price bubbles in the RRE sector. The extension is scheduled to enter into force on 31 December 2023 for a period of two years. Since the proposed extension of the measure increases risk weights for identified exposures by, on average, more than 25%, Article 458(10) of the CRR does not apply.

The measure applies to retail exposures[8] to Swedish obligors collateralised by immovable property (referred to in this assessment as "Swedish mortgage loans"). The exposure class largely consists of mortgage loans granted to private individuals, but it also includes certain exposures to small businesses with loans collateralised by real estate. In addition, as a consequence of the need to implement the measure in a practical and simple way using common reporting templates, it may include certain exposures collateralised by real estate other than residential property and also some exposures collateralised by real estate located outside of Sweden, even though neither of those two types of exposure fall within the intended scope of the measure.

The draft measure applies to credit institutions that are authorised to use the IRB approach ("IRB banks") and have issued Swedish mortgage loans. This includes subsidiaries based in Sweden of foreign credit institutions. Branches of foreign credit institutions and direct cross-border exposures of foreign banks are covered through the reciprocation of the existing measure. Credit institutions using the standardised approach to calculate the capital

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5 See the ESRB **Opinion** and **Background note** of 19 October 2021 on the previous extension of the measure

6 **Vulnerabilities in the residential real estate sectors of the EEA countries**, ESRB, February 2022.

7 For the purposes of this assessment, the term "bank" has the same meaning as "credit institution" as defined in Article 4 of the CRR.

8 Article 147(2)(d) of the CRR.

requirement for credit risk are not affected. The requirement applies both at the individual (solo) and at the consolidated level.

The 25% floor applies to the exposure-weighted average risk weight for the portfolio of Swedish mortgage loans specified above. The exposure-weighted average risk weight is calculated by dividing the portfolio's risk-weighted exposure (as calculated in accordance with Article 154 of the CRR) by its exposure at default (EAD).

FI requested reciprocation of the existing measure by other Member States[9] **under Article 458(8) of the CRR, and the General Board of the ESRB decided to recommend reciprocation.**[10] The ESRB's recommendation for reciprocation of the existing measure will continue to apply to the measure in its extended form, under the same conditions as for the previous recommendation, including the institution-specific materiality threshold of SEK 5 billion. FI emphasised that reciprocity remains relevant in order to avoid leakages and regulatory arbitrage.

1.2 Background to the measure

FI has been applying the measure under Article 458 of the CRR since 31 December 2018. Previously a risk weight floor for Swedish mortgage loans within the Pillar 2 framework had been applied since May 2013. This was first set at the level of 15% and was increased to 25% in 2014. The floor was introduced as part of the supervisory capital assessment under Pillar 2 to cover risks that are not fully captured by the regulatory capital requirements. Since the transformation of the measure into a risk weight floor under Article 458 of the CRR at the end of 2018, the measure has been extended twice – in 2020 and in 2021. The ESRB was of the view both when the risk weight floor under Article 458 of the CRR was introduced and when it was extended in 2020 and 2021, that the measure and its extensions were justified, proportionate, effective and efficient.

FI indicated that its primary motivation for continuing to apply a stricter national measure was that Sweden is experiencing a significant and prolonged build-up of systemic risk related to Swedish mortgage loans and RRE. The large and concentrated Swedish banking sector is highly exposed to the RRE market and is also vulnerable to funding risks related to this market through the issuance of covered bonds backed by residential mortgage pools. Moreover, cyclical vulnerabilities reflected in the high house prices, as well as the high level of household indebtedness, can exacerbate and intensify the identified systemic risks. Should risks from the RRE market materialise and spill over to banks, credit provision could be affected. FI considers that banks' IRB approaches are unlikely to be able to fully capture the current credit loss risk of Swedish mortgage loans in a severe downturn which could lead to major spillover effects for the Swedish economy and for regional economies.

In addition, credit risk models for Swedish mortgage exposures often generate risk weights that, from a broader perspective, can be considered to be relatively low. Credit losses realised on Swedish mortgage loans have been very low for a long period of time. Therefore, FI considers that IRB models – which have parameters based on historical observations – do not fully reflect the systemic risk related to increased house prices and household

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9 For the purposes of this note, the term Member States refers to European Economic Area states, EU Member States included, unless the context indicates otherwise.

