Summary

Preventing and managing financial crises

The Financial Crisis Committee's work and the contents of its report

The Financial Crisis Committee's work aims to improve the government's ability to reduce the risk of financial crises breaking out and should a crisis nevertheless occur, reduce its impact.

In this report, the Financial Crisis Committee presents its findings on part of its work. The report focuses on preventing financial crises and managing liquidity disruptions. Matters that concern EU proposals for a crisis management framework will be addressed in our next report.

In this report we:

- describe and evaluate Sweden's management of the 2008 crisis and the period immediately following it.
- analyse and present proposals on how to improve crisis prevention within the framework of the current governance structure. The Committee proposes a new organisational platform – a macroprudential council – for developing expertise, analysis and policy discussion.
- analyse and present proposals on how to distribute roles and tools between the Riksbank and the Government/support authority on measures to counteract liquidity disruptions.
- discuss principles for the design of the Stability Fund and stability fees.
- analyse authorities' remit and propose a new and clearer description of the Riksbank's remit for its work on financial

system stability and propose that the Swedish National Debt Office in its role as a support authority and guarantee authority should have a remit similar to those of the Riksbank and Finansinspektionen (the Swedish Financial Supervisory Authority).

- make proposals aimed at improving the ability of the Government/Government Offices, the Riksbank, Finansinspektionen and the National Debt Office to exchange classified information in order to improve their cooperation on matters concerning financial stability.

In our next report, in addition to presenting proposals on how the EU Crisis Management Directive will be incorporated into Swedish law and taking a position on whether the Government Support to Credit Institutions Act (2008:814) should be changed, we will present our final proposals concerning the Stability Fund and stability fees, as the possibilities here depend on the outcome of current negotiations within the EU. Below is a summary of the discussion and proposals in this report.

Why should financial institutions be treated differently?

Why the government should attach so much importance to that part of the economy represented by the financial sector is an important and fundamental issue. Why are banks and other financial institutions considered different from other enterprises? Why will the government support banks but not industrial enterprises?

The reason is the special role that the financial sector plays in the economy. A modern economy cannot exist without a functioning system for making payments, allocating capital from savers to borrowers and providing risk management, for example in the form of insurance. These core financial services are as important to society as a functioning energy supply. At the same time, banks and some other financial institutions are vulnerable to shocks, and shocks in one financial institution may rapidly spread to others. All this means that the government needs to regulate and supervise the financial sector in a completely different way. Moreover, financial services are of major importance to individual consumers but it is often difficult for them to assess the quality of these services.

History clearly shows what may happen when the financial system does not work, i.e. when there are financial crises – the social costs are often very high. There are thus good arguments for the government to play an active part to prevent problems and as effectively as possible reduce the impact of those problems that do occur.

The global crisis

A few years after the turn of the millennium, financial imbalances and risk-taking in the financial markets began gradually to increase. This set in motion a dramatic crisis in autumn 2008 that affected the economy in every part of the world.

Development of the crisis

After the economic downturn in 2001 and 2002, the world economy experienced strong growth and low inflation. There was growing confidence that this would continue. Interest rates were low, credit was easily accessible and the risks considered low and under control.

Borrowing increased in many economies and household and business debt increased, as did government debt. Global imbalances grew, most conspicuously in the form of growing budget and current account deficits in the United States and growing surpluses in China. Banks tried to increase lending by such means as new financial techniques whereby they used various ways to remove credit risk from their balance sheets and sold it on. This was done using new and complex instruments and creating institutions not covered by banking regulation – so-called *shadow banks*. The financial expansion and increased risk-taking thus became less transparent, particularly because bankers also bought the new instruments. It was difficult to get an overall picture of the effects on the market and the system as a whole. To begin with, these changes were generally perceived as unproblematic and many saw them as positive for market efficiency. But from spring-summer 2007, the picture began to crack and uncertainty began to spread in the markets. In early autumn the unrest grew. Liquidity conditions in the international financial markets worsened substantially and the interbank rates rose sharply. These events were triggered by problems in the American mortgage market. More specifically, this referred to home loans that, kindled by the ambition that less well-off households should also be able to own their own home, had been given to borrowers with weak finances and a poor credit rating, commonly referred to as *sub-prime* loans.

In spring 2008 the unrest continued. In March a major financial player, the American investment bank Bear Sterns, experienced acute payment problems. The solution was that the company was bought by another company. But early in September, the American authorities were forced to take over the large mortgage institutions Freddie Mac and Fannie Mae.

