

20 January 2010

**Swedish answers to the Commission Communication ‘‘An EU framework for Cross-Border Crisis Management in the Banking Sector’’**

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**1. PARTICIPATING AUTHORITIES**

This memorandum includes the joint answers to the Commission Communication ‘‘An EU framework for Cross-Border Crisis Management in the Banking Sector’’ (hereinafter ‘‘the Commission Communication’’) of the Swedish Ministry of Finance, the Riksbank, the Swedish Financial Supervisory Authority and the Swedish National Debt Office (hereinafter ‘‘the Swedish Authorities’’).

**2. GENERAL REMARKS**

The global financial crisis has revealed gaps in legislation, in supervision and in crisis management. Changes are called for in all three areas, both at the national level and in cross-border settings and it is important to keep in mind the full picture of the ongoing regulatory reform and its consequences. One reason is that the resulting regulatory framework – encompassing everything from legislation, supervisory mandates and tools for crisis management – has to ensure not just stability and depositor protection. Equally important is that the banking system is able to fulfil its fundamental tasks also in normal times. The framework must therefore be in line with broader aspects of regulation of EU financial markets, such as to:

- ensure that the financial sector efficiently provides services to the real economy and to the general public.
- ensure the further development of the internal market in Europe, including cross-border financial services.
- maintain financial stability nationally, regionally and in the whole of Europe.
- resolve a situation of instability at the lowest overall cost from a European perspective.
- reduce moral hazard associated with public support.
- create a level playing field in the European banking market.

In this regard, it is important to bear in mind that the Commission Communication deals with crisis management, but the rules put in place for this purpose will affect the behaviour of banks also in normal times. Indeed, they are *intended* to affect their behaviour, since this is one of the ways that crisis management rules and procedures reduce the risk of financial instability. (The same applies to rules on capital, liquidity etc., of course.) Banks – and their owners – will consider the risks of being subjected to the crisis management procedures available. The more onerous or discretionary the measures that can be taken, the more cautious banks will be, for example, applying more stringent criteria when giving credit and charging higher rates. Moreover, the greater the risk that shareholders run of having their control and ownership of the bank circumscribed, the higher the return they will require to invest in bank shares.

Consequently, when discussing, for example, what rules are appropriate for protecting shareholders, it is essential to consider not only their property rights in the light of the European Convention on Human Rights, but also how these rules will affect the supply and cost of credit from privately controlled banks.

Although we have in the recent past erred on the side of too little stability (and too cheap credit), it would also be a mistake to let the pendulum swing too far in the opposite direction. To secure a continued recovery of the economy and favourable prospects for growth in the medium and long term, access to credit to the private sector on fair and reasonable terms is essential. Indeed, many of the measures taken *during* the crisis have been aimed at securing continued provision of credit from banks. In the same spirit, we must in the reform process *after* the crisis strike a balance between the need to take steps that help preserve financial stability and the need to maintain banks' ability to provide credit to the economy.

The following comments on the specific questions posed in the Commission Communication should be seen in the light of this fundamental trade-off. It is not possible to say with any precision where the proper balance lies, but it is essential that legislators, supervisors and crisis managers reason – and act – with this trade-off in mind.

With this in mind, the Swedish authorities place a high priority to developing an EU framework for Cross-border crisis management.

In developing an EU framework for cross-border crisis management the priorities are to:

- ensure that authorities in all Member States have a minimum set of supervisory tools to intervene early when a bank begins to face problems, and, if such intervention is not appropriate or sufficient to restore the bank's health, a minimum set of powers to safely resolve a systemic bank failure through winding-up or restructuring,
- ensure that the powers of supervisors and resolution authorities in all Member States can be applied in a timely and robust manner proportionate to the severity of the situation, which may require carve-outs in EU as well as national company and insolvency legislation,
- ensure that banks can operate efficiently cross border as credit institutions or as banking groups without discriminating between legal forms,
- facilitate the exchange of information, cooperation and coordination between authorities across borders in both normal times and in times of crisis,
- develop arrangements for burden-sharing.

The three parts of the Commission Communication – early intervention, resolution and insolvency are all intertwined. To make a clear distinction, as explained below, we believe that the bank resolution measures should enter into force at a stage when normal intervention tools for the supervisor have been exhausted and when it has been determined that an orderly winding-up is not possible.

