The crisis in Ireland – similarities and differences compared to the Swedish bank crisis

The ongoing restructuring of the Irish banking sector, as well as the measures taken by the Irish authorities, have clear similarities with, but also differences to, the Swedish bank crisis in the early 1990s and the measures taken by the Swedish authorities at that time. Both countries closed banks that were considered unable to survive and set up special companies to manage and sell bad loans and the asscoiated collateral. Both cases also entailed conducting a thorough analysis of all the banks applying for assistance to ensure that their long-term capital requirements could be met. However, there are also differences in how the countries chose to manage the situation, for example with regard to the bank guarantee schemes that were introduced and the structures that were set up to specifically manage the bad loans. Another important difference between the Swedish and the Irish bank crises is the size of the problem and that Sweden, unlike Ireland, managed to deal with the crisis without financial support from outside. The end result in Ireland will probably be a change in the structure of the banking system to a situation with fewer and larger banks, in the same way as in Sweden in the early 1990s.

Bank guarantee scheme and liquidity support

Prior to the crisis, the Irish banking system was dominated by six banks (Bank of Ireland, Allied Irish Banks, Anglo Irish Bank, Irish Nationwide, EBS Building Society and Irish Life and Permanent).[21] When the market lost confidence in the Irish banking system in connection with the financial crisis in 2008, the authorities chose to introduce a bank guarantee scheme for depositors and creditors in the six largest Irish banks. This scheme corresponded to potentially 260 per cent of GDP. The intention was to avoid a liquidity crisis. The Swedish bank guarantee scheme, which was introduced in the autumn of 1992, guaranteed the commitments of the Swedish banks rather than the specific banks as such. It could also be said that the Swedish bank guarantee scheme was more competitively neutral as it covered the commitments of all the banks. The Swedish scheme was phased out in 1996 after the Riksdag judged that it was no longer needed.[22]

During both the Swedish bank crisis and the Irish crisis the central banks provided emergency liquidity assistance and other forms of liquidity support to banks that had liquidity problems. In addition to this the Irish banks were able to use the normal liquidity facilities of the ECB.

21 For a description of the causes of the crisis in Ireland see the box "Support package for Ireland" in *Financial Stability Report 2010:2*, Sveriges Riksbank.

22 For more information on the Swedish banking crisis, see for example S. Ingves and G.Lind "The Management of the Bank Crisis – in retrospect", *Economic Review 1996:1*, Sveriges Riksbank.

Management of bad loans

The Irish authorities set up the National Asset Management Agency (NAMA) in November 2009. The task of the NAMA is to identify, value and purchase loans on the balance sheets of the banks applying for support against collateral in property.

During the Swedish crisis too, special companies were used to manage bad loans. However, a difference between the crisis management conducted in Sweden and that conducted in Ireland is that in Ireland NAMA is solely responsible for managing the banks' bad loans. In Sweden, on the other hand, the government formed Securum and Retriva which only purchased assets from the state-owned banks Nordbanken and Gota bank. The other, privately-owned banks in Sweden formed their own companies to manage their bad loans.[23] The ultimate aim of the NAMA is, however, similar to the aim that Securum and Retriva had, that is to purchase, manage and sell assets at a profit. Another general similarity between the two bank crises is that the authorities in both countries faced major methodological challenges with regard to the valuation of a great number of property loans in a situation in which few property transactions were being carried out.