When the American authorities decided, however, that Lehman Brothers, the American investment bank, would *not* be rescued, an acute crisis of confidence in the global financial system erupted on September 15, 2008. Banks all over the world began to hoard liquidity and credit between the financial institutions in the interbank markets dried up. Interbank rates skyrocketed and financing also became difficult in other important parts of the financial market. The result was a shock wave that caused the world economy, already in a downturn, to nosedive.

How could the crisis happen?

The difficulties in apprehending the risk situation and the increasing vulnerability, both among individual players and in the system in general, had contributed to the failure of the lines of defence that could have prevented excessive risk build-up. Instead the crisis escalated almost uncontrollably early in autumn 2008.

The first line of defence that had been breached was companies' managers and boards, who often appeared to have a very incomplete picture of their actual risk exposure.

The second line of defence concerned market players whose duty was to examine and evaluate companies and their operations, particularly auditors and credit rating agencies. In many cases, these players were not up to the task. In particular, the latter had made serious errors of judgement, chiefly with regard to the risk in the new financial instruments.

Nor was the third line of defence, government regulation and supervision, up to standard. Among other things, government regulation had not been adjusted to the rapid changes in the markets, and the authorities in many cases had too narrow a perspective in their analysis and lacked an overview of market developments. Furthermore, authorities' international cooperation and rules harmonisation had not kept pace with the internationalisation of the financial markets, as became evident not least in the EU. At the same time, inordinate expectations about the market's ability to manage risks and solve problems had built up. Due in part to these expectations, there was also an unwillingness to intervene with measures, particularly if these measures could be expected to be unpopular with the market and the public. All this contributed to insufficient vigilance and activity on the part of the authorities.

Last but not least, when problems subsequently escalated, the financial resilience of financial institutions in many cases proved to be totally inadequate to cope with the strain.

Swedish crisis management

Strong public finances, relatively good financial viability in Swedish financial institutions, relatively favourable external conditions, relevant and prompt measures, and Swedish authorities' effective cooperation provided the basis for successful crisis management in Sweden. There is room for improvement, however, both in preventing and managing crises.

The Committee notes that neither the Swedish authorities nor authorities and players in other countries could foresee either when or how the crisis would break out or its course and repercussions. Furthermore, there were deficiencies in the financial regulatory framework concerning capital and liquidity requirements. There were also no measures covering parts of the financial regulatory framework, particularly a framework for handling banks in crisis. But with a combination of relatively favourable conditions and relevant measures, management of the crisis in Sweden was still successful.

It is important to emphasise that in a crisis, rapid and resolute action is more important than perfection in the measures' design.

Management of a financial crisis is not unlike what is required in the event of natural disasters and major accidents – but with the not unimportant difference that the management of a financial crisis also directly affects the course of the crisis. The ability to act in a way that inspires enough confidence that it can halt a negative expectations spiral may be critically important. It is the Committee's opinion that in all essential respects, the Government and the authorities concerned succeeded in this task.

Sweden's position when the crisis began

Sweden had been largely unaffected by the global financial problems until the crisis in confidence became acute in connection with Lehman Brothers' bankruptcy. Swedish banks had certainly had higher financing costs and they had been affected by the problems in the dollar financial markets, but since Swedish players generally had neither direct nor indirect exposure to the risks in the sub-prime market and similar types of structured products, Sweden had managed to avoid major problems up to that point.

After the Lehman Brothers' bankruptcy, interbank rates also rose sharply in Sweden, if not to the same extent as in the euro area and the United States. But just as in the rest of the world, Swedish banks' financing in the interbank market could only be done in shorter and shorter maturities. The possibility of other market financing also largely disappeared. The supply in the market for short dollar loans in principle completely dried up and the same was true of long-term market financing.

A good starting position with regard to its public finances and relatively recent experience from the crisis of the early 1990s were important factors in the success of Swedish crisis management. Furthermore, Swedish banks had a comparatively strong financial position. Another factor contributing to the successful management of the crisis was the authorities' effective cooperation, despite the existence of uncertainties such as distinguishing between different authorities' responsibilities. Various programmes and measures were launched to ensure the banks' ability to pay and their financial position – and thus the financial system's core functions for handling transactions and providing capital. This involved credit, different forms of liquidity assistance, guarantees and capital injections.