### 3. EARLY INTERVENTION

#### 3.1 Early intervention tools

**Q: Which additional tools should supervisors have in order to address developing problems?**

The Swedish Authorities agree with the proposal to complete the intervention toolbox of the CRD to enable early detection of problems in banks and appropriate action to prevent further deterioration.

As regards to *early detection* of problems it is important that the supervisory authorities have the powers and tools to detect early on adverse circumstances that may cause a future failure of a bank. As a starting point, such circumstances will result in more intense supervision. The supervisor must be able to request more frequent reporting and carry out on site and off site inspections. The supervisor should also be able to require the institution to explain its view on specific matters, e.g. decreasing capital ratios.

Common tools for *early intervention* within the EU are important to achieve efficient cross-border cooperation and to deal with problems occurring in cross border banks. However, a common toolbox is not sufficient. It is also crucial that intervention tools can be used without unwarranted delay and in a synchronised manner. For example, coordinated action may be counteracted by legal actions such as requests of stay of execution, or by differences between Member States regarding procedures of injunctions. Due to Member States' different legal traditions it is worth considering clarifying the scope of Article 55 in CRD.

As regards the scope of supervisory early intervention tools, they should optimally apply to all banks, national as well as cross-border banks. A less comprehensive scope could encourage the banking industry to take (socially inefficient) measures to circumvent the regulation.

The following additional early intervention tools may be considered as parts of the common set of tools.

*Measures aimed at restoring compliance, capital adequacy and soundness of an institution:*

- power to require the submission of a restoration or capital contingency plan, i.e. a rescue plan before insolvency is declared, including plans on how to restructure unprofitable activities,
- power to require an institution to cease unsound activities/practices.,
- power to require wind-down plans (living wills).

*Measures directed at the management body of the institution:*

- power to oppose the appointment of a board member or a director,
- power to require the replacement of board members or directors. It is vital that the power to influence appointments is restricted by objective criteria.

*To appoint an official observer*

- power to appoint an official observer in the management or the board pre-insolvency to monitor the situation and gather information. At the stage of early intervention, the running of the business should remain with the bank.

**Q: How should their use be triggered?**

The underlying motive for early detection and early intervention measures is most often to ensure the stability of individual banks that have run into problems. At an early stage, the supervisor should be able to choose freely between the possible measures. *Early detection* tools (for instance more intense supervision) should clearly be used at the supervisor's judgement.

As regards early intervention tools, a starting point for any discussion on triggers must be that a supervisor shall intervene immediately if a credit institution violates national prudential rules (maybe with the exception that the violation is of minor significance or excusable or where the institution has made rectification). Having said this, it should be acknowledged that the exact point of time for a violation can be difficult to establish, especially when it is based on qualitative factors (for example when it comes to rules based on Article 22 and 123 in CRD) and intervention might come too late or not to the extent necessary.

In cases where the situation is deteriorating, intrusive supervisory methods will be needed, but still short of those that fall under the heading of resolution tools. In such a situation more objective triggers may be considered. A balance must be struck between the financial stability objective and the objective of a free and well functioning private financial market. For example, the goal of allowing the supervisor to appoint an official observer or require a restoration plan is not to give supervisors additional powers generally, but to ensure that they have the capability to detect and react to unsound practices in individual banks. This could possibly be combined with an obligation to intervene before it is too late.

Hard triggers, based on specific limits related to i.a. solvency and liquidity requirements, used as a complement to discretion may decrease the risk of harmful supervisory forbearance and increase legal certainty. In addition, a set of well-defined and harmonised hard triggers may increase the possibilities for coordinated cross-border action. The Swedish Authorities thus support further work on finding suitable hard triggers at the EU level, but not to the exclusion of supervisory discretion. In this context, it is important to note that there is a risk in introducing hard triggers for intrusive measures which deviate from existing regulation e.g. in the area of capital and liquidity. The triggers might be viewed as a parallel regulation and may cause confusions on which levels are relevant to regulators.

An exclusive use of hard (pre-defined) triggers may also result in too blunt intervention which, instead of providing an efficient legal framework, would limit the supervisory authorities in seeking the best available solution for a particular situation. Hard triggers are to be used as complements (a backstop) rather than as substitutes to judgement. The triggers should be set at the EU level to avoid the obstacles to cross-border cooperation and coordination implied by different national triggers.

