Economic Commentaries

SVERIGES RIKSBANK

NO. 5, 2014

The major Swedish banks have improved their transparency relatively much since the financial crisis, and are currently some of the most transparent banks in Europe with regard to liquidity risk. This is a very positive development as it promotes the stability of the Swedish financial system. The Riksbank has taken an active role in promoting this development and our analysis shows that the recommendations aimed at the major banks in the Financial Stability Report have been a useful tool in this work. Even though the banks have improved their transparency since the financial crisis, a further increase in transparency would be beneficial for financial stability.

Transparency in the major Swedish banks is increasing

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Introduction

One of the lessons learnt from the financial crisis in 2008 was that banks around the world needed to become more transparent. For a long period of time, both their operations and some of the financial products used by certain banks increased in complexity, which made it more difficult for investors and other market agents to assess the banks' financial position and risk-taking. This undermined market discipline and is therefore often stated as a contributory factor to both the origin of the financial crisis and its final scope.[2] The work on improving the banks' transparency as part of the international reform and regulation work following in the wake of the crisis was therefore intensified. This has resulted in a number of recommendations and requirements regarding the information the banks should publish.[3]

In Sweden, the four major banks have improved their transparency relatively much since the financial crisis. The information published today is more comprehensive, detailed and in many cases easier to compare between the banks than was the case pre-crisis. The Riksbank has taken an active role in promoting this development, where the most important tool has been the recommendations aimed at participants in the Swedish financial system in the Riksbank's Financial Stability Report.

This Economic Commentary presents a quantitative measure of how much the major Swedish banks' transparency regarding *liquidity risk* has improved since the crisis and how transparent they are in this field now, compared with a group of other European banks. Further, there is a discussion of what role the Riksbank's recommendations may have played in this development.

Why is transparency in the banking system important for financial stability?

Financial markets are often characterised by asymmetrical information. This means, for instance, that an issuer of a security (in this case a bank) has better knowledge of the risk in the security issued than its buyer (the investor). As the buyer lacks full knowledge of the risk, it cannot completely differentiate regarding the prices of securities issued by banks that take little risk and securities issued by banks that take large risks. Banks that take little risk therefore do not receive full compensation (in the form of lower interest) for the lower risk profile and will therefore either be forced to increase the risk in their operations or, in extreme cases, be forced out of business.[4]

1. The author would like to thank Mikael Apel, Tomas Edlund, David Forsman, Martin W Johansson, Kristian Jönsson, Björn Lagerwall, Sofia Possne, Olof Sandstedt and Marianne Sterner for their valuable comments.
2. See, for instance, "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience", 7 April 2008, "The financial crisis inquiry report – Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States", 25 February 2011, and "Enhancing the Risk Disclosures of Banks – Report of the enhanced disclosure task force", 29 October 2012.
3. See, for instance, "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience", 7 April 2008 and "Enhancing the Risk Disclosures of Banks – Report of the enhanced disclosure task force", 29 October 2012.
4. A lower risk profile can entail both direct costs linked to, for instance, increased risk management or improved IT systems and alternative costs resulting from, for instance, increased liquidity reserves or a larger percentage of low-yield exposures.

This means that the level of risk in the banking system rises, which in turn increases the risk of financial stress in the market.[5]

The existence of asymmetrical information may also spread and worsen financial stress that has already arisen. This is because investors who lack adequate information on the banks' financial positions are not able to distinguish sufficiently well between stable and unstable banks. When a given bank has suffered such large problems that it is forced to inform the market about them, investors are thus unable to determine whether the problems are limited to this individual bank or whether other banks have similar problems. There is thus a risk that investors will also withdraw their funding from the stable banks, which in turn increases the risk that also these banks will suffer liquidity problems and that the financial stress thus will worsen.

If the banks instead increase their transparency, the investors will gain better knowledge of the banks' risks and financial positions, which means that the banks' securities will be priced more fairly. This in turn provides the banks with an incentive not to take too large risks and also reduces the probability of stress that arises in part of the banking system will spread to other parts.