Even though Sweden in general had a good starting position, there were certain conditions in the Swedish banking sector that were of concern. Five factors in particular can be singled out. *First,* Sweden has a concentrated banking system, in which confidence in the system as a whole is highly dependent on confidence in each of the four largest banks. *Second,* the Swedish banking sector is large relative to the Swedish economy – the banking groups' assets relative to GDP are clearly higher in Sweden than in most comparable countries. *Third,* Swedish bank groups have extensive foreign operations. *Fourth,* two of the large banks have and had extensive operations in the Baltic economies. There had been strong growth in these countries for a number of years in a row, but at the same time, large imbalances had accumulated that led to a deep economic downturn when the global economy deteriorated. This had a substantial impact on these banks and thus the Swedish banking system as a whole. *Fifth,* Swedish banks had developed a large and growing dependence on short-term market financing, much of it from abroad, and thus a dependence on functioning markets.

Measures

In the Committee's opinion, the Government and the Riksbank acted promptly, transparently and forcefully in response to the problems. Under the stability plan, vital legislation, in the form of the Government Support to Credit Institutions Act, was passed and a strategy for crisis management, which included the most important measures, was presented. We consider it to have been important to strengthen confidence in the early stages of the crisis.

Strengthening *depositor protection* helped maintain confidence in the Swedish financial sector. The stronger protection could have been a decisive factor had the Swedish banks' problems become more serious than they did. *The guarantee programme* made a crucial contribution to financial stability. With the government able to step in as guarantor of the banks' loans, the banks had a better chance of borrowing with longer maturities and without collateral. *The capital injection programme* contributed to financial stability because the market knew that it was possible for the banks to get an injection of capital from the government if needed. *The Stability Fund* was in the Committee's opinion an adroit and appropriate budgetary solution giving the Government the right to execute unlimited measures and payments to realise the aim of the Government Support to Credit Institutions Act. The fact that the government started the fund with a substantial contribution probably helped increase confidence.

The Riksbank used several tools to manage in various ways the liquidity crisis that arose and ensure that the banks' strained liquidity situation would not lead to a credit crunch or stoppage in the payment system. Extra borrowing facilities with longer maturities than normal, lending with a broader spectrum of collateral and a greater number of counterparties were offered. A swap agreement was established with the US Federal Reserve to secure the dollar financing needed and a similar agreement was made with the ECB. Swap agreements were also reached with the central banks in Iceland, Estonia and Latvia. Emergency credit was also given to two financial institutions, Kaupthing and Carnegie. Monetary policy was also promptly and forcefully reversed to be more expansive in order to generally reduce financing costs and counteract the economic downturn, thus indirectly improving financial institutions' general operating conditions.

Effects and experience

One indication that the response to the crisis in Sweden was effective was that in light of the depth and extent of the crisis, there was little decrease in the growth of credit to business. Lending to households continued to increase, confidence was maintained and no big credit crunch occurred.

Another indication of the successful response to the crisis was that the measures taken to manage the financial crisis had no cost to taxpayers. On the contrary, looking at their direct financial impact, the measures have clearly had a positive effect on government finances. But the measures would have been equally justified even if the outcome for government finances had been negative. The aim of both support measures in a crisis and government involvement in general in the financial sector is to protect the economy and the citizenry. A well-functioning financial market is a prerequisite for growth, employment and welfare, and strains on government finances may in some situations be a necessary price to pay.

None the less, there are weak points as regards knowledge and analysis of systemic risks and the availability of adequate tools to mitigate these risks and a clear governance framework for preventing and managing financial crises. Hence, bearing in mind the enormity of the harmful effects to society that a full-blown financial crisis may cause, there is every reason to remedy these weak points.

Financial crises will not be eliminated. But better knowledge and supervision can help lead to fewer and less extensive crises. With better tools to limit the harmful effects of those crises that do occur, major social benefits can be gained.

International lessons from the crisis

The crisis has precipitated changes in the regulatory framework and new institutional solutions, both at the national and at the international level.

In the wake of the crisis, there has been a lively debate, both internationally and in individual countries, about how governments – individually and in cooperation – can in a better and more comprehensive way counteract and manage shocks that may threaten financial system stability. At a global level, this has been manifested in the revision of the Basel framework known as Basel III. A framework for managing banks in crisis has been developed through the G20 cooperation. Both these initiatives have had a direct impact on EU rules in the form of new capital requirements and the Crisis Management Directive. In the EU, there have also been important institutional changes with the formation of the three European Supervisory Authorities and the European Systemic Risk Board. In addition to measures at the international level, institutional changes and changes in financial regulation have been proposed and introduced in a number of countries. These changes are still mostly underway.