10 **Recommendation of the European Systemic Risk Board of 15 January 2019 amending Recommendation ESRB/2015/2 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2019/1) (OJ C 106, 20.3.2019, p. 1)**.

indebtedness, with concerns about unjustified variability in model-based risk weights between banks. According to data provided by FI, the average risk weight for all IRB banks was 5.0% in the second quarter of 2023.

Section 2: Analysis of the underlying systemic risks

The ESRB issued a warning in 2016[11] and a recommendation in 2019[12] on medium-term vulnerabilities in the RRE sector of Sweden. In the warning and recommendation, the ESRB identified increasing residential property prices, resulting in an overvaluation in the market, as well as high indebtedness, particularly among certain groups of households, as the main medium-term vulnerabilities in the RRE sector in Sweden.

In its assessment published in February 2022[13], the ESRB was of the view that vulnerabilities related to the RRE market in Sweden remained high. Key vulnerabilities included high levels of household indebtedness, house price overvaluation, high house price growth, high mortgage lending growth, a large share of non-amortising mortgages in the stock of existing mortgages, and interconnectedness with the Nordic banking system.

Since 2022 house prices in Sweden have been levelling off, with overvaluation in the RRE market declining. However, vulnerabilities remain high as the level of household indebtedness is still among the highest in the EU.

2.1 Vulnerabilities in the residential property sector

RRE prices have increased substantially over the past two decades and they remain high despite a levelling-off that started in 2022. The rise in house prices was supported by the low interest rate environment, strong economic growth, rising real wages, and the limited supply of housing. Although prices have decreased somewhat since 2022, they remain more than two and a half times the level recorded in 2005 and at about the same level as in 2021 when the measure was last extended. At the beginning of 2023 prices started to pick up again and they have been stable for the past few months. The limited supply of housing, reflecting subdued levels of new home building over a long period time, has contributed to elevated house prices. After a pick-up in homebuilding in the past decade, a sharp decrease is now expected in 2023 and beyond in the current economic environment. Several international bodies have made the assessment that residential properties in Sweden may be substantially overvalued. For example, the European Commission pointed out in 2022 that the price-to-income ratio is still about 40% above the historical average.[14] The ESRB's econometric valuation model also indicated that homes in Sweden were overvalued by around 51% in the second quarter of 2021, the highest overvaluation in Europe.[15] Given the evolution of house prices during 2022, the

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[11] Warning of the European Systemic Risk Board of 22 September 2016 on medium-term vulnerabilities in the residential real estate sector of Sweden (ESRB/2016/11) (OJ C 31, 31.1.2017, p. 55).

[12] Recommendation of the European Systemic Risk Board of 27 June 2019 on medium-term vulnerabilities in the residential real estate sector in Sweden (ESRB/2019/9) (OJ C 366, 30.10.2019, p. 35).

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

[14] In-depth review for Sweden 2022, European Commission, May 2022. https://economy-finance.ec.europa.eu/system/files/2022-05/sweden_swd_2022_639_10_en_autre_document_travail_service_part1_v1.pdf

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

degree to which house prices are overvalued has likely lessened somewhat since the publication of those reports. In 2023, despite the levelling-off of house prices in Sweden, risks remain high as the ongoing correction in the RRE market has as yet been too short-lived to bring down the level of accumulated risks significantly. In its latest report on the Swedish mortgage market, the FI assessed that there is still an elevated risk of a substantial price correction in the housing market.[16]

2.2 Vulnerabilities in the household sector

Household debt has increased much faster than both household disposable income and GDP for a prolonged period. Household debt increased on average by 7.7% in annual terms over the period 1997-2022. By contrast, average disposable income only increased by 4.5% in the same period. However, household credit growth has slowed over the past year, with an annual growth rate of 0.9% in July 2023. Mortgages are the primary driver of developments in household debt, with an annual growth rate of 1.3% recorded in July 2023. Households' aggregate debt-to-income (DTI) ratio was almost 190% of disposable income in July 2023, up from under 100% in 1997. The new interest rate environment and current stabilisation in house prices might lead to a corresponding stabilisation in the aggregate DTI ratio, reflecting in part the stricter amortisation requirement introduced by FI in 2018. The level of the ratio is nonetheless high from a historical perspective.

