

# Management of a financial crisis in banks with cross-border subsidiaries or branches

## **Memorandum of Understanding (MoU) between the central banks of Estonia, Latvia, Lithuania and Sweden**

### **Introduction**

The central banks of Estonia, Latvia, Lithuania and Sweden actively work with national financial stability and may provide liquidity assistance if deemed necessary. The importance of Swedish banking groups' establishments in Estonia, Latvia and Lithuania entails risks of a financial crisis in a bank belonging to these banking groups having repercussions for financial stability in more than one of these countries. In line with the principles of co-operation provided in the Memorandum of Understanding on co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis situations, April 2005, the central banks of Estonia, Latvia, Lithuania and Sweden have drawn up this MoU with a view to enhancing the monitoring of financial stability and facilitating the management of a financial crisis.

The MoU is based on the following principles:

- The cooperation between the central banks will be facilitated by the establishment of a structure for crisis management and dissemination of relevant information ("operational networks"). In the event of a financial crisis, it is important that an appropriate form of cooperation between the affected central banks can be established quickly.
- A non-legally binding MoU is an appropriate instrument for facilitating cooperation between the central banks without curtailing their flexibility as independent institutions.

The MoU does not affect or bypass the powers of the national authorities or their international undertakings or agreements on cooperation.

### **The parties to this MoU are in agreement on the following:**

#### **1 Scope of cross-border cooperation in crisis management situations**

1.1 The MoU may be applied in the event of a financial crisis in a bank in Estonia, Latvia, Lithuania and Sweden belonging to one of the banking groups specified in Annex A.

## 2 Conditions regarding solvency and liquidity

- 2.1 The responsibility for managing a financial crisis in a bank rests primarily with its owners and management. It is expected that problems in parts of a banking group will be solved by making use of the collective financial strength of the whole banking group. Thus, emergency liquidity assistance from the central banks will only be provided in exceptional circumstances.
- 2.2 A bank can encounter different kinds of liquidity problems. Usually, the problems affect the entire banking group or group of companies. In exceptional cases, liquidity problems may be local in nature, e.g. due to technical disruptions in the payment systems. However, in general, if the parent bank cannot obtain funding in the market or through the central bank's customary sources of liquidity, such as monetary policy credits or intraday credits, neither will the subsidiary banks have this option. Conversely, as long as the parent bank is capable of obtaining funding in the market, it can fund its subsidiary banks.
- 2.3 Where a liquidity problem affects the banking group as a whole, the provision of emergency liquidity assistance will inevitably benefit the entire group. Consequently, a decision by one or more central banks to provide or not to provide emergency liquidity assistance to a bank belonging to one of the banking groups specified in Annex A will have implications for the other central banks as well.
- 2.4 In all the central banks, one of the conditions for a decision to provide emergency liquidity assistance is that the bank in question is not judged to be insolvent. In cases where a bank is judged to be insolvent or where its solvency is deemed uncertain, the central banks will contact their respective Ministry of Finance immediately.

## 3 Crisis management structure

- 3.1 In a crisis, it is necessary that there is a clear structure for communication between the central banks. In order to ensure this a Contact group must be in place already beforehand. The parties to the MoU shall establish a Contact group consisting of one high level representative from each of the central banks and an alternate who shall take the place of the ordinary representative in his/her absence.
- 3.2 In the event of a crisis, the representatives in the Contact group shall be able to communicate directly with their respective central bank's Board.
- 3.3 The central bank that is first to identify a potential crisis shall notify the Contact group. The central bank of the country where the parent company of the banking group is domiciled shall thereafter be responsible for coordinating the Contact group's continued work.
- 3.4 The extent of contacts will depend on the situation. The Contact group will decide what is considered proportional for the purpose of the management of the crisis in question.
- 3.5 The Contact group shall ensure that the central banks will be able to quickly exchange information. Information should be exchanged as agreed between the parties.<sup>1</sup>

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<sup>1</sup> The recommendations in Joint Task Force on Crisis Management. Banking Supervision Committee, JTFCM/05/16, Committee of European Banking Supervisors, CEBS/06/20. 9 January 2006 "Joint Report Recommendations for Crisis Management" provide a valuable guideline to what information may be relevant.

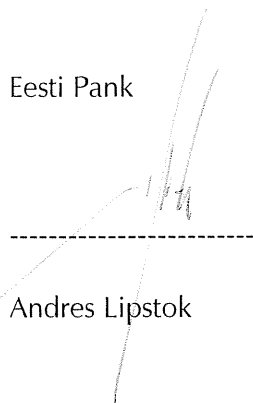
- 3.6 The Contact group will be responsible for producing background material to facilitate potential decisions of the central banks' Boards with regard to emergency liquidity assistance or other relevant measures. This background material should, in addition to presenting information on systemic importance and solvency, clarify any differences of opinion between the affected central banks. Decisions by the respective central bank shall be taken in accordance with its decision-making procedures.
- 3.7 In a crisis situation, internal information between the central banks and external information to the media should, as regards its content, be coordinated through the Contact group as far as possible.

#### 4 Regular co-operation on financial stability analysis

- 4.1 The Contact group shall ensure that the central banks regularly exchange information about the business activities and balance sheets of the banking groups specified in Annex A.
- 4.2 The central bank of the country where the parent company of the banking group is domiciled shall ensure that a fact book containing relevant public information about the group is updated regularly. The purpose of the fact book is to give the central banks a common body of knowledge about the structure of the group's business activities and balance sheet.
- 4.3 The Contact group shall regularly share assessments on the financial stability implications of the operations of the banking group. The central bank of the country where the parent company of the banking group is domiciled shall be responsible for convening the Contact group at regular intervals to share financial stability assessments.

Governors of the following central banks in Stockholm 18 December 2006

Eesti Pank




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Andres Lipstok

Latvijas Banka



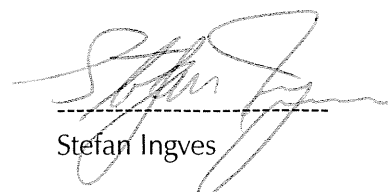
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Ilmārs Rimševičs

Lietuvos bankas



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Darius Petrauskas on behalf of Reinoldijus Šarkinas

Sveriges Riksbank



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Stefan Ingves

**Annex A.**

Scope of cross-border co-operation in crisis management situations

The banking groups referred to in paragraph 1.1 are:

SEB

Swedbank