Crisis Prevention

Finansinspektionen's powers

Finansinspektionen today already has extensive powers to act and its powers will grow further with new EU rules. There is currently no need for any additional powers. Nor is introducing a greater degree of "prompt corrective action" justified.

Finansinspektionen's powers and tools to avert possible problems at an early stage are crucial in preventing financial stability problems. It is important that it has the means and is obliged to intervene at an early stage when there are problems in financial institutions.

Finansinspektionen thus must have the resources both to ensure high quality in its supervision and to provide room for long-termism and planning. It is also critical that there is flexibility, allowing for a prompt increase in resources in crisis situations. It is also important, in line with the tradition of Swedish government authorities, to ensure that that there are genuine opportunities to independently manage and decide individual matters and set the necessary priorities.

It is the Committee's opinion that Finansinspektionen does not need to be given new means of intervention in addition to those it already has and those expected to be added because of EU work to develop rules. Nor does the Committee think that an ordinance should be introduced compelling Finansinspektionen to intervene in a certain way in particular defined situations (prompt corrective action), beyond what has been introduced or will be introduced as a result of rules developed in the EU. There may admittedly be some advantages in such a methodology with respect to transparency and predictability, but it is the Committee's view that there are greater disadvantages in a system in which legislators specify in advance and in detail how Finansinspektionen should act in various situations. A model like this also conflicts with the view of financial supervision expressed in Swedish banking legislation and elsewhere and based on the expectation that the supervisory authorities will ground their action on an overall qualitative assessment in each case. A view like this does not prevent it from being highly desirable for Finansinspektionen to actively work towards publicising and clarifying how priorities are set and how and why its conducts its work. This provides better transparency even though it cannot mean predictability in each question or matter.

A macroprudential structure

It is essential to build up better expertise on systemic risks and develop new tools for preventing them. This can best be done in the context of a broad and open cooperation. The proposed platform for this is a macroprudential council. The responsibility for deciding and implementing a particular macroprudential measure should be given to either the Riksbank or Finansinspektionen. The authorities should consult each other before this type of measure is decided.

What is macroprudential policy?

In the Committee's opinion, macroprudential policy has several elements: acquiring expertise on systemic risks, developing new tools to counteract these risks, monitoring financial stability and identifying systemic risks on an ongoing basis, and finally, acting when necessary using the tools developed and available for this purpose.

Macroprudential tools can be described as measures that have a general impact and promote systemic stability. The Committee provides an overview of the tools that are under discussion in Sweden and internationally. These involve both tools aimed at affecting the often strong cyclical element in the build-up of risks in the system, for example, countercyclical capital requirements, and tools that focus on risky interdependence and links between players and markets, for example, rules on debt levels. We do not make any proposals on the introduction or management of new tools but have concentrated on establishing the proper governance structure for macroprudential policy, as it is more appropriate that the development of new tools take place within this structure.

Expertise and new tools are needed

One lesson learnt from the crisis is that there was insufficient knowledge about how risks accumulate in the financial system, how the system may react to strains and how shocks in the financial system may affect and interact with the economy. There was no overview of the aggregate risks in the financial system. Even if there were concerns about some phenomena, no tools explicitly aimed at managing market-wide stability risks were at hand. Nor in the absence of such tools, was there a clear division of responsibilities between different authorities.

The international picture that has emerged is that even though the supervisory authorities have many tools in their arsenal, the authorities often lacked an adequate overview of the aggregate risk situation owing to their focus on institution-specific conditions and they usually did not have any explicit remit to act on market-wide problems. Central banks, on the other hand, were more focused on market-wide and systemic risks in their stability analysis, but they too did not realise the magnitude of the risks building up and the way in which the risks could materialise. They also had no recourse to any tool other than monetary policy.

In order to remedy these deficiencies and organise preventive action, work is underway in many parts of the world, not least in EU Member States, to improve the institutional basis for macroprudential policy. A number of proposals on how macroprudential policy could be organised have been put forward in the debate. The Committee has based its analysis on a number of models that could be applicable in Sweden. In the analysis, certain conditions have been taken as given and the Committee has identified certain basic conditions that should be met in a Swedish governance structure.