While the introduction of borrower-based measures has strengthened households' resilience, in FI's assessment some Swedish households are still relatively highly leveraged in relation to the value of their home. Approximately 76% of new mortgages taken out in 2022 were at a loan-to-value (LTV) ratio of 50% or more, while about 49% of new mortgages comprised loans with an LTV ratio of 70% or more. Across the stock of Swedish mortgage loans, the LTV ratio was about 53% in the third quarter of 2022 (in volume-weighted terms). Until the introduction of the amortisation requirement by FI in 2016, incentives to amortise had long been weak, leaving many households highly indebted for a long time after the purchase of a new home.

In July 2023 56% of the total household mortgage stock had a variable interest rate. In combination with a high DTI ratio, this makes Swedish households sensitive to rising interest rates. The increases in interest rates since 2022 and the more challenging macroeconomic environment have been accompanied by falls in real consumption and house prices. However, Sveriges Riksbank assesses that, despite a well-functioning monetary policy transmission mechanism, the impact of the policy rate increases implemented so far has not yet been fully passed through to all households with mortgages. There is, therefore, a risk that the interest rate increases implemented so far could dampen household demand more than expected once their full impact has been passed through.

2.3 Vulnerabilities in the banking sector

Swedish banks are increasingly exposed to the residential property sector. The banking sector supplies essentially all mortgage loans in Sweden. According to FI data, IRB banks constitute around 94% of the total mortgage market, making them a crucial supplier of mortgages to households. Mortgages account for 83% of banks' total lending to households and correspond to about 65% of Swedish GDP. For the three major banks, mortgage loans to households

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

constitute almost 50% of their total lending, making them particularly vulnerable to negative developments in the housing market.

A severe downturn in the Swedish RRE market could lead to credit losses for banks which would reduce their capital. In the event of a severe downturn in the Swedish economy or turbulence in the financial system, a negative dynamic may arise between the RRE market, the macroeconomic situation and bank behaviour in Sweden. Deterioration in the banks' capital position or reduced capital requirements could lead to diminished market confidence and negative consequences for households, banks and the entire Swedish economy. If banks were to respond by generally restricting the supply of credit to the economy – including to creditworthy households and businesses – in an attempt to improve their financial position, this would further exacerbate the economic downturn. It should also be noted that there may be cross-border impacts as Swedish banks are closely interlinked with other countries in the Nordic and Baltic region, with significant market shares in some of these countries.

The bank funding structure may constitute a vulnerability on the liquidity side, in view of the high degree of interconnectedness and exposure to the RRE market via covered bonds. The large and concentrated Swedish banking sector is highly exposed to the RRE market and is also vulnerable to funding risks related to this market through the issuance of covered bonds backed by residential mortgage pools. Banks' financial position and ability to supply credit to the economy could also be affected if investors become reluctant to fund banks' covered bonds – a key source of funding for banks.

Section 3: Effectiveness and efficiency of the measure

3.1 How the measure addresses the identified risk

The objective of the measure is to increase and strengthen resilience in the Swedish banking sector to the prolonged and elevated systemic risk linked to Swedish mortgage loans and RRE. The proposed measure is intended to ensure that banks are fully resilient and able to 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 RRE exposures. The elevated vulnerabilities at the macro level and the resulting systemic risks are, however, not reflected in the model-based risk weights for mortgage exposures. Banks' IRB approaches are unlikely to be able to fully capture the current credit loss risk of Swedish mortgage loans in a severe downturn which could lead to major spillover effects for the Swedish economy and for regional economies. Therefore, there is a need to target the systemic risks associated with high household indebtedness and high house prices through having a sufficiently strong bank capital position for mortgage exposures.

