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Urgent need for new financial regulations and tools

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The regulation of the banks is inadequate and the options available to the government and the authorities to handle problem banks need to be strengthened. Several important change processes have finally begun at the international level. But there is also a need to renew the regulatory framework in Sweden. We believe that there is a need to review and amend the Sveriges Riksbank Act, that a clearer division of roles between the authorities is required and that a new and improved regulatory framework for distressed banks should be set up.

The financial system is of fundamental importance to the economy and the banks are the hub of the financial system. One only has to consider how dependent ones' own financial situation is on the fact that there are banks that can lend money and that can conduct all the payments that are made every day.

We, the Riksbank with its two decision making bodies, the General Council and the Executive Board, agree that the experience gained during the crisis management of the last two years clearly shows that a regulatory framework is needed that improves the ability of the government and the authorities to prevent and manage crises in the future. Such a framework is also needed to limit the costs of a crisis to the banks' customers and to society at large as much as possible. The Riksbank is therefore taking the unusual step of calling on the Riksdag to request the government urgently to appoint one or several commissions of inquiry to review the financial regulatory framework.

The Riksbank is usually associated with the objective of maintaining price stability; that is ensuring that inflation is low and stable. However, we also have the task of promoting a safe and efficient payment system. Unfortunately, the Sveriges Riksbank Act is somewhat vague about what this entails. We believe that the Riksbank has a responsibility for stability throughout the financial system. In order to improve the ability of the Riksbank to safeguard financial stability, we believe that there is a need to update the Sveriges Riksbank Act so that it is clearly stated that we have a responsibility for financial stability.

Division of roles

It is also important to clarify the division of roles between the authorities. Today, responsibility for regulation, supervision and oversight is shared by several different authorities. To enable the interplay between these authorities to function as effectively as possible, it is important to clarify who should do what and when. We believe that this is unclear today. For example, the division of responsibility and the coordination between the Riksbank and Finansinspektionen should be reviewed. The financial crisis has

demonstrated that supervision has not taken sufficient account of the risks that may have repercussions for the entire financial system and the economy as a whole. One example is that several Swedish banks lent large sums of money in the Baltic countries. This extensive lending contributed to the rapid economic development of these countries and, eventually, to substantial loan losses. Despite the fact that there was a risk that the resulting problems would spread to Sweden, it was not clear who was ultimately responsible for counteracting these developments. Although Finansinspektionen has tools that could be used to influence the behaviour of the banks, it is not one of Finansinspektionen's tasks to counteract macroeconomic developments that pose a risk to financial stability. The Riksbank, on the other hand, has a responsibility for the stability of the financial system in Sweden but lacks effective tools to perform this task. There is a risk that unclear and inadequate supervision will have negative effects for both households and undertakings. There are two possible ways of dealing with this problem. One can either give the Riksbank better tools or one can strengthen the coordination between Finansinspektionen and the Riksbank. Another alternative that is being discussed within the framework of the new European supervisory structure is to give the central bank the possibility to draw systemic risks to the attention of the authority responsible for supervising the banks which could then choose to either take action or explain its decision not to act. It should be considered whether a similar model, adapted to Swedish conditions, would be appropriate for Sweden.

The Riksbank should be financially independent. The currency reserve must therefore be large enough to meet the Riksbank's statutory undertakings. The main rule is that borrowing to meet the currency reserve requirements of the Riksbank is carried out in the name of the National Debt Office. The question of the division of responsibility between the Riksbank and the National Debt Office has previously been discussed in a number of different contexts and has been raised again in connection with the implementation of the expansion of the currency reserve that the Riksbank decided on in the spring of 2009. The extent and range of the Riksbank's borrowing entitlement and of the National Debt Office's obligation to assist the Riksbank with such borrowing should be analysed, all in the light of the various regulations of the Treaty on the Functioning of the European Union.

Regulations for distressed banks

Finally, it is the opinion of the Riksbank that an entirely new regulatory framework for how the government and the authorities can handle distressed banks should be drawn up. Today, banks that can not pay their debts should, like other undertakings in the same situation, be declared bankrupt. This is usually a lengthy process in which bank customers may have to wait years to get their money back. There is a deposit guarantee scheme in Sweden which ensures that depositors will get their money back, up to a sum of SEK 500 000, if a bank is declared bankrupt. But this is not enough. If all that is available is the standard bankruptcy legislation, the risk that the government will be forced to save the bank using public funds increases. This is not a desirable alternative as it means that the Swedish taxpayers will have to foot the bill for a bank that has taken too high risks.

To sum up, the Riksbank hopes that it will be possible to set up one or several commissions of inquiry that can contribute to the implementation of appropriate changes in the regulations. This is needed so that we can get, as soon as possible, a better regulatory framework that can help to prevent crises in the future and to ensure that the costs of a crisis are as limited as possible.