The basis for a Swedish structure

Changing the overall structure of financial supervision by merging Finansinspektionen and the Riksbank would obviously have a major impact on the basis for organising macroprudential policy. But such a fundamental change would require investigating several issues in addition to organising macroprudential policy. These issues are not included in the Committee's remit, and we have thus not considered this alternative.

The Committee has also had to take into account that Swedish authorities must act individually when they issue regulations or take decisions on individual matters. Consequently, for each macroprudential tool it must be decided which authority would be authorised to decide its use.

Also, it is the Committee's view that a Swedish structure for macroprudential policy should provide good opportunities to build expertise on systemic risks and possible countermeasures and make it possible to take decisions based on a broad picture of the stability situation. The Committee has the view that the knowledge and competence of both Finansinspektionen and the Riksbank are needed for an effective macroprudential policy. A Swedish structure for macroprudential policy must be able to make use of and combine the competencies of both these authorities.

Both Finansinspektionen and the Riksbank should be given responsibility for macroprudential policy and a macroprudential council should be established by law.

The Committee has based its evaluation of different possible models for macroprudential policy on a number of criteria:

- the ability to develop expertise, analysis and new tools,
- the quality of the basis for decisions,
- resource efficiency,
- clear division of responsibilities,
- compatibility with the EU,
- continuity.

In the Committee's view, the model that best meets these criteria and would work best in the Swedish environment is to make both Finansinspektionen and the Riksbank responsible for macroprudential policy and to establish a *macroprudential council* in which the two authorities cooperate, together with independent experts, in order to prevent serious shocks to the financial system. Unlike the Council for Cooperation on Macroprudential Policy established by Finansinspektionen and the Riksbank by agreement, the macroprudential council should be established by law. In particular, the council should promote increased expertise about systemic risks and the development of macroprudential tools and analyse risks in the financial system and discuss appropriate measures for counteracting these risks.

The Ministry of Finance does not take any preventive action with regard to systemic risk, but it is responsible for financial market legislation and in this context should prepare decisions on new tools. There are links between macroprudential policy and economic policy. It is therefore the Committee's opinion that the Ministry of Finance should be given the opportunity to participate in the macroprudential council as an observer.

Responsibility for applying each macroprudential tool developed should be given to either Finansinspektionen or the Riksbank. The Committee proposes that decisions on the application of such a tool be taken after consultation with the other authority. With respect to existing supervisory tools, which could be used for macroprudential purposes, the need for consultation should be discussed by the authorities on a case-by-case basis, and the authorities could make a request to the Government that a tool be subject to consultation.

The Committee proposes that the council include the Governor of the Riksbank (chair), the Director-General of Finansinspektionen, one additional official from each of the Riksbank and Finansinspektionen and two independent members with specific expertise in the area of financial stability who are appointed by the Government. A council secretariat should be established at the Riksbank.

A central idea in the Committee's proposal is that macroprudential policy should be characterised by an open discussion where all relevant expertise can be utilised and where different views can be aired. Work developing systemic risk expertise is very much a matter of spreading knowledge, not least to market players, in order to influence their behaviour and provide incentives for sound risk management. An open and a broad approach are particularly important as macroprudential policy is in an early stage of development. The work in the council should not be, or be perceived to be, a closed forum for negotiation between authorities. In this perspective, the Committee attaches great importance to the participation of independent experts as full members of the council and to the documentation of the discussions at the council's meetings in public minutes.

The establishment in law of a cooperative body in the form of the macroprudential council introduces an obligation for Finansinspektionen and the Riksbank to cooperate in macroprudential matters. The introduction of mandatory consultation between Finansinspektionen and the Riksbank prior to decisions on macroprudential measures creates a macroprudential policy structure that makes it possible to base decisions on measures on an overall picture of the stability situation while clarifying which authority is responsible for a decision.

It should be emphasised that the macroprudential council is not intended to replace the existing Stability Council, where the Ministry of Finance and the National Debt Office also participate in addition to the authorities mentioned above. The task of the Stability Council is to function as a forum for the exchange of information about financial stability and systemic risk. The Stability Council is primarily focused on crisis management, which is why the Ministry of Finance chairs the Council. The Committee does not propose any changes with respect to the Stability Council. It should also be emphasised that the cooperation between the Riksbank and Finansinspektionen in the macroprudential council does not replace the ongoing cooperation and exchange of information between these two authorities on financial market issues but is an additional component in this cooperation.