Cross-border cooperation should also be improved by continuing to strengthen the cooperation within the supervisory colleges to agree on a joint decision and a suitable coordinated response. Even before a crisis, a discussion of triggers for different supervisory actions would

clearly be useful. In this regard further clarification is needed of when, in a stressed situation, the work of the supervisory college should be taken over or strengthened by the intervention of other authorities.

**Q: How important are wind-down plans (“living wills”) as a tool for crisis management?**

The concept of living wills or restoration and resolution plans and the power of supervisory authorities to request them could be a valuable addition to the authorities’ toolkit. However, resolution plans are more a tool for regular supervision *before* a bank is in trouble than means for in practice crisis management. If the resolution plan indicates that the bank cannot be wound-down in a foreseeable way, changes must be made then and there, in line with existing regulation on complex business structures. To ask for the plan when the supervisor fears that the bank is in difficulty will typically be too late.

As other supervisory tools, requests for living wills should be proportionate to the size and systemic importance of the bank and objectives and definition of living wills must be clearly established as well as the supervisory authorities’ powers connected to them. As pointed out in the Staff Paper, the implementation of living wills must interact with the development of a resolution framework in order to avoid negative effects on economies of scope and scale within cross border banking groups to the detriment of the single market.

### **3.2 Intra-group asset transfers**

**Q: Is the development of a framework for asset transfer feasible? If so, what challenges would need to be addressed?**

Intra-group lending and other intra-group transactions are normal features in organising a banking group’s business. Such transactions are generally not a problem for viable banks and in normal circumstances. However, the question of asset transfers becomes more complicated in a situation with developing problems. To ensure efficient crisis management a framework for asset transfers should be considered. In times of liquidity crisis, asset transfers may be the optimal solution whereas ring-fencing may lead to an inefficient bankruptcy of the group. At the same time, asset transfers should not give rise to problems in the transferor. A possible solution could be to require that asset transfers are allowed if specific entities within the group experience problems but the group as a whole and the transferring entity is still sound and with reasonable probability expected to remain so also after transfer. Deciding on asset transfers will be a decision made under some degree of uncertainty and such transactions may therefore raise concerns for the home authorities of

the transferring bank. A possible European framework would require careful consideration.

**Q: What safeguards for shareholders and creditors are needed?**

It is essential that asset transfers and changes to insolvency or company law do not jeopardize the claims of shareholders, depositors and creditors in a way that could undermine public confidence in the banking system. It is therefore vital that the development of such a framework carefully take into consideration the balance between the interest of the stakeholders in the individual institution, national interests and the interest of the banking group as a whole and EU wide efficiency.

When striking the balance between group interest and the protection of stakeholders in the individual institution, it must be emphasized that, because of the potentially large externalities arising from a failure of a cross border banking group, the weight of financial stability for the group is unusually large and it is vital to protect the interest of the tax payers.

#### **4. BANK RESOLUTION**

##### **4.2 Objectives of a bank resolution framework**

**Q: What should be the key objectives and priorities for an EU bank resolution framework?**

The Swedish Authorities' view is that key objectives of an EU bank resolution framework should be to:

- maintain financial stability,
- preserve (critical) banking functions,
- maintain or restore public and market confidence for the financial system,
- minimise the overall costs of resolving the situation and additionally minimise the fraction of costs that are borne by taxpayers,
- ensure that the stakeholders in banks are not treated more favourably than stakeholders in non-financial firms or more favourably than if no resolution tools would have been used.

The last objective warrants some further remarks. Public support to failing banks implies that the stakeholders may not face the same risk of loss as comparable stakeholders in non-financial firms or stakeholders in smaller non-systemic banks. This is a violation of the basic principles of a market economy where the possibility of a profit is reflected in the risk of a loss. The prospect of public support creates

moral hazard, dilutes market discipline and distorts competition. Moral hazard and weak market discipline implies higher risks for bank failures and thus higher overall costs of financial instability over time. Therefore – as the last objective implies – losses should primarily fall on shareholders and junior and unsecured creditors rather than on governments and taxpayers.

