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Consultation response: Sweden and the banking union (SOU 2019:52) 2020-04-21

The Riksbank essentially supports the Inquiry's analysis and welcomes the fact that the issue has been analysed so thoroughly. That the banks within the banking union come under joint supervision and resolution and contribute by sharing risk between them has been positive for the stability of the European financial markets, in the Riksbank's opinion. Thanks to the joint banking supervision, it is possible to make general analyses and comparisons of the banks in the 19 countries currently taking part in the banking union.

From the Riksbank's perspective, membership of the banking union has good prospects for functioning well for Sweden. The Swedish banking sector has a high degree of cross-border activities, particularly within the EU. This means that supervision and resolution at EU level are appropriate for the Swedish banking sector – which has become increasingly international – and more so than national supervision and resolution. If Sweden were to take part in the banking union, we would also be able to benefit from the competence and experience the banking union has gathered in that it manages so many more banks than the Swedish authorities do.

However, the Riksbank does not take a stance on the issue of whether or not Sweden should join the banking union. This is an assessment for the politicians to make. There are also questions that need clarifying with representatives of the banking union before a potential political decision on joining the banking union is taken. One such question is what possibilities a country within the banking union has in a crisis to provide government support to a bank.

Background – what is the banking union?

The banking union was formed as an acute response to the euro crisis, to break the harmful interdependence between bank and state: weak public finances contributed to weakening confidence in the banks, partly because the banks often owned a large share of the national debt. At the same time, the weak banking system meant that confidence in public finances weakened, as banks in crisis have often entailed large costs for the state. Removing the costs for banks in distress from their own government would contribute to breaking this vicious circle.

In political terms, however, it was inconceivable to contribute to saving banks in distress in other countries, if supervision remained national. At the same time, it was difficult to imagine joint supervision if individual countries and their banks would bear the costs alone when the banks were in distress. The gradual phasing in of the different parts ("pillars") of the banking union therefore became an important part of the political agreement: first the single supervisory mechanism (SSM) would be put in place (2014) and then the single resolution mechanism (SRM) to deal with banks in distress (2015). The single resolution mechanism was to take care of the single resolution fund; the fund initially had financial means earmarked per country, but the idea is to gradually transfer this so that the fund will fully become a single mechanism in 2024. The future is uncertain for the final notified pillar of the banking union, namely a European deposit insurance scheme.

It was considered important right at the start of the negotiations on the banking union that non-euro countries should also have the opportunity to take part in the banking union on the same terms as the euro area countries. However, it was not legally possible to create any new EU authority with the necessary decision-making powers without changing the EU Treaty. The solution became instead to make the supervision work an organisationally independent part of the ECB, but with the final decision-making power lying with the Governing Council of the ECB. Special safeguard mechanisms have been created to compensate non-euro countries for not being able to take part in the final decision-making on supervisory issues in the ECB Governing Council (see the next section).

A new authority was created for resolution, but as a result of the EU Treaty, this authority is also unable to take final decisions in all parts of its work. Many of these decisions must be approved by the European Commission, and in some cases, for instance when the resolution fund is to be used, by the EU finance ministers (Ecofin).

The Single Supervisory Mechanism, SSM

The Single Supervisory Mechanism (SSM) consists of the ECB supervisory board and the participating countries' national supervisors. The supervisory board is an organisationally independent part of the ECB. It is responsible for all supervision within the banking union, but carries out its work in collaboration with the national supervisors. The supervisory board exercises direct supervision over 'significant' banks, while the national supervisors continue to monitor the remaining banks.[1]

The supervisory board has a large measure of independence within the ECB. Monetary policy and financial supervision are also held separate; for instance, the employees are located in different buildings in Frankfurt. However, the Governing Council of the ECB is the highest decision-making body for the supervisory board and makes the final decision on supervisory issues by either objecting to the board's draft decision – whereby the supervisory board is to produce a new draft decision – or by not objecting – whereby the decision comes into force. The supervisory board deals with around 2,000 supervisory decisions a year. The Inquiry says

[1] The subsidiaries of SEB and Swedbank in the Baltic countries are already under the direct supervision of the ECB. Whether or not a bank is significant (and thus under the direct supervision of the ECB) is determined by the ECB, which makes an assessment based on several criteria, including the size of the bank in absolute terms (a bank is significant if its assets have a value in excess of EUR 30 billion) and in relation to the country's GDP. As a minimum, the three most significant credit institutions in each country shall be under the direct supervision of the ECB.

that the Governing Council of the ECB has so far not objected to any of the supervisory board's draft decisions.[2]

If Sweden were to join the banking union, we would take part in the supervisory board on the same conditions as the euro area countries. Finansinspektionen would participate with the right to vote (decisions are reached on the basis of a simple majority) and the Riksbank would participate as observer.[3] On the other hand, the Governor of the Riksbank would not take part in the Governing Council of the ECB, which consists of the central bank governors of the euro area countries. However, if Sweden wished to object to either the supervisory board's draft decision, or to the Governing Council of the ECB's objection to a draft decision, Sweden would have the opportunity to put forward its arguments.