Liquidity measures

The 2008 crisis clearly demonstrated how sensitive liquidity in the economy is to shocks. It is important for the government also in future to be able to act to counteract liquidity shocks as resolutely as it did during the crisis. It is the Committee's view that the Riksbank should also continue to have a central role in supplying liquidity. The Government/support authority must also be able to take measures to improve liquidity that supplement the Riksbank's measures.

Liquidity is the access to legal tender. In normal circumstances, financial institutions, banks in particular, and markets supply liquidity and direct state intervention is limited to a few measures. The measures primarily concern the issuance of cash and granting of intra-day loans against collateral by the Riksbank within the framework of the central payment system (RIX). But in a financial crisis, the situation may be different. The government may then have to take extraordinary measures to strengthen liquidity, as it did in the recent financial crisis.

Liquidity shocks

One lesson from the autumn 2008 crisis is that liquidity can rapidly disappear when uncertainty emerges in the market. As the banks get a major part of their funding from the market, they are sensitive to market shocks. If a bank gets funding problems, they may spread to other banks. The problems may then also spread to the real economy, if, for example, bank credit is no longer available to customers because of the bank's funding problems.

With no immediate access to liquidity, banks and other players may have to sell assets such as property or securities in order to meet their obligations. Such sales create downward pressure on the prices of the assets concerned and may lead to substantial losses. The result may be a vicious circle of more selling and falling prices. As the prices of assets used as collateral fall, banks and other players may have to pledge additional collateral for their loans. Thus, a liquidity squeeze in the financial markets and falling asset prices may rapidly lead to liquidity shocks.

The Riksbank and the Government's roles

It is the Committee's view that the Riksbank should have a liquidity-supporting role as it had in the recent crisis and should be able to take measures both to counteract liquidity shocks in the market and to support individual institutions with liquidity problems. The Committee proposes that the Sveriges Riksbank Act be amended to clarify that the Riksbank is to promote well-functioning liquidity. Having overall responsibility for financial stability, the Government, may, as it did in the recent crisis, need to take supplementary measures to strengthen liquidity, possibly with the assistance of one or more authorities.

The Committee presents a proposal for a new provision in the Sveriges Riksbank Act, which enables the Riksbank to take general liquidity measures in order to counteract liquidity shocks. The measures proposed for this purpose are the same as the Riksbank may take for monetary policy purposes. This implies that loans may only be granted against adequate collateral. The Riksbank is to inform the Government prior to important decisions that concern such measures.

The Committee in this report does not make any proposals for changes in the Riksbank's remit to provide liquidity support to individual financial institutions, so-called emergency liquidity assistance. Instead, the Committee will deal with this issue in its next report and in connection with the review of the Government Support to Credit Institutions Act and the design of proposals for a reconstruction and bankruptcy regulation for financial institutions, as it is important that these regulations are consistent. Furthermore, future EU rules on liquidity requirements may affect the Riksbank's role in liquidity support, which should be taken into account in designing the regulation.

When expanding its lending to financial institutions, the Riksbank must also make it possible for such funds to be invested in Riksbank assets. One alternative is for the Riksbank to issue certificates, but as these instruments are not very well known, it may be difficult for financial institutions to use them as collateral. It may thus be preferable to be able to invest in government securities. Therefore, the Committee proposes that the National Debt Office be allowed to decide to lend government securities to the Riksbank, which in turn can lend them to the financial institutions. The securities should be returned to the National Debt Office before maturity in order to avoid any impact on government debt.

If other liquidity measures are needed than those within the remit of the Riksbank, for example to maintain credit supply or prevent credit problems for more financial institutions, this is the Government's responsibility. Based on the Government Support to Credit Institutions Act, the Government may take several measures of this kind if it is necessary to avoid a shock to the financial system. For example, the Government may activate the guarantee and capital injection programmes established during the crisis in 2008 and 2009. The Government may also issue a general guarantee that credit institutions will meet their obligations. In this report, the Committee does not propose any legislative amendment to increase the Government's scope for action.

Financing issues – the Stability Fund and stability fees

The arrangement with a Stability Fund and stability fees introduced in connection with the crisis was good, but the Stability Fund should be merged with the Deposit Guarantee Fund to establish a banking crisis reserve. However, two different fees should continue to be charged. The deposit insurance fee should be differentiated according to risk. A decision on a possible risk differentiation of the stability fee should be deferred pending a future EU Directive.

A system for financing public support measures in a financial crisis was introduced in Sweden during the financial crisis. The system consists of a Stability Fund and a stability fee, which is charged to financial institutions eligible for support. A deposit insurance scheme already existed. This system also includes a fund and a fee, the Deposit Guarantee Fund and the deposit insurance fee.