The measure is part of a wider set of initiatives that have been introduced over several years to address concerns about developments in the Swedish RRE sector. FI has also taken a number of borrower-based measures with the objective of increasing households' resilience. These include an LTV limit of 85% on mortgages and an amortisation requirement, according to which new borrowers with mortgages with LTVs between 50% and 70% must amortise at least 1% of their mortgage each year, while those with mortgages with LTVs above 70% must amortise at least 2%. In addition, a stricter amortisation requirement has been added, according to which households borrowing more than 4.5 times their annual income before tax must amortise an additional 1% of their mortgage each year. These measures have been deemed necessary and appropriate to strengthen the resilience of households and possibly curb household indebtedness. In addition, a 2% countercyclical capital buffer and a 3% systemic risk buffer applicable to the three largest credit institutions are also in place.

The risk weight floor measure calibrated at 25%, which is kept unchanged in the proposed extension of the measure, was assessed by the ESRB in February 2022 as appropriate for addressing the vulnerabilities related to the overvaluation of house prices, the stock of loans and household indebtedness.[17] The policy mix of Sweden was assessed as appropriate and partially sufficient, with proposals to consider complementing the policy mix with borrower-based measures that would limit the borrowing of overindebted households (e.g. a DTI ratio limit), improve the timely availability of data on lending standards, and continue with policy actions beyond the macroprudential remit to address structural vulnerabilities related to the housing market.

3.2 How the measure relates to possible alternatives

As required under Article 458 of the CRR, this section assesses whether other macroprudential instruments available under the CRD and the CRR could adequately address the increase in systemic risk, taking into account their relative effectiveness. These instruments need to be considered before resorting to stricter national measures under Article 458 of the CRR. The ESRB's assessment of the existing measure already considered this question. The main reasons why these other measures are not deemed to be appropriate alternatives to the envisaged extension of the measure under Article 458 of the CRR remain the same.

a) Increasing the risk weights for banks applying the standardised approach to credit risk (Article 124 of the CRR)

Relevant authorities can, on the basis of financial stability considerations, impose higher risk weights for exposures secured by mortgages on credit institutions that apply the standardised approach.

Article 124 of the CRR would not be effective in meeting the objectives of the proposed extension of the measure. About 94% of Swedish mortgage market exposures are held by credit institutions applying the IRB approach. In addition, IRB risk weights are relatively low, while risk weights of banks applying the standardised approach are considered to be sufficient.

b) Increasing the loss given default (LGD) floor for banks applying the IRB approach for credit risk (Article 164 of the CRR)

Relevant authorities can, on the basis of financial stability considerations, set higher minimum values of exposure-weighted average LGD for exposures secured by immovable property. LGD is one of the parameters used in the risk-weight function. Increasing the LGD indirectly increases the risk weight and the resulting capital requirements.

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

Increasing the LGD floor for mortgages would serve to widen the differences in risk weights between IRB banks and result in a disproportionate increase in risk weights for the banks with the highest initial probability of default. The use of Article 164 of the CRR would add further complexity to the determination of capital requirements and could reduce the transparency of IRB risk weights for market participants.

Consequently, FI assesses that a measure under Article 164 of the CRR would not adequately and effectively address the identified systemic risks.

c) Using the systemic risk buffer (Article 133 of the CRD)

Member States may introduce a systemic risk buffer (SyRB) to address systemic or macroprudential risks not covered by the CRR or by Articles 130 and 131 of the CRD, meaning a risk of disruption in the financial system with the potential to have serious negative consequences for the financial system and the real economy in a specific Member State. In Sweden, a SyRB of 3% already applies to all exposures of the three largest banks, addressing the risk of a large, similar, and concentrated banking system. The systemic risk covered by this SyRB differs from the risks covered by the risk weight measure. It would not be effective or appropriate to further increase the SyRB designed to apply to all exposures of a credit institution to address the systemic risks linked to Swedish mortgage loans and the RRE sector. Applying this instrument would risk penalising other types of exposures, which do not give rise to the identified systemic risk.