The major Swedish banks have become more transparent since the financial crisis

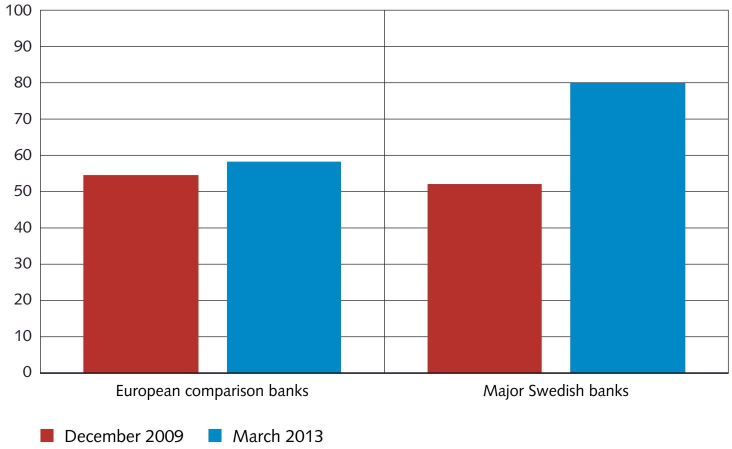
The major Swedish banks have improved their public reporting since the end of the financial crisis. With regard to the reporting of the banks' liquidity risk, Liquidatum's transparency index offers a means of quantifying the improvement.[6] This index measures the scope, frequency and detail in the banks' public liquidity reporting on the basis of 18 different categories. These categories include the maturities of various assets and liabilities, the allocation of the securities issued according to type of security, the allocation of deposits according to the type of deposit and the percentage of encumbered assets. For each category, the banks receive between zero and three points. The results are expressed as a percentage, where hundred (zero) is the best (worst) result a bank can receive.

Chart 1 shows that the major Swedish banks improved their results by 28 percentage points from the fourth quarter of 2009 to the first quarter of 2013.[7] This can be compared with a group of ten European comparison banks which only improved their results by three percentage points during the same period of time (see Chart 1).[8] As the Swedish banks improved their results more than the other banks, they were at the top of the comparison group in the most recent survey (see Chart 2).

However, one should bear in mind that no index can be all-inclusive and that a result of 100 per cent therefore cannot be interpreted to mean that a bank is fully transparent with regard to liquidity risk. Although the major banks thus obtain high results in the index, there is scope for improvement that would mean that investors and other market participants would gain a better understanding of the banks' liquidity risks.

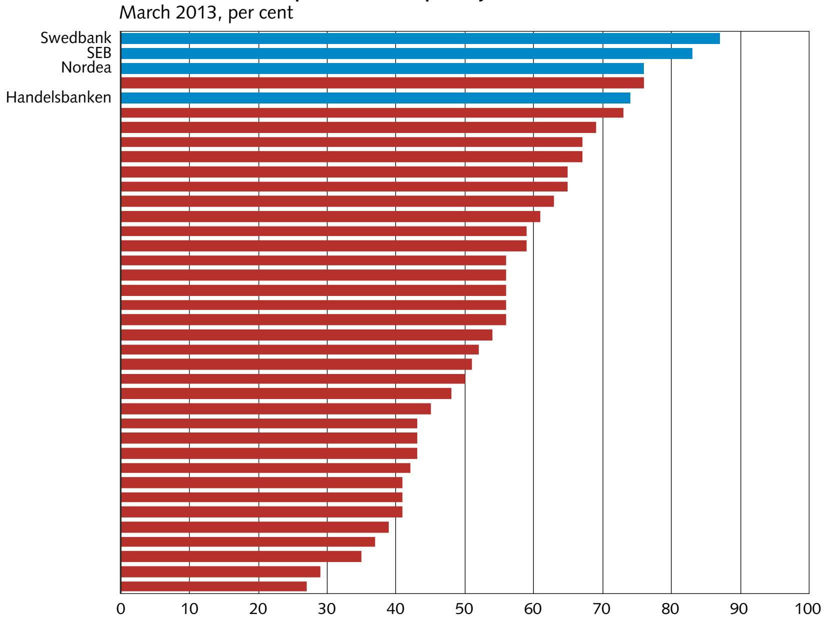
5. Inefficiency caused by asymmetrical information was described for the first time by George Akerlof in "The Market for Lemons: Quality Uncertainty and the Market Mechanism" (1970).
6. For further information on Liquidatum, see www.liquidatum.com.
7. The results from Liquidatum's transparency index are only available for the fourth quarter of 2009 and the first quarter of 2013.
8. For the fourth quarter of 2009, there is only data for 10 of the 34 comparison banks included in the results for the first quarter of 2013. The comparison group in Chart 1 has therefore been limited to ten banks, while all 34 banks are included in Chart 2.

Chart 1. Average results for the major Swedish banks and European comparison banks in Liquidatum's transparency index
Per cent



Sources: Liquidatum and the Riksbank

Chart 2. Results in Liquidatum's transparency index
March 2013, per cent



Sources: Liquidatum and the Riksbank

How does the Riksbank work to persuade the major Swedish banks to increase their transparency?

As part of its work on influencing the financial system in a way that promotes financial stability, the Riksbank regularly communicates the risks and vulnerabilities detected in the system and proposes measures to counteract them. Following the financial crisis in 2008, the Riksbank drew the conclusion that this general communication was not sufficient but needed to be supplemented with communication directed at certain recipients. The Riksbank therefore began to issue public recommendations to specific participants, above all the major banks, in its Financial Stability Report. The first recommendation was issued in autumn 2010 and new recommendations have followed in every report published since then.