The Stability Fund was established in 2008 when the Government's stability plan was put in place. A basic principle was that the financial firms, over time, were to bear the cost of the management of future financial crises themselves. That would create sustainable financing in the long term and strengthen government finances in advance of future crises. Making firms bear the costs of financial instability would also reduce the incentives for excessive risk taking. There was thus both a financing purpose and an intent to influence behaviour.

The Stability Fund, which consists of funds deposited in an interest-bearing account in the National Debt Office and other assets acquired by the government when providing support, finances support measures taken under the Government Support to Credit Institutions Act. Initially, the Government contributed SEK 15 billion to the Fund via a budget appropriation. All credit institutions pay an annual stability fee that is put into the Fund. When the Stability Fund was established, the aim was that this Fund (together with the Deposit Guarantee Fund) would amount to 2.5 per cent of GDP on average within 15 years, i.e. 2023.

It is the Committee's view that the purpose and set-up of the financing arrangements are basically good and that the fee level is appropriate, but that a number of improvements should be made. However, a final position on these issues should await the result of the negotiations on the EU Commission's proposed Crisis

Management Directive, as it also includes regulations about stability funds and fees.

The Stability Fund and the Deposit Guarantee Fund should be merged into a new *banking crisis reserve*. The Deposit Guarantee Fund's investments in government securities should be redeemed by the National Debt Office in connection with the merger.

The Government should continue to charge two fees, a deposit insurance fee and a stability fee. Both the fees should be credited to the banking crisis reserve to finance support measures related to financial crises.

The deposit insurance fee is to be paid by all deposit-taking institutions. The deposit insurance fee is to be financing and in line with actuarial practices. It should be calibrated so that over time, it can be expected to meet the costs of honouring claims on the deposit insurance scheme, the costs of measures to reconstruct individual institutions, if these measures can be expected to be cheaper than meeting the claims, and the system's administrative costs. The deposit insurance fee should be differentiated according to risk. The Deposit Guarantee Inquiry's proposal could serve as a basis for the design of the fee.

The Committee has considered several models for differentiating the stability fee according to risk, but in the Committee's opinion, a final position on the design of the fee should not be taken before the EU Crisis Management Directive has been decided. The basis for the stability fee should be amended to exclude insured deposits, as they would otherwise be counted twice.

There should be no targeted level for the reserve, for example, in terms of a percentage of GDP. Consequently, the fees will be the same regardless of whether or not a crisis occurs; that is, no fees should be charged ex post in order to finance support measures during a financial crisis.

The SEK 15 billion initially contributed to the Fund via a budget appropriation to the Stability Fund should not be repaid to the government. Given the proposed abolition of the targeted level, a decision to withdraw the initial contribution would have no real effect. The credit institutions will pay the same fees regardless of whether or not the account balance is reduced.

The Committee proposes some technical modifications of the current stability fee system for clarification purposes.

The authorities – responsibilities and division of labour

All the authorities which in practice have a financial stability role, i.e. the Riksbank, Finansinspektionen and the National Debt Office, should have a clear remit to work for a stable and well-functioning financial system. The Committee proposes that the Riksbank's remit to promote a safe and efficient payments system be reformulated as a remit to promote a stable and well-functioning financial system. The Committee is of the opinion that the instructions for the Debt Office should also clearly state that it is to promote a stable and well-functioning financial system.

Same overall objective

The Committee notes that Finansinspektionen, the National Debt Office and the Riksbank have different remits concerning the financial system. Even if the authorities' remits and tools differ, they have the same overall objective, namely a stable financial system. The Committee is of the opinion that the authorities' joint responsibility for financial stability should be expressed in law or ordinance. This can be achieved by making it clear that each authority is to promote a stable financial system.

In the ordinance containing instructions for *Finansinspektionen,* it is already clear that it is to promote a stable but also a well-functioning financial system. The expression "*well-functioning*" should capture the meaning that the financial sector should meet several objectives, stability being an important – but not the only – such objective. If the stability objective is the sole objective, it could in principle be achieved with a stability requirement that is so draconian that the financial system could not function effectively. As stability must therefore be weighed against other objectives, this should also be expressed in the general formulation of objectives. In the Committee's opinion, the wording in Finansinspektionen's appropriation directions therefore gives a good description of what Finansinspektionen and the other authorities' remit on financial stability should concern and therefore provides a suitable basis for a future regulation. It is the Committee's opinion that no legislative amendment is therefore needed for Finansinspektionen.

