

Submission to the Riksdag

2009/10:RB4

Submission on certain areas that require investigation as a result of the financial crisis

Summary

This submission proposes that one or several commissions of inquiry be appointed as soon as possible to review the financial regulatory framework. The purpose of the inquiry's work should be to establish a coherent and effective framework that can contribute to maintaining financial stability and to minimising the costs to both the economy and consumers. The approach should be comprehensive and include, for instance, the division of roles between public authorities, provisions for financial supervision that can be taken at an early stage, the activation of the deposit guarantee, the Riksbank's tools in the field of financial stability and the management of financial undertakings in distress.

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Proposal for Riksdag decision

The Riksdag should inform the Government of its opinion that the Government should urgently appoint one or several commissions of inquiry with the task of reviewing the financial regulatory framework in the areas stated in the Riksbank's submission.

Stockholm, 12 February 2010

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Certain areas that require investigation as a result of the financial crisis

The Riksbank's proposal:

The Riksbank proposes that the Riksdag should inform the Government of its opinion that the Government should urgently appoint one or several commissions of inquiry with the task of reviewing the financial regulatory framework in the areas stated in the Riksbank's submission.

1. *Sweden's financial regulatory framework needs amendment*

In autumn 2008 a financial crisis reached its peak and had a severe effect on the international financial markets. Although opinions are divided as to what caused the crisis, most decision-makers around the world point to the same problem: namely serious flaws in the existing regulatory frameworks for financial regulation and supervision. As a result of this, the financial regulatory frameworks are now being examined under a magnifying glass and we will probably see major changes in this regulation in the future, both on national and international levels. The Swedish regulations are to a great extent governed by the regulations drawn up at international level, for instance by the Bank for International Settlements (BIS) and the EU. Swedish financial undertakings and public authorities will thus be directly affected by the future international regulatory amendments.

At national level, the Swedish authorities have already adopted a number of targeted measures to mitigate the effects of the financial crisis. Among other things, the amount of compensation in the deposit guarantee has been raised and more types of deposits have been included in it. The Riksdag has also passed the Government Support to Credit Institutions Act (2008:814) (the Support Act), which makes it possible for the so-called support authority (the Swedish National Debt Office) and the government to provide support to credit institutions which have financial problems. In several respects, these measures represent a significant reinforcement of the public framework for dealing with credit institutions with problems. At the same time, one must remember that the measures were adopted during an ongoing crisis and within tight time constraints. Therefore, it has not been possible to carry out a thorough analysis of how to set up an effective financial regulatory framework which will be sustainable in the long term.

On the basis of the lessons that the financial crisis has taught us, and the wide-ranging regulatory work taking place at an international level, the Riksbank considers that a thorough review of the Swedish financial regulatory framework should be carried out. The aim should be to create a regulatory framework which can help to maintain financial stability and to minimise the costs to both the national economy and consumers when a credit institution (banks and credit market undertakings) suffers problems. A similar regulatory framework may also be needed for other types of financial businesses. The Riksbank considers that a consolidated approach should be taken towards everything from provisions for financial supervision that can be taken at an early stage, to the activation of the deposit guarantee and forms for administrating, winding up or reconstructing financial undertakings in distress.

A number of specific questions which need to be analysed in more depth are set out below. Although each individual question is important in itself, they need to be dealt with in a single context, when possible. This will improve the chances for the development of a coherent, modern and transparent regulatory framework. At the same time, certain issues may need to be examined more rapidly than others. Furthermore, the Riksdag may take its own initiatives, when appropriate. The need to appoint more commissions of inquiry may also arise. However, regardless of the manner in which the investigatory work is conducted, it is important that the legislative work be implemented promptly.