The Single Resolution Mechanism, SRM

The Single Resolution Mechanism (SRM) consists of the single resolution board and the participating countries' national resolution authorities. The resolution board administers the Single Resolution Fund. The aim is that this fund will contain resources corresponding to 1% of the deposits covered by the deposit insurance scheme within the EU (around EUR 60 billion) and it is the banks that will pay the fees.[4]

The single resolution board prepares and makes potential decisions on resolution for significant banks in the banking union. National resolution authorities have the corresponding tasks for crisis management of other banks, which shall normally be liquidated. The resolution board makes decisions on the forms for resolution of significant banks. It is then the national resolution authority that is responsible for the actual implementation.

If Sweden joins the banking union, the Swedish National Debt Office would take part in the work of the single resolution board on the same conditions as a euro area country. Sweden would also have the same influence as a euro area country in the two other decision-making instances in the single resolution mechanism, namely the European commission and Ecofin.

We live in an increasingly globalised world with cross-border banking activities

Previously, countries around the world used capital controls and tariffs to protect their own country's output from foreign competition. While such measures could benefit domestic producers of goods, the limited competition meant that good became more expensive for consumers than they would otherwise have been. Major steps have been taken towards increased free trade in recent decades. Countries and companies are now tightly interlinked through flows of goods, services and money.

This applies not least within the EU, where free movement of goods and services, people (including labour) and capital are so-called fundamental freedoms. This means that within the EU, companies can now transport their goods across national boundaries without customs tariffs or quantitative limitations. This development does not solely apply within the

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[2] p. 116.
[3] The central banks that do not have responsibility for banking supervision may take part in the supervisory board as observers.
[4] To increase its capacity, there shall also be a credit line by 2024 to the European Stability Mechanism (ESM), which entails an opportunity to borrow up to a further EUR 60 billion.

EU; free trade is becoming more common on a global level, although setbacks do arise. With a few clicks, Swedish households can now buy cheap TVs and clothing from Asia. At the same time, IKEA is selling its products not only in the whole of Sweden but a large section of the world, through its stores in more than 50 countries. The fact that we are trading with other countries to an increasing extend, and have companies that are active internationally, forms a base for Sweden's wealth.

Goods move cheaply and easily now, and money moves even more easily. In Sweden, we abolished currency regulation in 1989, which means that capital can move freely in both directions across Sweden's borders. Within the EU, the free movement of capital is the most recent addition to the four fundamental freedoms. The fact that capital has been allowed to flow freely has meant that the financial markets within the EU have become increasingly internationalised. Although it has become cheaper over time to buy goods across national boundaries in that most trade barriers have been removed, trade in goods normally entails a transport cost. Since the capital controls were abolished, the product that banks trade in – money – does not entail any transport cost. When it is just as cheap to send money from Stockholm to Norrköping as it is to send it to Tallinn, it is natural for the banks to extend their activities to other countries, to attain economies of scale. This is what the major Swedish banks did around the turn of the millennium when they began their expansion to the Baltic countries. Swedish banks' subsidiaries currently have a market leading position in Estonia, Latvia and Lithuania, and as these countries are a part of the euro area cooperation, the subsidiaries' market dominance means that they are currently come under the supervision and resolution of the banking union.

The same development has occurred throughout the EU. There is a total of around 6,000 banks in the EU, many of which are small and largely local. Measured in terms of market share, however, a relatively small number of very large, cross-border banks dominate. The 115 or so banks that come directly under the supervision of the ECB represent 80 per cent of the banking assets within the euro area, despite comprising in number less than 5% of the banks in the same area. As with cross-border trade in goods, cross-border banking activities have many advantages, for instance, by spreading risk and enabling better management of local macro shocks. But it also involves challenges. One challenge is that national supervision and resolution become much more difficult.

If a country suffers a bank crisis, the costs to society may be much higher than the costs that can affect the banks' owners. The banks are therefore subject to supervision by the authorities in a different way from many other companies. For instance, there are requirements regarding how much cash the banks need to hold for each krona they lend, and they also need to have a plan (approved in advance by the resolution authority) showing which measures they can take themselves to manage problems that arise. When a bank is active in several countries, this means that several countries will be affected at the same time, if the bank suffers problems. Moreover, it is difficult for the authorities to take effective measures against the banks when the authorities' mandate is a national one, while the banks' operations are international. Irrespective of how well a national supervisory authority or resolution authority carries out its tasks, the cross-border banking activities do not match with the national supervision and resolution. The Inquiry describes the so-called financial trilemma: which in brief means that financial stability, cross-border banking activities (financial integration) and national policies on banking supervision are not compatible.

The banking union is therefore a logical and welcome response to the high degree of integration among Europe's major banks, with extensive operations across national borders in Europe.

The scope for national individual solutions will decline regardless

Developments within the EU, and also globally, are moving towards increased harmonisation of the regulatory frameworks governing the financial markets, for instance, with regard to bank capital adequacy and banking recovery and resolution. This is a logical response to the increased globalisation on the financial markets. If the authorities are to be able to effectively limit potential negative effects on the economy from the banks' operations, the regulatory framework needs to be at a supranational level. The development towards greater harmonisation within the EU means, as the Inquiry points out, that there is less scope for national special solutions within the EU and this is regardless of participation in the banking union.