The CRD provides for the application of a sectoral SyRB, which may be designed in a way that targets exposures in the RRE market. However, a sectoral SyRB would be less suitable and effective than the draft measure. Banks' internal models are currently under review, with concerns about unjustified variability between model-based risk weights. The sectoral SyRB would not act as a floor, but rather as a multiplier in terms of nominal capital requirements, with the heaviest impact on IRB banks with the highest risk weights and the least impact on IRB banks with the lowest risk weights. According to FI, a sectoral SyRB differentiated across banks would be very complex to calibrate while the IRB model review is still ongoing. The size of the buffer required to generate the equivalent capital impact would also be extremely large and, therefore, challenging from both a communication and reciprocity perspective. However, since a sectoral SyRB should not be entirely ruled out as a viable alternative after the review of the IRB models, it seems advisable to closely monitor and frequently assess the risk weight floor set in accordance with Article 458 of the CRR.

d) Using the countercyclical capital buffer (Article 136 of the CRD)

The countercyclical capital buffer (CCyB) addresses some of the procyclicality in the financial system. FI currently applies a CCyB rate in Sweden of 2%, effective as of 22 June 2023.

It would not be effective or appropriate to further increase the CCyB to address the systemic risks linked to Swedish mortgage loans and the RRE sector. The CCyB rate is applied to all Swedish credit exposures and not just the mortgage exposures. Using the CCyB to specifically target the systemic risks linked to the Swedish mortgage and housing markets would penalise other exposures which are not the target of the measure. Moreover, it would penalise most the banks with the lowest share of relevant exposures in mortgage loans. In addition, a very high CCyB rate would need to be applied to achieve a capital requirement corresponding to a risk weight floor of 25%.

Section 4: Analysis of the net benefits of the measure

4.1 Effects on financial stability, financial system resilience and economic growth

The proposed extension of the measure is expected to maintain the resilience of the affected banks, although further developments regarding the vulnerabilities in the RRE sector in Sweden need to be monitored closely. Assuming that the measure is fully reciprocated by Member States that have credit institutions with material exposures to the Swedish RRE market, the capital requirements for the IRB banks should remain broadly the same in terms of nominal amounts. In view of the combination of elevated vulnerabilities but a possible turning point in the cycle in the Swedish RRE sector, developments need to be monitored closely and the policy stance may need to be further adjusted.

Although the measure is an important part of capital requirements in Sweden, since the proposed extension of the measure does not change existing capital requirements, its impact on banks' funding costs, loan margins and economic growth can be expected to be limited. The measure increased the implied risk weights on Swedish mortgage exposures from 5.0% on average to 25%. Thus, the risk weight floor has increased the capital levels that the affected banks are required to hold. According to FI data, at the end of the third quarter of 2023 the additional capital requirement in nominal terms stemming from the 25% risk weight floor for Swedish mortgage loans was SEK 123 billion at the consolidated level or about 23% of the total capital requirement for the largest Swedish banks. The extension of the measure, however, implies keeping the current capital requirements unchanged. Consequently, the impact of the measure on banks' funding costs, loan margins and economic growth can be expected to be limited, as long as the calibration is not materially adjusted.

Overall, the ESRB has concluded that the proposed extension of the measure would not entail disproportionate adverse effects on the internal market or other national financial systems. The measure should maintain the resilience of Swedish banks to shocks in the Swedish RRE market and thereby reduce potential channels for contagion from Sweden to other Member States. As the 25% risk weight floor has already been in place since 2014 in one way or another, it should not introduce any disproportionate adverse effects for the internal market or other national financial systems. Members of the ESRB General Board did not raise any material concerns under the procedure laid down in Article 4 of Decision ESRB/2015/4 as far as negative externalities of the measure in terms of adverse cross-border spillover effects were concerned.

4.2 Effects on both domestic and cross-border lending

The ESRB does not expect the draft measure to materially affect domestic and cross-border lending, given that no material impact of the current measure under Article 458 of the CRR has been seen in the past.

The measure seems not to have restricted households' access to mortgages, since the average growth rate of mortgages has remained positive since the introduction of the risk weight floor. Household credit growth has slowed but remained positive over the past year, with an annual growth rate of 0.9% in July 2023. Mortgages are the primary driver of developments in household debt, with an annual growth rate of 1.3% in July 2023.