The largest share of the recommendations have concerned the major banks' transparency, and nine out of ten transparency recommendations have referred to liquidity risk (see Table 1). The first recommendations were worded in a relatively general manner and there was no public follow-up of whether or not the recommendations were observed. To promote the observance of the regulations, therefore, the Riksbank began to formulate more precise regulations with effect from autumn 2011, and since spring 2012 each Financial Stability Report has contained a follow-up of the earlier recommendations.

Table 1. Recommendations regarding the banks' transparency

RECOMMENDATION	DATE OF RECOMMENDATION	HANDELS-BANKEN	NORDEA	SEB	SWEDBANK
The banks should improve the clarity of their public liquidity reporting.*	2010:2	Not assessed	Not assessed	Not assessed	Not assessed
The banks should improve the clarity of their public liquidity reporting, including:	2011:1	See below	See below	See below	See below
• Information on the size of the freely available liquidity reserve, broken down into type of liquid asset and currency.	2011:1	2012:1	2012:1	2012:1	2012:1
• Information on the time to maturity of their assets and liabilities per currency.	2011:1	2012:2	2012:2	2012:2	2012:2
• Relevant and comparable key figures and liquidity measurements.**	2011:1	2013:1	2013:1	2013:1	2013:1
The major Swedish banks should report their Liquidity Coverage Ratio (LCR) at least once a quarter beginning no later than the interim report published after 1 July 2012.	2011:2	2012:1	2012:1	2012:1	2012:1
The banks should improve the transparency regarding information on the degree of encumbered assets.	2012:2	2013:1	2013:1	2013:1	2013:1
The banks should report their Net Stable Funding Ratios (NSFR) at least once a quarter.	2013:1	2013:2			2013:1
The banks should report their leverage ratios at least once a quarter.	2013:2		2013:2	2013:2	2013:2
The banks should report their Liquidity Coverage Ratios (LCR) in Swedish kronor at least once a quarter.	2013:2				2014:1

Observed   Not observed

Note. The figures in the green field indicate at which FSR the respective bank observed the given recommendation.
* The recommendation was not followed up with any formal assessment of whether or not it was observed by the banks.
** The recommendation on relevant and comparable key figures and liquidity measurements was later specified, first so that the Swedish Bankers' Association should specify which key figures and measurements the banks should report (FSR 2011:2) and then so that the banks should report the sub-components of the LCR (FSR 2012:1).

The Riksbank's recommendations appear to have contributed to the banks improving their transparency

Table 1 shows that the major banks have acted in accordance with most of the Riksbank's recommendations regarding transparency – Swedbank has observed all of the recommendations, while the other major banks have observed all but two. Of course, it has not necessarily been the recommendations that have been the decisive factor behind the banks' actions in each individual case. In addition to the Riksbank's recommendations, the banks are subject to pressure and demands from many other agents, such as other authorities and investors.[9] However, in many cases the banks began to act in accordance with the recommendations soon after they were issued (see Table 1). In these cases, at least, one can regard it as highly probable that the Riksbank's recommendations affected the major Swedish banks.

9. For instance, Finansinspektionen (the Swedish Financial Supervisory Authority) introduced a regulation in 2010 that the banks should increase their publication of information related to liquidity risk. Other publication requirements have been introduced through EU regulation and, in addition, investors often call for the banks to publish more and clearer information.

As mentioned earlier, Liquidatum's transparency index also shows that the major Swedish banks have improved their results more than the European comparison banks. This applies in particular to the information categories that are compatible with the Riksbank's recommendations (see Table 2). This, as well, indicates that the recommendations have had the desired effect.

Table 2. Improvement in Liquidatum's transparency index between the fourth quarter of 2009 and the first quarter of 2013

	CATEGORIES COMPATIBLE WITH THE RIKSBANK'S RECOMMENDATIONS	OTHER CATEGORIES
Percentage improvement in the major Swedish banks	90	48
Percentage improvement in the European comparison banks	16	12

A continued improvement in transparency in the major Swedish banks would be desirable

To summarise, the major Swedish banks have improved their transparency relatively much since the financial crisis in 2008 and, measured according to Liquidatum's transparency index, they are currently among the most transparent banks in Europe with regard to liquidity risk. This is a very positive development, as it promotes the stability of the Swedish financial system both by reducing the risk of financial stress arising and by alleviating the spread of a stress that has already arisen.

However, one should bear in mind that a high result in Liquidatum's transparency index does not necessarily mean that the banks are sufficiently transparent and that further improvement is not necessary. On the contrary, there are many areas for improvement, which would increase the investors' and other market participants' understanding of the banks' liquidity risks, which would in turn further strengthen financial stability. One example of this is the recommendations from the Riksbank that have not yet been observed by three of the major banks.

Finally, our survey shows that the Riksbank's recommendations appear to have been an effective tool in influencing the banks to become more transparent. The recommendations can therefore have an important role to play in the work on further improving transparency.