As the national room for manoeuvre steadily shrinks, the argument often put forward – to remain outside of the banking union to retain national room for manoeuvre – becomes weaker.

As participant in the banking union, Sweden would be contributing to a smoothly-functioning single market in the EU

As many large banks currently have cross-border operations within the EU, they need to obey the same rules. The banking union is a logical solution. The Riksbank assesses that the banking union has been good for the stability of the banking system in the EU.

Swedish banks finance themselves to a large degree on the European financial markets, and relative to Sweden's size they do so to a higher degree than other countries' banks.[5] Sweden's welfare is affected to a very large degree by the banking system within the EU functioning smoothly. At present, Sweden benefits from the work of the banking union, without actually contributing anything. If Sweden were to join the banking union, we would be involved in contributing to a smoothly-functioning single market, at the same time as the opportunities for influence increase. The banking union is now an integral part of the EU collaboration, largely all work in the financial market area is linked to the banking union.

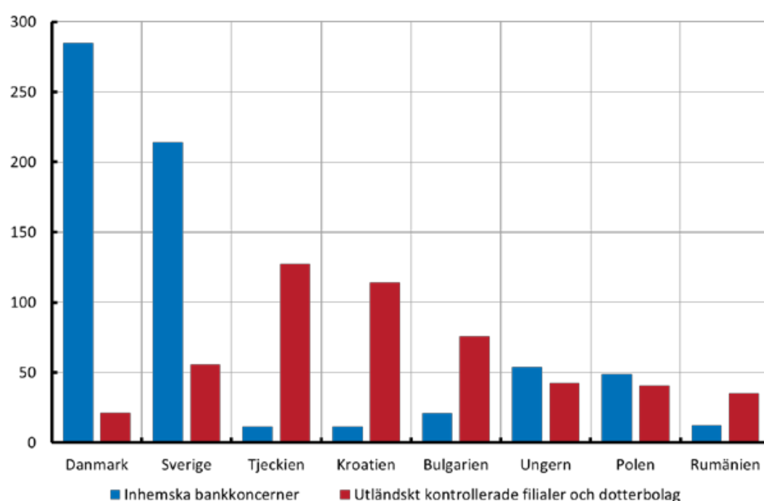
The Inquiry further describes how Sweden, for several reasons, is moving towards having less international influence. The Riksbank agrees with this assessment. Sweden's share of global GDP is declining, and our representation on many international groups can no longer be taken for granted. We are standing on an unstable foundation, which is illustrated, for instance, by Sweden being kept outside of important multilateral cooperation groups such as the FSB and G20. The Riksbank agrees with the Inquiry's assessment that this marginalisation will probably increase if Sweden remains outside the banking union, and even more so if more countries choose to join. The majority of EU countries are already members of the banking union. The group of non-euro countries within the EU will also have much less weight in future, as the most influential member of this group, the United Kingdom, has now left the EU. As the Inquiry also notes, there has often been concordance between Sweden

[5] See Wissén (2019), *Den svenska finanssektorn i bankunionen (The Swedish financial sector in the banking union),* a background report presented to the Inquiry on a potential Swedish participation in the banking union.

and the United Kingdom (and also Denmark) on issues regarding the banking union. When the United Kingdom left the EU, we thus lost an influential ally. The remaining non-euro countries are, with the exception of Denmark, countries with whom Sweden has less in common: Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania. One of the main differences is that Sweden and Denmark are home countries to large banking groups (blue stack in the Figure below), while the other countries outside of the banking union are primarily host countries for foreign banks (red stack).

Figure 1. Size of the banking sectors in non-euro area countries, 2019 Q3

Percentage of GDP



Source: ECB.

The relevant alternatives to weigh against one another are not thus "have things the way they are now" or "participate in the banking union". The comparison instead needs to be forward looking. Participation in the banking union has an advantage in that it could act as a counter-force to the general tendency towards reduced international influence for Sweden. Bearing in mind in particular the increasing harmonisation of financial market regulations, it is important to participate fully when these regulations are drawn up.

Irrespective of the degree to which Sweden is involved in shaping the regulations, the joint regulatory framework will be applied to actors on the Swedish financial market. It is therefore important that Sweden protects its international interests. The major Swedish banks' subsidiaries have, as mentioned earlier, market dominance in Estonia, Latvia and Lithuania. This means that they are under the direct supervision of the ECB. But as Sweden is not part of the banking union, no Swedish authorities are sitting at the table when the Swedish subsidiaries are discussed by the supervisory board (however, they are allowed to sit in on the supervisory colleges).[6]

[6] The Inquiry describes (on p. 163) how the supervisory colleges do not have decision-making powers and therefore do not influence the national supervisory authorities' powers of authority. "A supervisory college shall work to ensure the supervisory authorities take measures in agreement; if it not possible to reach an agreement, the coordinating supervisory authority makes a decision for the whole group and each national supervisory authority takes a decision for the respective subsidiary."

Participation in the banking union is not participation in the monetary union

Membership of the monetary union requires entirely different commitments of a country than membership of the banking union. The processes for joining are therefore also different.