The Swedish Authorities regard the following bullets as appropriate priorities for an EU bank resolution framework:

- 1) The EU framework should ensure that in all Member States there exists a possibility and preparedness for an administrative authority to assess systemic risks of a failure and suitably address these concerns when a bank is failing on the conditions for its license.
- 2) The EU framework should ensure that authorities have access to necessary tools to deal with the systemic risks in a suitable manner. In this respect, central powers should be:
  - *The ability to propose a support plan including conditions for any necessary restructuring.*
  - *The ability of an administrative authority to take control.*
  - *The option of temporary public ownership should always be reserved as a last resort.*
- 3) The EU framework should ensure that the authorities when addressing the systemic concerns can take effective and timely actions. This implies that the authorities must be able to take control over the firm and take actions without the shareholders' consent. More generally, measures taken to, for example, preserve financial stability may in some circumstances infringe on stakeholder rights as set out in general company and/or insolvency laws. EU must ensure that stakeholder rights do not prevent the authorities from fulfilling the objectives of the bank resolution framework. A proper balance between stakeholder rights and public interest can be found by installing appropriate safeguards. However, it should be emphasized that the safeguards should also reflect the objective that stakeholders in banks should not be treated more favourably than stakeholders in non-financial firms. This does not necessarily mean that the safeguards for stakeholders in a financial firm have to be identical to the safeguards in general company and insolvency law.
- 4) The EU framework should ensure that the objectives of the bank resolution framework can be achieved in the case of a failing cross-border bank. This would entail finding suitable



mechanisms for cooperation, information exchange and coordination of the resolution processes in relevant Member States.

#### 4.3 What resolution tools are needed?

**Q: What are the key tools for an EU resolution regime?**

It is important to distinguish between a failure in a single bank during normal circumstances and a failure during a general systemic crises. In the latter situation more drastic intervention may be justified to protect the economy as a whole. For example, in balancing between public and private interests, shareholder rights will in this situation have less priority because of the vital public interests that are at stake in a systemic crisis.

Even prior to the activation of the bank resolution framework, authorities should have the powers to facilitate private solutions and prevent the situation from deteriorating further. This may also include the use of funds, such as deposit guarantee funds, as is being considered by the Commission in the work on deposit guarantee schemes. Another tool to be used when licence revocation is imminent for a systemically important bank will be to give the state the right to propose a restructuring plan. Failure to accept a reasonable restructuring plan could result in the resolution framework being activated.

At a stage where the authorities have not made a successful early intervention and a failure of a systemically important institution is deemed imminent, state intervention will be unavoidable. A key factor must then be to provide for the state to take control of the bank's business/activities in order to prevent contagion and to maintain the bank's customers' access to basic financial services while carrying through adequate resolution and restructuring measures.

State control could be enforced in several ways such as the appointment of a special administrator or nationalisation. Sweden has considered a way in which the administrator (a special authority) assumes control of the running of the business by representing all of the shares (but not ownership) at the general meeting. Control should be ensured in clearly defined situations, in particular if the bank no longer fulfils the requirements for retaining its license, is deemed to be unable to rectify the situation and its failure would harm financial stability. In cases deemed especially serious, including a very low level of own capital as defined by the capital adequacy regulation (much below 8 per cent) control should be taken immediately.

Given that state control has been secured, the state should be able to carry through all measures deemed necessary in order to provide for a

restructuring, including powers to facilitate private acquisitions, setting up a temporary bridge bank, a good and bad bank etc.

In accordance with the general objectives for the resolution process -- transparency, cost efficiency, minimising use of state funds and limiting moral hazard – the resolution authority should have a wide range of legal tools available, the purpose of which would be, for example, to continue essential operations and payment services, secure sufficient new financing and continue servicing essential contracts. Furthermore, powers to make the shareholders pay in full for losses by reducing share capital before capital increases, to enforce reduction of claims towards subordinated creditors, and to inject new capital in the institution on adequate terms (see also below under 4.6 on the need for exemptions from EU Company law).

In conclusion, a legal framework that confers far reaching legal tools to the authorities, but sets clear conditions for their use increases transparency and legal certainty in favour of general values like market discipline and cost-efficient solutions. These far reaching tools require safeguards for shareholders and creditors (see discussion under 4.6 below).