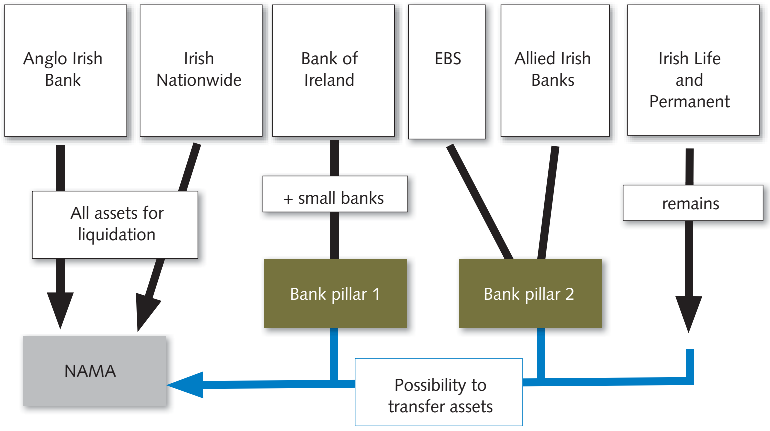
Capitalisation of the banks

Government capitalisation of the banks has been an important measure. The Irish government has recapitalised the banks on several occasions since the first time in December 2008 when it injected EUR 1.5 billion into the Anglo Irish Bank. As this bank continued to make substantial losses that required additional capital injections, it was completely nationalised in January 2009. At the same time, the Allied Irish Banks and the Bank of Ireland were recapitalized by the government with injections of EUR 3.5 billion per bank. The government took a 25 per cent holding in each of the banks (see Figure B1:1 for the consolidation plan for the Irish banking sector). The total cost to the government of the support measures for the banks amounted in April 2011 to EUR 46 billion. This sum includes capitalisation costs, losses in connection with sales and ongoing losses in the nationalised banks.

During the Swedish bank crisis too, repeated capital injections to the same bank were required in some cases as the situation

23 When assets are sold from a bank to a management company with the same owner then, by definition, no long-term transfer of wealth takes place. However, this could happen in the NAMA's case as the NAMA is jointly-owned by the state and private owners and buys bad loans from both wholly state-owned banks and banks with private ownership. This makes it even more important to set sales prices with a great deal of care.

Figure B1:1. Consolidation plan for the Irish bank sector



at the bank proved to be worse than first feared. This applied to Nordbanken and Första Sparbanken. The form of the capital injections for the Allied Irish Banks and for the Bank of Ireland can be compared to the support provided to Föreningsbanken. It consisted of capital guarantees, which if it had been used would have led to the state becoming a major owner of preference shares in the bank.

Stress test

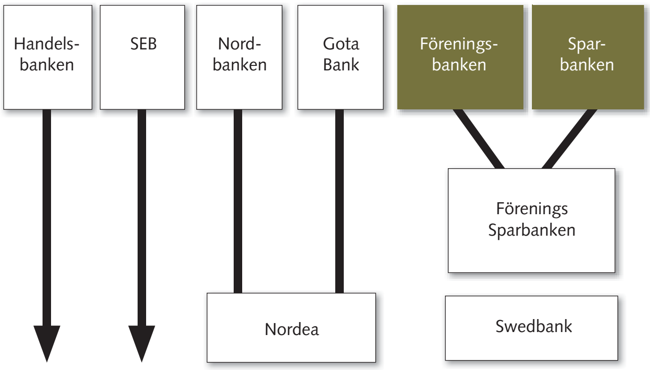
To dispel uncertainty concerning the situation of the banks and to enable a reinforcement of the capital situation of the banks in the long term, the Irish authorities conducted a stress test and published the results on 31 March 2011.[24] The stress test investigated whether the banks would be able to hold 6 per cent of core Tier 1 capital in a stressed scenario, as well as a capital buffer. The results of the stress test showed that the banks needed additional capital of EUR 24 billion to meet the target. This means that the total costs of restructuring the Irish banking sector amount to at least EUR 70 billion.

Ireland's stress test can be compared to the detailed analyses of the portfolios and future prospects of the banks that applied for support conducted by the Swedish Bank Support Authority.[25] These analyses led to conclusions about how much capital was needed and whether the bank concerned could survive at all. For example, it was concluded that Gota Bank was not viable, after which this bank was split up and sold off (see Figure B1:2).

24 The CEBS (Committee of European Banking Supervisors) conducted a stress test of European banks that was published in July 2010. This stress test covered two Irish banks, the Allied Irish Banks and the Bank of Ireland. Both banks passed the test, although many analysts explain this by saying that the test was not strict enough.

25 The Swedish Bank Support Authority was a Swedish government authority formed in 1993 to support the government in managing the effects of the Swedish financial crisis.

Figure B1:2. The Swedish banking sector before and after the crisis of the 1990s



The size of the problem an important difference

An important difference between the current Irish bank crisis and the Swedish bank crisis of the 1990s is the size of the problem in the two countries. In 1991, the Swedish banks' balance sheets amounted to approximately 100 per cent of GDP, while the corresponding figure for the Irish banks when the crisis began was 300 per cent.

The public financial gross costs for managing the Swedish bank crisis in 1991 corresponded to approximately 4 per cent of GDP, while the direct public costs of managing the bank crisis in Ireland may reach up to 45 per cent of GDP. In contrast to Ireland, Sweden managed to cope with the crisis without needing to seek external financial support.