A member state wanting to join the euro area cooperation must meet four economic convergence criteria: price stability, sound public finances, a stable exchange rate and sufficiently low interest rates. The requirement for a stable exchange rate is met automatically when a member state has been connected to the European exchange rate mechanism, ERM, for two years prior to applying for membership. As Sweden has not joined the ERM, it remains outside the monetary union.[7] In the referendum that was held in Sweden in 2003, 56 per cent voted against joining the monetary union.[8]

A member state wanting to participate in the banking union must first submit a request to the ECB to establish a so-called close collaboration. The ECB will only approve the request if the country has prepared to introduce the legislation required to take part in the banking union. As part of the collaboration, the ECB also examines the state of health of the banks in the country that will be subject to direct supervision by the ECB (so called comprehensive assessment). This examination consists partly of an asset quality review (a snapshot), and partly of a stress test using the ECB's methods.

A new Sveriges Riksbank Act affects the implications of joining the banking union

The Inquiry writes that it has not been able to take into account the proposals of the Riksbank Inquiry, which has been carried out parallel to this inquiry. However, in the summary there is a reference, reading between the lines, to the Riksbank Inquiry's proposal that the Riksbank should only be allowed to provide so-called general liquidity support to safeguard financial stability, and not for monetary policy purposes. The Inquiry writes: "If a central bank in the banking union wished to provide general liquidity support, with the explicit aim of promoting financial stability, this might nevertheless be a question on which the ECB, in its role as supervisory authority, might have opinions."[9]

The Riksbank realises that it is difficult to assess what role the ECB/single supervisory board might choose to play if the Riksbank were to provide general liquidity support to banks under the supervision of the ECB/single supervisory board with the explicit purpose of safeguarding financial stability. The new type of general liquidity support that is suggested in the legislative proposal – a general liquidity support separated from monetary policy – namely has no equivalent within the EU. When other central banks within the EU provide the equivalent support, it is for monetary policy purposes, which means that the supervisory board (as a result of central banks' independent responsibility for monetary policy) may not

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[7] In addition to the economic convergence criteria, each country wanting to join the monetary union must also ensure that its national legislation complies with the relevant parts of the ECB statute and the Treaty on the Functioning of the European Union. The ECB concludes in the most recent convergence report (2018) that Swedish law "does not comply with all the requirements for central bank independence, the monetary financing prohibition and legal integration into the Eurosystem".

[8] The Swedish prime minister said in 2016 that there must be total respect for the results of the people's referendum regarding the euro. See the link: https://www.europaportalen.se/2016/02/lofven-sverige-har-ett-undantag-euron.

[9] p. 34.

have any views on this. The Riksbank Inquiry's proposal therefore deviates from the system in the other EU countries and it is also unclear which EU regulations will apply to general liquidity support, and this creates uncertainty and demarcation problems in several fields, including the question of the role of the supervisory board. The Riksbank therefore points out in its consultation response to the Riksbank Inquiry that it would be more effective to give the Riksbank broad liquidity tools that can be used both for monetary policy purposes and to contribute to a stable and efficient financial system.

If this suggestion is nevertheless introduced into the new Sveriges Riksbank Act, the Government should raise this issue with the supervisory board in any entry discussions regarding the banking union, to gain clarity on how the board views this. If Sweden joins the banking union, the Riksbank considers that the obligation to consult with Finansinspektionen and the National Debt Office proposed by the Riksbank Inquiry would need to be extended to include the single supervisory board and also the single resolution board.

The proposal would also have the consequence that the Riksbank - unlike all of the other central banks in the banking union, or for that matter in the EU - would need to gather approval for state support from the Commission before giving general liquidity support.[10] Here there is no difference whether Sweden takes part in the banking union or not; the Riksbank Inquiry's proposals entail increased requirements for reconciliation of crisis measures at EU level.

Probable that liquidity assistance to solvent banks within the framework of precautionary government support can be provided in the same way within the banking union

The Inquiry notes that participation in the banking union does not prevent so-called precautionary government support (*without a resolution*) being a possibility.[11] Such support is initiated by the respective country's government or parliament, irrespective of whether or not the country is in the banking union. And in both cases the support must be submitted to the Commission's state support examination. On the other hand, within the banking union, it would be the ECB/single supervisory board instead of Finansinspektionen that would be responsible for assessing whether a bank is failing or likely to fail (abbreviated as FOLTF). If the bank is assessed to be FOLTF, it may not receive precautionary government support, but must be put into resolution. On the basis of the cases that have come up so far, the Inquiry finds it difficult to draw any conclusions as to how the ECB would assess whether or not the conditions for precautionary government support were met.[12]

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[10] According to the bank communication (2013), liquidity support for monetary policy purposes is not state support.
[11] So-called preventive state support is in Sweden included in what is known as the support act (2015:107) and entails the possibility to provide a state guarantee for liquidity facilities provided by the Riksbank to provide a state guarantee for new promissory notes issued by the bank or to inject capital at prices and terms that do not give the bank any advantage and on condition that the bank is solvent, etc. In Sweden, this financing takes place through the so-called Stability Fund, and must be approved by the Government. Preventive state support in the form of capital injections may only be given after a stress test that shows the need in a crisis scenario or after what is known as an Asset Quality Review, AQR. In 2015, two Greek banks received this type of support through capital injections, followed by an Italian bank (Monte die Paschi di Siena) in 2017.
[12] p. 83.