#### **4.4 Threshold conditions and timing for use of tools**

**Q: What are the appropriate thresholds for the use of resolution tools?**

The Swedish Authorities support the conditions to be fulfilled according to the Commission Communication, namely that an institution is failing to meet core regulatory conditions and a public interest is at stake. A generally accepted trigger for state intervention and control could be the point in time at which the supervisory authority would decide to withdraw the licence of the institution according to the rules laid down for such occasions. Together with an authoritative assessment that a withdrawal of the licence would imply a systemic risk, this decision should be the trigger for the above mentioned control and resolution powers.

The exact point in time for such a decision would be up to the supervisory authority (as with all types of withdrawal of licences) and be taken on the basis of quantitative as well as qualitative factors together with the need to take account of the prevalent systemic risk. The decision on systemic risk should be taken in consultation with the central bank.

The power to decide should rest within the frame of relevant financial authorities due to the need for speed and also their knowledge of the financial system. The factual decision should in practice not be possible for a court to reverse (no stay of execution should be

possible), but as explained further under 4.6 there should be a right for shareholders and creditors to seek damages.

As for public ownership and nationalisation, this option should be available when private or cooperative solutions are found not to be available or when less intrusive methods such as for instance administration will not result in a suitable handling of the problem, i.e. will lead to a solution along the basic goals of the framework. At a trigger point more close to insolvency (e.g. 2 per cent capital level) immediate nationalisation may be necessary to avoid systemic problems.

#### **4.5 Scope of the bank resolution framework**

**Q: What should be the scope of an EU resolution framework?**

The Communication is addressing the banking sector and given the special features of banks, including their deposit taking function, a resolution framework should be built with the primary purpose to efficiently deal with credit institutions and not at this stage be expanded to for example the insurance sector.

**Q: Should it apply only to cross-border banking groups or should it also encompass single entities which only operate cross-border through branches?**

There should be no difference between cross-border groups and branches. Cross-border systemic risks may occur in both cases, in principle requiring the same type of intervention and control by the relevant authorities.

As pointed out above under section 2, General remarks, the scope of the framework must ensure that authorities in all Member States have a minimum set of supervisory tools to intervene early when a bank begins to face problems, and, if such intervention is not sufficient to restore the bank's health, a minimum set of powers to safely resolve a bank failure. Such powers to resolve a crises are important also for national institutions without cross border activities, where there is a risk for systemic problems. Problems in one Member State, that originate in a national bank, may easily develop into cross-border instability.

#### 4.6. Stakeholders' rights in bank resolution procedures

**Q: Is it necessary to derogate from certain of the requirements imposed by the EU Company Law Directives, and if so which conditions or triggers should apply to any such derogation?**

The Swedish Authorities agree that amendment to Company Law Directives (including the Second Company Law Directive) are necessary to specify that certain shareholders' procedural rights under those directives may be waived when a bank is under resolution (and not only in bankruptcy).

A bank with solvency problems should either be wound-up or restructured and recapitalised. The latter alternative is often the preferred solution for systemically important institutions. Any restructuring measure – including recapitalisation – must be prompt and distinct in order to uphold confidence in the restructuring process. When private solutions are not available, it is also desirable that a recapitalisation measure in the form of a share issue is allowed to be directed to the restructuring body.

However, the current crisis shows that provisions in the Company Law Directives may leave too much powers to shareholders in a rescue situation to allow desirable resolution measures. The requirements in the Second Company Law Directive stating that any increase in capital must be decided upon by the general meeting and that the shares must be offered on a pre-emptive basis to shareholders whenever the capital is increased by consideration in cash mean that shareholders can block issues directed at the restructuring body. If rescue of the bank is necessary to maintain financial stability this may lead to shareholders negotiating terms for the recapitalisation that are unfavourable for the state and the taxpayers. The state must therefore be given possibilities to override these powers given to the shareholders. The rights of the shareholders and creditors have to be safeguarded, but it has to be done through means that do not prevent an efficient handling of the crisis. See discussion below.

In addition, pursuant to the Second Company Law Directive any reduction in the subscribed capital, except under a court order, must be subject at least to a decision of the general meeting acting in accordance with the rules for a quorum and a majority laid down in Article 40 of the same directive. If a bank resolution regime places the responsibility for the reorganisation and recapitalisation measures with a special body, it would be desirable to let any possible capital reduction decision be vested in that body. Using a court procedure is likely to delay the recapitalisation which could endanger the reorganisation process.