2. *Dealing with institutions with problems*

Although Sweden underwent a serious banking crisis at the beginning of the 1990s, we do not have a coherent arrangement for the support, administration, reconstruction or winding up of credit institutions. International experience, for example the manner in which the British authorities handled Northern Rock, has shown that such an arrangement can be enormously important for a country's authorities to be able to safeguard stability in the financial sector and protect depositors and taxpayers. The Riksbank believes that there should be a fundamental review of how a working Swedish arrangement for supporting, administering and reconstructing or winding up institutions with problems should be designed. It should also be considered whether such an arrangement could be applied to all institutions and not just those deemed to constitute a threat to the system. In order to create a coherent system, an analysis should be carried out of the manner in which an arrangement for support, administration and reconstruction or winding up should be integrated into the deposit guarantee system. Finally, in view of the Swedish banks' fairly wide-ranging operations in other countries through branches or subsidiaries, an analysis should be conducted of the manner in which the regulation should be drawn up so that Swedish authorities can deal with problems arising in cross-border operations.

3. *Definition of financial stability*

In a Memorandum of Understanding from 2009 between the Government Offices (Ministry of Finance), the Riksbank, Finansinspektionen (the Swedish Financial Supervisory Authority) and the Swedish National Debt Office regarding cooperation in the fields of financial stability and crisis management, financial stability is defined as "the ability of the financial system to maintain its basic functions without disruptions which entail significant economic costs". Although financial stability is deemed to be an important prerequisite for society in general and financial stability is included among the tasks of Finansinspektionen and the Riksbank, there is, at present, no definition in law of the term financial stability. The Riksbank considers that a definition of this term should be contemplated.

4. *The Riksbank's responsibility for promoting stability in the financial system*

The Riksbank is often associated with the aim of maintaining price stability, which is usually interpreted as attaining a low and stable level of inflation. In addition, the Riksbank has another task, namely that of *promoting a safe and efficient payment system*. The Riksbank's responsibility for financial stability rests on this formula, according to current legislation. However, neither the Sveriges Riksbank Act nor the preliminary work on the Act make clear what the task of promoting a safe and efficient payment system is supposed to include. Moreover, the Riksbank may only conduct or participate in such activities for which it has been authorised by Swedish law (Chapter 1, Article 1, Sveriges Riksbank Act). The inquiry should examine whether it should be explicitly stated in the Instrument of Government or the Sveriges Riksbank Act that the Riksbank has a responsibility for financial stability and, if so, how such a regulation would comply with the provisions of the Treaty on the Functioning of the European Union.

5. *The Riksbank's tools for achieving the price stability target and promoting stability in the financial system*

During the financial crisis, the Riksbank, with the help of the tools which may be used for monetary policy purposes under the terms of Chapter 6, Article 5, Sveriges Riksbank Act, adopted comprehensive measures to mitigate the effects of the financial crisis. These measures can largely be divided into two groups. The first group includes measures taken to safeguard financial stability in order to achieve, by extension, the price stability target, while the other group includes measures more directly connected to the price stability target. The first group includes the Riksbank's lending of dollars and Swedish kronor with longer maturities than normal, which was expected to ease the

solvent banks' liquidity management. The other group includes the rapid decrease of the repo rate to 0.25 per cent by the Riksbank, which was intended to achieve the inflation target of two per cent and support the economic recovery. Even if these tools were suitable for these purposes, it needs to be considered, on the basis of the experience which can be drawn from the present crisis and from international experience in this area, whether the Riksbank should be granted additional monetary policy tools.

The preliminary work for the Sveriges Riksbank Act (1997/98:40 p. 54) reveals that monetary policy instruments are only supposed to be used to maintain price stability. However, to promote a safe and efficient payment system, the Riksbank has other instruments, for example the possibility of granting emergency liquidity assistance on special terms ('lender of last resort'). At the same time, according to that same preliminary work, there may be situations in which a crisis in the payment system threatens to jeopardise the price stability target. In such situations, monetary policy tools must be used with a view to warding off such a crisis.