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The Riksbank wishes to point out in this context that precautionary government support is financed nationally, not by the single resolution fund (this is because precautionary government support is not resolution). The EU authorities should therefore have reason to be more positive to national authorities providing precautionary government support than to them not doing so. Such measures should reduce the risk of the single resolution fund needing to be used. At the same time, the authorities within the EU do not want distorted competition in that countries with good public finances are better able to help their banks out than countries with poor finances. However, the EU state support regulations are the same, regardless of whether or not a bank is taking part in the banking union. In both cases, it is the European Commission that determines whether it is in line with the state support regulations to provide precautionary government support in a specific situation.

If it is nevertheless the case that preventive government support is more difficult to use in the banking union, all else being equal there will be greater pressure on the Riksbank's liquidity support function.

The conditions for the government stabilisation tools may need to be clarified

The EU's banking recovery and resolution directive (BRRD) enables the member states to introduce so-called government stabilisation tools into national legislation. The tools are voluntary and shall, as the Inquiry points out, be regarded as a final resolution measure in a very exceptional crisis. The government stabilisation tools can be used when a bank is put in resolution, and they include the possibility for the state to acquire capital instruments to entirely or partly nationalise a bank that is in resolution (after significant bail-in). The single resolution board cannot use the government stabilisation tools. It is the respective country's government, or in certain cases ministry, that makes the decision and provides the financing. The Inquiry further writes that participation in the banking union does not assume that the government stabilisation tools will be removed in national law, but that it is unclear whether - and if so, how - a member state can use the tools within the single resolution mechanism. There is therefore good reason, according to the Inquiry, to clarify prior to Swedish participation the circumstances under which these tools can be used. The Riksbank agrees with the assessment that the rules need to be perfectly clear. As no two crises look the same, it is important to retain the capacity to use both belt and suspenders that we have in the current bank crisis management, and this includes the opportunity to use the state stabilisation tools.

With regard to the uncertainty over whether or not the government stabilisation tools can be used within the banking union, the Riksbank notes that the BRRD was reached through negotiation after the banking union had been established, and that half of the countries within the banking union (nine countries) have introduced government stabilisation tools into their national legislation with the support of the BRRD. From this perspective, it appears less likely that participation in the banking union would mean that the tools could not be used. The fact that the financing is national, and thereby does not burden the single resolution fund, also indicates that it should be possible to use the government stabilisation tools in the banking union.

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More probable that Swedish banks in the banking union will become net payers rather than net recipients

If Sweden joins the banking union, the major Swedish banks will ultimately have the back-up of a larger resolution fund. As the major Swedish banks are very large, this is a clear advantage in the event of the failure of a Swedish bank. As the Inquiry writes, banks with international operations, if they suffer problems, may be "too large and too complex for a single country to manage".[13]

But the risks are scarcely evenly distributed in Europe. Swedish banks are currently in a better condition than many other European banks, for instance, if one looks at the share of non-performing loans, NPL.[14] It thus does not appear as though Swedish banks from an insurance perspective will benefit *in the current situation* from the bank union sharing risks with banks in Europe. But nor will the heaviest burden within the banking union fall to the Swedish banks. Swedish banks' contributions to the single resolution fund are expected to amount to 2-3% of the total amount of the fund, according to the Inquiry. The major financial burden will fall, as the Inquiry shows, to banks in France, Italy, the Netherlands, Spain and Germany. The banks in these countries will account for just over 80% of the total amount in the single resolution fund.[15]

The Inquiry further states that the burden on the single resolution fund should be limited under normal circumstances, partly because the single fund is to finance *temporary costs* for resolution (for instance, providing guarantees to a bank in resolution). The basic principle is that the fund should not be used for *permanent costs* (for instance, recapitalisation). Exceptions can only be made under exceptional circumstances, which includes a bail-in of 8% of the bank's assets being made before the fund can be used. This threshold is set very high, with reference to historical losses in the banks. During the financial crisis that broke out in 2008, there was only one systemically important European bank that made losses in excess of 8% of its assets.[16] There is also a limit as to how much support an individual bank can receive from the fund, as the allocation from the resolution fund may not exceed 5% of an individual bank's assets.

Several Italian banks have handled crisis management nationally, without financing from the banking union

In the Swedish debate on the banking union, the view is sometimes expressed that if Sweden joins, we will have to pay for Italian banks' old sins. One of the purposes of the banking union is of course that costs can be spread over several participants - an insurance function. But it is worth a reminder of the management of two failing Veneto banks in summer 2017.

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[13] p. 291.
[14] There is a risk component in the calculation of the respective bank's risk fee. This will be relatively high for Swedish banks, as they have a relatively low percentage of guaranteed deposits in relation to their total debts (see the Inquiry, p. 278). The Inquiry also highlights the fact that banks that use internal models to a greater degree, such as the Swedish banks, are dependent on these models really capturing the actual risks. The Inquiry writes: "Assessing and comparing risk levels in different banking systems is therefore not without complications".
[15] pp. 361 and 362.
[16] See Danmarks nationalbank, *The banking union is not centred round joint liability,* 20 November 2018, p. 5. When one looks at loss levels during the financial crisis that broke out in 2008, however, one should bear in mind that many states contributed massive financial support to the banks.