For the *National Debt Office*, there is currently no formulation that expressly states that it has a remit to promote financial stability, but it should be made clear in the Debt Office's instruction that it has such a remit. The Debt Office's remit should be worded in the same way as that for Finansinspektionen, i.e. that the Debt Office is to promote a stable and well-functioning financial system. The Debt Office's remit on financial stability should be linked to its role as support authority and guarantee authority, as well as to other tasks it may receive in the future.

As to the *Riksbank*, the Committee notes that its remit to promote a safe and efficient payments system has in practice come to mean a responsibility for promoting stability in the financial system. In the Committee's view, the interpretation given this task should be expressed directly in the Sveriges Riksbank Act. The Committee proposes that this be done by clarifying in the Sveriges Riksbank Act that the Riksbank is to promote a stable and well-functioning financial system. The new wording, combined with the clarifications to be made concerning the Riksbank's role concerning liquidity and macroprudential policy, will make the Riksbank's role in the work on financial stability clearer.

How do the proposals change the future division of labour?

The Government

The Instrument of Government gives the Government overall responsibility for financial stability. By law, the Government has also been assigned a number of specific tasks. In addition to preparing legislative proposals for the Riksdag – including financial legislation – the Government has, for example, the right to make decisions on state support in accordance with the Government Support to Credit Institutions Act. Under the Committee's proposals, the Government Offices would be given the opportunity to participate as an observer in the macroprudential council.

Finansinspektionen

Finansinspektionen is responsible for supervision, regulation and permits that concern financial markets and financial institutions.

The Committee does not propose any changes in Finansinspektionen's remit in these areas. The Committee does propose, however, that Finansinspektionen within the framework of a new macroprudential structure, based on its supervisory perspective and together with the Riksbank, develop expertise in the field of systemic risk and develop appropriate tools for mitigating such risks, as well as analyse and assess the stability situation and the need for measures based on an overall perspective. This would thus be a statutory task for Finansinspektionen.

It is the Committee's opinion that this work is accommodated within its existing remit to promote a stable and well-functioning system. Finansinspektionen currently also does similar work within the framework of the Council for Cooperation on Macroprudential Policy. Thus in principle, the work in the macroprudential council does not mean any expansion of Finansinspektionen's remit. The same applies if Finansinspektionen is given new macroprudential tools.

The National Debt Office

The Debt Office is the support authority under the Government Support to Credit Institutions Act and has the powers assigned it under this Act. But the Debt Office currently does not have the power to make decisions on guarantees or capital injections as these programmes, which were initiated in 2008, have expired. The Debt Office is also the guarantee authority under the Deposit Guarantee Act (1995:1571) and the Investor Compensation Act (1999:158). The Debt Office administers the deposit insurance and stability fees and manages the Stability Fund.

In this report, the Committee does not propose any changes in the Debt Office's remit. When the Government Support to Credit Institutions Act is reviewed in connection with the introduction of a new regime for the reconstruction and liquidation of some of these institutions, the Committee will consider first, whether the support authority should also be responsible for handling reconstruction and liquidation and, second, whether the Debt Office should continue as support authority, and/or become the crisis management authority.

The Riksbank

The Riksbank has – in addition to its monetary policy remit – an operational responsibility for parts of the payment system. The Riksbank may also provide emergency liquidity assistance to financial institutions under supervision to meet this objective.

The Committee does not propose any changes in the Riksbank's financial stability remit but has aimed to clarify its legal basis. We propose that the Riksbank promote a well-functioning liquidity supply and we clarify when the Riksbank should take liquidity support measures. We also make clear that the Riksbank should help identify systemic risks and measures that can prevent them. As part of this work, the Riksbank should, within the framework of a new macroprudential structure, based on its central bank perspective and together with Finansinspektionen, improve systemic risk analysis, propose new tools for preventing systemic risk, and monitor financial stability. The Riksbank may also be given new macroprudential tools.

Effective information exchange

To enable a number of authorities to work efficiently towards a common overall goal, it must be possible for them to work on these issues as a single authority. To improve the authorities' chances for effective cooperation, the Committee proposes expanding the exchange of information between the authorities in the financial market area in situations in which we consider there is a need to strengthen their ability to get an overall picture of financial stability. The Committee has also analysed the confidentiality rules available to the authorities and finds that they are appropriate.