As described above, the Riksbank used the monetary policy tools to safeguard financial stability and reduce the effects of the financial crisis. However, the Riksbank considers that there needs to be an analysis of whether the Riksbank should be granted particular tools which could be used for the sole purpose of promoting stability in the financial system, regardless of whether this is needed to achieve the price stability target and regardless of whether there is a financial crisis situation. Minimum reserve requirements form one example of a tool which perhaps should be considered.

6. *The financial infrastructure*

It is generally accepted that a properly functioning financial infrastructure is a decisive factor for financial stability. Weaknesses in this infrastructure can lead to disruptions in the financial system. Several other countries are currently reviewing the frameworks of their financial infrastructure. They are also examining whether the tools the authorities have at their disposal are adequate for maintaining financial stability. Against this background, we should investigate whether the Riksbank's oversight role should be reinforced in some way and, if so, how.

7. *The division of roles between the authorities*

According to the existing regulations, responsibility for financial stability work is shared between the government, Finansinspektionen, the Riksbank and the National Debt Office. This division requires close cooperation between the parties concerned. To enable the interplay between these authorities to function as effectively as possible, it is important to clarify who should do what and when. In addition, it should be investigated how best to organise the exchange of information and knowledge between the authorities involved. Regulations governing confidentiality should also be reviewed to the same end.

The Riksbank and Finansinspektionen

At the same time as the work of both the Riksbank and Finansinspektionen is central to the promotion of stability in the financial system, it is important that the government's total oversight should be organised in the most effective manner possible. This is necessary to ensure that the financial stability target can be safeguarded at the same time as the costs to society are minimised. The Riksbank believes that it should be considered how all of the government's functions to promote and maintain financial stability can be organised in the most effective manner possible. An unprejudiced analysis of whether the present division of responsibilities and coordination between Finansinspektionen and the Riksbank can be improved in any respect should therefore be performed. The advantages and disadvantages of various conceivable solutions should be considered. One alternative presently being discussed in several other countries involves tightening the organisational links between the supervisory authority and the central bank, in one way or another.

Another alternative being discussed in connection with the introduction of a new European supervisory structure is whether the European Systemic Risk Board should be able to draw the European supervisory authorities' attention to systemic risks under a so-called comply-or-explain model. The supervisory authorities would thus be induced either to take measures to mitigate these or to explain why no such measures are being taken. It should be investigated whether a similar model would be suitable for Sweden. Particular attention should be paid towards the fact that Finansinspektionen and the Riksbank have different principals.

Another issue that should be analysed is whether it is appropriate – as the law currently provides – to allow Finansinspektionen to decide which supervisory measures and/or sanctions should be adopted in each individual case or whether completely different solutions would be more appropriate. One alternative solution would be to set out, in advance, which measures Finansinspektionen is to adopt when certain events occur. Finansinspektionen's duty to intervene may, for instance, be more clearly coupled to certain predetermined thresholds. International comparisons need to be made and the work currently being conducted internationally should be taken into account.

Emergency liquidity assistance on special terms is the last resort for a credit institution facing liquidity problems and, in many cases, the ultimate guarantee for financial stability. In order to try to avoid credit institutions encountering liquidity problems at all, it should be investigated how the banks' liquidity and matching structures should be regulated and supervised.

The Riksbank and the Swedish National Debt Office

One question which came to the fore when Kaupthing Sverige AB and Carnegie Investment Bank got into difficulties in the autumn of 2008 was how the Riksbank's scope for granting liquidity assistance on special terms works in relation to the National Debt Office's scope for providing liquidity assistance under the terms of the Support Act. It is important to clarify which authority is responsible for liquidity assistance in the different phases of a chain of events. It is also important to consider how the Riksbank's liquidity assistance should be handled if the institution receiving this assistance later becomes insolvent or, in some other way, no longer meets the requirements for the assistance.