The two Italian banks Banca Popolare di Vicenza and Veneto Banca were under the supervision of the supervisory board. In summer 2017, the supervisory board assessed that they were failing or likely to fail (FOLTF). However, the single resolution board assessed that the banks were not sufficiently systemically important to be put in resolution, and it was instead left to the national authorities to manage the crisis management under national insolvency regulations. The Italian state in its turn assessed that liquidation of the banks would cause such damage regionally, in the Veneto region, that they requested approval from the European Commission to be able to provide state support to the banks.[17] The European Commission gave its approval, and the Italian state undertook to pay up to EUR 17 billion.[18] Shortly afterwards, Italy received the go-ahead from the European Commission to support a further bank (Monte Paschi di Siena) with state funds, by providing a so-called precautionary government support outside of resolution. In this case, too, it was thus the Italian state that bore the costs, not the single resolution fund.

In summary, it can be noted that the three Italian banks that were under the ECB's direct supervision have been managed nationally with resolution and crisis measures that have been paid for partly by the banks themselves and partly by the Italian State. One condition for the national management was that the Single Resolution Board deemed that the banks were not systemically important in the EU. Against this background, the risk that countries in the banking union together will have to pay for failing Italian banks, for example, should not be exaggerated.

But it may actually be in the interests of Swedish banks - and Sweden - to contribute

The Riksbank thus considers that the risk that the single fund will be emptied to fund the resolution of Italian banks is sometimes exaggerated in the public debate. At the same time, however, it must be mentioned that it could very well be in the interests of both Swedish banks and the country to actually help other countries with their banks during crises. Sweden is a small, open economy that is highly dependent on imports and exports functioning. Consequently, Sweden is also very sensitive to financial instability, primarily in Europe. It is thereby important for Sweden that the international financial system is healthy, otherwise we run a major risk of seeing our own financial system affected. It is well worth remembering how, in 2008-2009, the Riksdag authorised the Government to support Iceland and Latvia with state funds. Ireland also borrowed from the Swedish State during the euro crisis. The Riksbank also contributed loans to the central banks of Iceland, Latvia and other countries.[19] It should not be ruled out that situations may also arise in the future where it will be in Sweden's interest to contribute funds when the financial markets are turbulent in other countries.

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[17] State aid is when the public sector (that is the state, the local authorities or county councils) support economic activities using public funds and this results in the recipient receiving an advantage in relation to other participants in the market, as the support benefits a particular operation or production. Injections of state aid are not normally allowed in the EU, but the European Commission can approve the granting of state aid under certain circumstances.

[18] The Italian State transferred EUR 4.8 billion to a third Italian bank (called Intesa Sanpaolo), in exchange for it taking over the robust parts of the two failing banks' operations. In addition, the Italian State left a guarantee of EUR 12 billion. The so-called bad bank part of the two crisis banks was settled, and owners and junior debt holders had to carry the losses. On the other hand, holders of senior debt took no losses (which they would have had to, on the other hand, had the banks instead entered resolution).

[19] In 2008, the Riksbank entered so-called currency repurchasing agreements with Iceland and Latvia; both their central banks received short-term loans in EUR in exchange for domestic currency.

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The single resolution fund is mainly funded by the banks

In the banking union, the single resolution fund is mainly funded by the banks, not the states. If the fund were to be consumed, the banks within the banking union would pay in more money (so-called ex-post charges). However, it may be inappropriate to demand that the banks rapidly pay in more in times of crisis, which is why there is a political agreement that the fund is to be supplemented with a credit line from the European Stability Mechanism (ESM[20]) by 2024 at the latest. Non-euro countries cannot participate in the ESM. If Sweden were to join the banking union, the Swedish National Debt Office would instead extend a credit line to the fund. This credit line would have to amount to an estimated SEK 14-18 billion.[21] The credit lines should be able to lend money to the resolution fund temporarily (3-6 years). Repayment is then made with the funds received by the fund from the banking sector. The credit lines that the state provides are to be neutral in public finance terms over the medium term (the 3-6 years mentioned above). But inside the banking union, it is thus primarily the banks that take care of risk sharing, not the states. In line with this, the Inquiry emphasises that, even with participation in the banking union, it will be up to the Government and Riksdag to decide on any bilateral loans (such as the Swedish State's lending to Iceland and Latvia in 2008-2009).

So this is not a matter of Swedish taxpayers contributing to the crisis management of other banks if Sweden joins the banking union, but it is mainly the Swedish banks that will contribute to (and, if necessary, also become the recipients of funds from) the resolution fund. Saying that Sweden should not join the banking union because we should not risk having to pay for other countries' high-risk banks is thus an argument primarily intended to protect Swedish banks from having to contribute to the management of European banks in crisis. It may also be in the interest of Swedish banks to actually share the burden mutually within the EU to a greater extent. In 2018, Nordea chose to move its head office to Helsinki, thereby being within the banking union. In Nordea's calculations, the advantages apparently outweighed the disadvantages of participation, even though it is the banks and not the states that mainly share risk within the banking union. However, a decision on whether Sweden should participate in the banking union should not focus on what is most profitable for the Swedish banks, but on what is deemed to be most favourable for financial stability and the Swedish banks.