In addition, convocation rules and rules relating to mergers may also need to be set aside to ensure an efficient handling of a banking crisis.

Given the extraordinary interests which are involved with crisis management of systemically important banks, it must be considered appropriate to derogate from directive provisions affording protection for shareholders in order to create an efficient restructuring procedure. This derogation could clearly be drafted in compliance with the European Convention of Human Rights, as far as the derogation is upheld by a public interest and furthermore proportionate in relation to that interest. The protection afforded today is absolute, in contrast to the protection for property rights under the European Convention of Human Rights that allows for a balancing between public and private interests.

However, as emphasized in the introductory remarks, it is vital that the protection of shareholders is not undermined to such extent that it will discourage private investors from investing in the financial industry, thereby limiting supply and/or raising costs for financial services vital to the economy as a whole (see also the next question).

Clearly, the triggers for derogation must be set high, but this is the case for bank resolution and state intervention in general. As stated under 4.4. above, when an institution is failing to meet core regulatory conditions and has reached a point where the supervisory authority would decide to withdraw the licence of the bank, state intervention may be unavoidable if the withdrawal of the licence would imply a systemic risk. When bank resolution regulation is triggered, derogations from Company Law Directives should be possible in order for the state to protect the legitimate interest of the taxpayers. Otherwise, shareholders may be able to extract value from state support that will not only lead to inefficient crisis resolution, but may spur moral hazard in a pre-crisis situation.

Possibilities for derogations from the EU Company Law Directives should apply to all financial institutions covered by the resolution framework.

**Q: What appropriate safeguards, review or compensation mechanisms for shareholders, creditors and counterparties would be appropriate?**

Compliance with the European Convention of Human Rights require that the derogation is upheld by a public interest and is proportionate in relation to that interest.

In line with this, derogations should never preclude the right to compensation if a court finds that the decision of the reorganisation body was incorrect. In order to avoid moral hazard, it would at the

same time be important to ensure that compensation is based on the value of the company ignoring the value-enhancing effects of state intervention. The shareholders and providers of risk capital must primarily bear the losses incurred and should not profit from state intervention.

In order not to interfere with an efficient restructuring process, any judicial review should not allow for stay of execution or be able to reverse the operations that have taken place, but should be limited to awarding financial compensation.

#### **4.7 Application of resolution measures to a banking group**

**Q: How can cooperation and communication between authorities and administrators responsible for the resolution and insolvency of a cross border banking group be improved?**

The setting up of relevant *Cross Border Stability Groups* including appropriate sub-groups and tasks assigned to these groups, would support and improve the prerequisites for cooperation and communication.

Developing appropriate arrangements and knowledge of the preconditions for *burden sharing* would most likely also act as a general support and incentive for cooperation among all authorities and at all stages of financial stability management.

The concept of *lead manager* is to some extent a reality within the context of cross-border group supervision. To extend this concept as regards crisis management including the responsibilities of Ministries of Finance and resolution/insolvency authorities could further make the cooperation and resolution process more efficient.

**Q: Is integrated resolution through a European Resolution Authority for banking groups desirable and feasible?**

At this stage of developing a more harmonised and coordinated European resolution framework a European Resolution Authority should not be a primary objective. Among the difficulties would be to create a common European financing facility with a properly functioning financing arrangements. As described under 4.8 private sector solutions and any ex-ante funding may not be sufficient.

**Q: If this option is not considered feasible, what minimum national resolution measures for a cross-border banking group are necessary?**

See answers under 4.3. on key tools.

#### 4.8. Financing a cross-border resolution

**Q: What is the most appropriate way to secure cross-border funding for bank resolution measures? What role is there for specific private sector funding? Is establishing ex-ante crisis funding arrangements practical? If not, how could private sector solutions best address the issue?**

In order to maintain public confidence and correctly align incentives, it is important to find mechanisms that transfer costs of financial instability from the government and the taxpayers to the credit institutions themselves. Work is underway at the G20 and the IMF, and we note that the Commission was invited by the Ecofin Council in December 2009 to elaborate the ways for the private sector to contribute to financing resolution measures and to explore the possibility of setting up resolution funds. Additionally, there is the ongoing Commission work on the report on the operation of the DGS Directive, expected by early 2010.