The market share of non-bank institutions is still negligible, but new entrants could complicate macroprudential policy in the future. Direct investment in mortgages by Swedish insurers and pension funds is negligible. However, FI noted that insurers and pension funds are showing an interest in indirect investments through mortgage funds, in addition to their investments in covered bonds. While new players, such as investment funds, have entered the market in recent years, their market share remains low. These new players fall outside the scope of existing macroprudential instruments. For example, they may be subject to lower capital requirements than Swedish banks on the basis of the risk weight floor or may not be subject to the amortisation requirement. Therefore, the Swedish authorities should continue monitoring developments, closely assess the effectiveness of macroprudential policy measures and, if necessary, update their macroprudential toolkit.

The measure is intended to ensure a level-playing field for all banks that operate in the Swedish mortgage market. Through reciprocity, the macroprudential risks identified in the mortgage and housing markets can be addressed for all relevant lenders in the Swedish market, contributing to a level playing field. The two largest subsidiaries of foreign banks operating in Sweden together account for about 14% of Swedish mortgage lending. These subsidiaries fall within the scope of the measure. Both of these banks also operate directly in the Swedish mortgage market through their Swedish branches to a limited extent, currently accounting for less than 1% of Swedish mortgage lending. Exposures of branches are covered through reciprocity of the measure subject to an institution-specific materiality threshold of SEK 5 billion.

4.3 Effects on intragroup behaviour of credit institutions

Given that credit institutions already meet the higher capital requirement, it is unlikely that the measure will cause a significant shift in operations within their group structures. Moreover, no significant changes in intragroup behaviour of relevant credit institutions have been observed since the introduction of the measure.

FI has also asked the ESRB to recommend that other Member States with material exposures continue to reciprocate the measure. FI emphasised that reciprocity remains relevant as these countries' banking sectors may be exposed directly, or indirectly through their branches, to the risk related to the real estate market in Sweden.

The development of cross-border mortgage lending and lending through branches should, therefore, be monitored.

Conclusions

The main purpose of the extension of the measure is to continue strengthening the resilience of the Swedish banking sector by addressing the risk of asset price bubbles in the residential property sector in Sweden and their potential spillover effects.

The current assessment is made against the backdrop of signs that vulnerabilities in the Swedish RRE market remain high, despite the recent levelling-off of house prices. Risks remain high as the ongoing correction in RRE markets has as yet been too short-lived to bring down the level of accumulated risks significantly. Both house prices and household indebtedness remain at historically high levels.

The ESRB notes that the calibration of the measure has not changed since the 25% risk weight floor was first introduced in 2014. Despite changes in the vulnerabilities related to the housing market and mortgages, and additional measures implemented to target these risks since the introduction of the original measure, FI assesses that the risk weight floor of 25% continues to be adequate.

The ESRB is of the view that the alternative macroprudential instruments listed in Article 458 of the CRR, which must be considered before any stricter national measure can be taken, would not be adequate to address the risk at hand. Measures such as those listed in Articles 124 and 164 of the CRR, as well as the SyRB and the CCyB, are considered to be less adequate, as they do not provide the intended incentives, are too broad-based, or do not, to the same extent, address the same risk, exposures or credit institutions. The ESRB also found that the extension of the measure does not entail disproportionate adverse effects on the internal market or other national financial systems.

Therefore, the ESRB is of the view that the extension of the measure is justified, proportionate, effective and efficient for the purpose mentioned above.

In addition, the ESRB would like to highlight that the effectiveness of the measure will depend on the extent to which it continues to be reciprocated by other Member States with credit institutions active in the Swedish residential mortgage market. In this respect, the ESRB's recommendation to reciprocate the existing measure[18] continues to apply to the extension of the measure.

The ESRB, therefore, supports FI's intention to extend the period of application of its stricter national measure. At the same time, the ESRB reiterates the need for continued monitoring by the Swedish authorities to ensure the effectiveness of the measure and to avoid unwarranted consequences. The ESRB also supports FI's intention to conduct a more thorough assessment, reviewing the need for and the calibration of the measure on the basis of residual systemic risk once the ongoing IRB review has been completed, including its potential substitution with a sectoral SyRB. In addition, the ESRB encourages FI to carry out a comprehensive assessment of the existing macroprudential policy mix and implement the changes that might become necessary owing to the introduction of the output floor in the future, to avoid overlaps and maintain the effectiveness and appropriateness of the measures.

[18] Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/2) (OJ C 97, 12.3.2016, p. 9).