[20] The ESM was established in 2012 by countries in the euro area in the form of an intergovernmental arrangement. The point of the ESM is to provide financial support to euro countries if this is needed to secure the financial stability of the euro area as a whole. Support is to be given under strict conditionality. Support can be given to euro countries that have, or are threatened by, serious funding problems. For this purpose, the ESM has the right to raise funding on the financial markets. The euro countries have paid capital contributions in to the ESM.

[21] According to the Inquiry's calculations, the Swedish banks must pay in an amount in the magnitude of SEK 14-18 billion to the single resolution fund. As the credit line, in total, must be as large as the resolution fund's balance, the Riksbank considers it reasonable to assume that the Swedish credit line to the fund shall be as large as the Swedish banks' contribution to the resolution fund, that is SEK 14-18 billion. To give a sense of the size, the amount can be compared with the resolution reserve, which amounted to about SEK 43.5 billion in 2019. (Funds already collected from the Swedish banking sector thus exceed the amount that Sweden would need to transfer with possible participation in the banking union.)

SVERIGES RIKSBANK

Continued uncertainty over whether a single deposit guarantee scheme can be put in place

It has been advised, since the formation of the banking union, that a jointly financed deposit guarantee scheme was to be a part of the banking union. At present, however, there is no agreement on this. On the other hand, the guarantee level has already been harmonised within the EU. Individual Member States may provide neither lower nor higher deposit guarantees than the harmonised EUR 100,000. Like the resolution funds, the deposit guarantee is funded by fees charged to the banks and other financial companies covered by the guarantee. A joint deposit guarantee would entail a significantly higher degree of risk sharing, which is naturally a sensitive and difficult issue to agree upon. The Inquiry deems that a joint deposit guarantee is probably a good idea for the banking union as a whole but of lesser importance for Sweden.[22] This is because the Inquiry considers it unlikely, for several reasons, that Swedish banks would have to access a single deposit guarantee.

The European Commission, which has the right of initiative for new legislation within the EU, presented its proposal for a joint deposit guarantee in 2015. This proposal involved a gradual transition from national systems (which is also the case with the resolution fund). However, it was not possible to reach political agreement on this proposal. In 2017, the Commission therefore presented a new proposal, involving a slower transition from national systems to a joint system. The revised proposal linked the transition to the banks' progress in reducing their risks. The EU countries have not been able to agree on this proposal either.

As regards Sweden's ability to affect the design of a possible joint deposit guarantee, the Inquiry writes that, even if the formal influence is the same for us, it may be more difficult for a Member State that does not participate in the banking union to make its voice heard in the concrete negotiation of new directives or regulations. Sweden's ability to affect the design of a possible joint deposit guarantee would therefore probably be improved by our participation in the banking union.

The safeguard mechanism to compensate non-euro countries is not insignificant

The Inquiry thoroughly analyses whether the conditions for an 'equal voice' within the banking union are good enough for non-euro countries. Two different safeguard mechanisms compensate these countries for their lack of any right to vote in the Governing Council of the ECB. They have both the possibility of not having to comply with a decision by the ECB/Supervisory Board and the possibility of withdrawing from the banking union after at least three years' participation. Ultimately, it is a political decision as to whether this is good enough. The Riksbank's message here is that the fact that there is a possibility of actually leaving the banking union appears as a not insignificant safeguard mechanism. The reasoning is developed below.

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[22] The Inquiry's conclusion is based partly on the Swedish banks being large and thereby being put into resolution rather than liquidation (this latter is charged directly to the deposit guarantee fund), and partly on there being a lot of wholesale funding to write down/convert (bail-in) in the resolution of a Swedish bank, before the hierarchy comes down to the deposits (which are exempted from bail-ins, although their share is compensated via the deposit guarantee fund). However, for countries in southern Europe, with many small banks that would be put into liquidation, and thereby a potentially high charge to the deposit guarantee fund, a single fund would be a significant help towards breaking the interdependence of bank and state.

In the Single Supervisory Mechanism (SSM), non-euro countries are not allowed to vote in the Governing Council of the ECB, which is the highest decision-making body. However, Sweden would have the possibility of presenting its arguments to the Governing Council against the *Supervisory Board's draft decisions* (which Sweden/Finansinspektionen is involved in drafting on the same terms as a euro country) or the *Governing Council's decision*s (where Sweden/the Riksbank would not have voting rights).[23] If a supervisory decision goes against Sweden, we have the right to explain that we do not intend to comply with the decision, which could have the consequence that the ECB decides to expel Sweden from the banking union.

There is also a more general safeguard mechanism that allows a non-euro country to choose to withdraw from the banking union at any point after three years' participation. This does not have to be linked to a supervisory decision against one of the country's banks. For example, the reason could be that the country does not consider that the Single Resolution Mechanism (SRM) and its crisis management of banks functions satisfactorily. As non-euro countries have the same conditions and influence in the SRM, the possibility for non-euro countries to leave the banking union if they are dissatisfied with SRM decisions is thus something of an 'overcompensation' in the area of resolution for their lack of the same decision-making power in the area of supervision.