There could arise a situation in which the Riksbank, against a government guarantee, considers granting liquidity assistance to an insolvent but systemically important bank, while waiting for the support authority (the National Debt Office) to handle the question of liquidity assistance to the bank. It should be investigated whether such a government guarantee would be in contravention of Article 123, concerning monetary financing, or Article 130, on the prohibition against instructions, of the Treaty on the Functioning of the European Union.

It should also be analysed which undertakings might qualify for special liquidity assistance. At present, the circle of those who can obtain the Riksbank's special liquidity assistance is narrower than the circle of those who are allowed to participate in the payment system (and even the circle of those who might be the subject of monetary policy measures). The Riksbank is therefore prevented from offering liquidity assistance on special terms to all participants in the Riksbank's payment system (RIX), regardless of whether they are deemed to be systemically important.

8. Procedures for scrutinising decisions by the authorities

One question which is linked to efficient supervision and an effective system of sanctions is the possibility of implementing decisions by the authorities within a reasonable amount of time. This has been a problem when dealing with acute situations. As such decisions can have extremely major consequences for affected institutions and their owners, it is important to pay consideration to the provisions of Article 6 of the European Convention on Human Rights, dealing with the right to a fair and public hearing. In order to establish a legally secure, coherent and efficient financial regulatory framework, it should be analysed whether the regulations currently prevailing for appealing against decisions by the authorities are appropriate or whether another arrangement should be introduced and,

if so, which legislative amendments would be necessary. One particular question which should be examined is how the provision on stay of enforcement in Article 28 of the Administrative Court Procedure Act (1971:291) affects these possibilities.

9. *The Riksbank's access to government bonds for the promotion of financial stability*

It is important to financial stability for institutions to be able to borrow in turbulent times, when liquidity is in short supply in the financial system. At such times, the demands on which collateral can be accepted become more stringent. In response to the demands on collateral becoming more stringent in the autumn of 2008, the National Debt Office, in consultation with the Riksbank, issued government bonds. The funds which the National Debt Office received were used to make reverse repos on covered mortgage bonds. Subsequently, an explicit provision was introduced to the effect that the National Debt Office, in consultation with the Riksbank, may take up loans to the government to meet the need for government loans with different maturities. In the preliminary work to this amendment (prop. 2008/09:61 p. 65), the government also took up the question of whether the Riksbank, with a view to helping the market to function, should be able to borrow government bonds from the National Debt Office, subsequently either to lend them on or to sell them with a promise to buy them back – in other words, to exchange them in a repo transaction. However, no such possibility was introduced, among other reasons because it was not clear whether it would be compatible with the provisions of the Treaty on the Functioning of the European Union governing monetary financing and the Riksbank's independent and autonomous role. The Riksbank considers that the issue of the Riksbank's scope for making use of government bonds should be taken up for renewed consideration.

10. *The Riksbank's borrowing for the foreign currency reserves*

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.

11. *The Riksbank's financial independence*

The report on the Riksbank's financial independence (SOU 2007:51) was presented in 2007. Among other issues, the inquiry dealt with the question of a suitable amount of equity for the Riksbank. As a result of the financial crisis, several of the conditions upon which this report was based have probably changed. Consequently, the commission of inquiry that the Riksbank now proposes should perform an assessment of the extent to which the report and consultation responses can serve as a basis for legislation. In this context, a suitable form for the continued discussion of this legislative matter should be considered. Where appropriate, the committee of inquiry should complement the report in light of the collected experience of the financial crisis. If deemed appropriate, the committee of inquiry may present its opinion of the preparation process and any complementary material in a sub-report.

12. *The Sveriges Riksbank Act*

This submission proposes a review of several issues central to the Riksbank which would require amendments to be made to the Sveriges Riksbank Act. In turn, these amendments would necessitate further amendments to the Act. In order for the Riksbank to be best able to fulfil its duties, it is important for the Sveriges Riksbank Act, as a whole, to include coherent, lucid and modern

regulations. Against this background, a review of the manner in which the Sveriges Riksbank Act could be modernised should be conducted.