We support this work, and as an example, in Sweden, a special stability fund has been set up as a part of the Government's stability plan for financial institutions. The purpose of this fund is to finance measures needed in order to counteract the risk of serious disturbance to the financial system in Sweden.

The fund, which in 15 years is targeted to reach 2.5 per cent of GDP, will be built up with the help of fees paid by banks and other credit institutions. The Swedish Government has initially allocated funds from the central government budget to the fund, but the aim is that the costs should be carried by the industry itself. All banks and other credit institutions incorporated in Sweden that are covered by the Act (SFS 2008:814) on state support to credit institutions will pay a stability fee to finance the stability fund. The fee, which amounts to 0.036 per cent per year, is levied on certain parts of the institutions' liabilities according to an approved balance sheet. The basis for calculating the fee is all liabilities excluding equity capital, junior debt securities that are included in the capital base, according to capital adequacy rules, and group internal debt transactions. To develop the system further the Government intends to make the fee risk differentiated and considers a combined system with the deposit guarantee scheme.

The Swedish National Debt Office has been appointed Support Authority and is responsible for managing the fund.

Letting banks and other institutions finance the stability fund creates a financing system that is similar to a funded deposit insurance system. Costs for reconstructing banks will primarily be paid by the credit institutions, which increases the protection of the taxpayers' interests. In the case of a truly systemic event where several major

banks have to be rescued, the reconstruction cost might exceed what has been funded ex ante and what the industry could bear going forward. In these cases it will be necessary to supplement the stability fund with other public funds; a systemic financial crisis almost inevitably has effects that touches national fiscal responsibilities. This implies, for example, that a stability fund does not eliminate the need to have procedures for ex post burden sharing; see below.

Building pan-European funding should not be a priority at this stage as there will be clear difficulties to combine such a system with national supervision and powers of taxation. However, a harmonisation of the funding within a revised directive of the DGS is clearly warranted.

**Q: Is there scope to achieve greater clarity on burden sharing? If so, would the first priority be to define principles for burden sharing?**

As the Commission Communication rightly points out, private sector solutions will not always be available in a crisis situation and any ex-ante funding may not be sufficient. The current financial crisis demonstrates the need for coordination of public interventions. An important objective for Crisis management, national or cross border, should be to minimise the total cost of the crisis. In a cross border systemic crisis, nation states might be tempted to pursue national agendas resulting in sub-optimal response to the crisis. To avoid a sub-optimal and/or delayed responses to a cross-border crises, at least some predefined principles on how the cost could be shared among the states are required, while maintaining decentralisation of fiscal responsibilities.

The Swedish Authorities agree that further work is necessary in this area. The Council concluded in December 2009 that the way forward is not ex-ante agreements on the precise allocation of costs among Member States but an increased preparedness for ex-post burden sharing. We look forward to further elaboration of principles for such preparedness by the EFC Ad Hoc Working Group on Crisis Management during spring.

## 5. INSOLVENCY

**Q: Is a more integrated insolvency framework for banking groups needed? If so, how should it be designed? Should there be a separate and self contained insolvency regime for cross-border banks?**

Insolvency rules are intertwined with rules regarding bank resolution and will influence behaviour and the availability of solutions in a restructuring situation. The winding up of integrated banking groups on a separate entity basis is no doubt difficult and probably often



inefficient. At the same time, insolvency law differs widely within the European Union as does the law of property, contract and commercial law. Therefore harmonised treatment of cross-border operations will not be an easy task to achieve.

The Swedish Authorities agree that as a minimum, an EU bank resolution framework should be supported by a binding framework for cooperation and exchange of information between courts and insolvency practitioners for a banking group.

However further harmonisation may be necessary and we would support looking into the option of national proceedings being coordinated by a 'lead administrator'.

A “28th regime” for cross-border banks could in theory be useful, but we are doubtful that such a regime is actually feasible. For example, criteria for application of the regime must be stable as uncertainty otherwise will increase for creditors and other stakeholders. Systemic importance may in that respect not be a useful criterion. We would support further research on this matter, but this should not be the key focus of the Commission's work.