The Riksbank agrees with the Inquiry's assessment that the fact that the safeguard mechanisms merely exist may *in itself* have a restraining effect on any negative special treatment of non-euro countries within the banking union. This is because a withdrawal from the banking union could be perceived as a credibility loss for the banking union. In the same way, there naturally exists a risk of a loss of credibility for Sweden in the event of a withdrawal, particularly if Sweden were to withdraw from the banking union in connection with problems in a Swedish bank – but probably less so if a Swedish withdrawal were to be linked to the banking union's general functions and not to the Swedish banking sector.

It is difficult to know in advance how great a problem it would be in reality to participate in the banking union without also being allowed to participate in final decisions within the SSM. However, it should be noted that the ability of the Governing Council to decide is limited in that the Governing Council (with the exception of certain macroprudential policy decisions) can only adopt or reject the Supervisory Board's draft decisions.[24] For an objection from the Governing Council to affect Sweden negatively, the draft decision from the Supervisory Board would thereby have to be a draft that Sweden/Finansinspektionen has supported. Consequently, the Governing Council cannot unilaterally decide to repeal the licence of an individual bank, for example. On the other hand, it is a disadvantage that non-euro countries do not have the possibility of euro countries to object in the Governing Council to a draft decision from the Supervisory Board. In other words, Sweden would not – like the euro countries – be given 'another chance'. The Inquiry writes that the Governing Council has not objected to any draft decision as yet. It must also be noted that the

[23] ECB rules of procedure (2014): "The Governing Council of the ECB shall consult with the Governors of the non-Eurosystem NCBs of the participating Member States before objecting to any draft decision prepared by the Supervisory Board that is addressed to the national competent authorities in respect of credit institutions established in non-euro area participating Member States. The same shall apply where the concerned national competent authorities inform the Governing Council of their reasoned disagreement with such a draft decision of the Supervisory Board."

[24] The ECB can raise, but not lower, macroprudential policy requirements decided by national authorities (so-called buffer requirements). This does not apply, however, for the macroprudential policy requirements that are not harmonised on the EU level, which includes loan-to-value limits and amortisation requirements, for example. Only national authorities can decide on such macroprudential policy requirements.

Governing Council passes decisions with a simple majority (which means that no single country can block a supervisory decision) and that, on each occasion, four members from the euro area also lack voting rights (there is a rota for this). The members of the Governing Council are also expressly forbidden from basing their standpoints in national considerations.

In the Riksbank's assessment, the deciding question should thus not be how great *direct* influence is, but whether *indirect* influence will be smaller than that of the euro countries, as a country outside the monetary union does not have voting rights in the final supervisory decisions. This assessment should also include an assessment of the strength of the safeguard mechanisms.

If the question is taken to its hypothetical conclusion, a large-scale financial crisis in the EU can be imagined, in which management of the banks becomes expensive for the members of the banking union and the funds in the Resolution Fund actually dry up. In a situation where the Resolution Fund needs to be refilled, Sweden could consider the part of the payments (from the Swedish banking sector) not repaid upon withdrawal as a 'sunk cost' and actually choose to leave rather than pay more. Euro countries have no such way out, short of leaving the monetary union.

Risk that funds transferred to the Single Resolution Fund would not be fully repaid upon a possible withdrawal from the banking union

The Inquiry writes that Sweden, upon a possible withdrawal from the banking union, would have the right to get back funds paid in, but with a deduction for any costs that may have arisen in the resolution of Swedish banks.[25]

However, the provision referred to in the SRM regulation is only applicable to *earmarked* funds in the Resolution Fund. As the Fund is gradually becoming more shared to become entirely shared in 2024 (which is to say no earmarking left), this provision is probably not the one that will be applicable. The Inquiry's description seems excessively simplified here.

In another section, the Inquiry writes that it will take 14 to 24 months to implement the legal amendments needed to participate in the banking union. As a mathematical example, let us take, as a starting point, the extremely unlikely event that the Government decides, on the same day that the consultation response is to be submitted, that Sweden is to join the banking union. Sweden would then be able to participate in June 2021, at earliest. To be able to use the general withdrawal paragraph, a country must have participated in the banking union for at least three years, which, for Sweden, would therefore be June 2024, at earliest. By this date, the Resolution Fund would be fully shared and the described repayment model would not be applicable.[26]

A fairer description would therefore be to reproduce the provision concerning repayment of funds included in the *shared part* of the Fund. This provision is not as generous in terms of repayment and neither is it as clear as regards what will apply.[27] This provision stipulates that the Resolution Board is to decide on the amount to be repaid on the basis of a number

[25] pp. 21, 129 and 243.

[26] There is certainly a narrower 'possibility' of being expelled from the banking union within three years, but this would require Sweden to oppose a specific supervisory decision over a Swedish bank, after which the ECB would decide whether this was serious enough for expulsion. By the time of this situation, part of the funds in the Resolution Fund would be shared, with this increasing the closer to 2024 we come.

[27] SRM regulation, article 4.3 points a-c.

of parameters, including the manner in which withdrawal from the banking union has taken place.

The Inquiry also points out that it is entirely possible to retain a national resolution reserve even after joining the banking union and gaining access to the Single Resolution Fund.[28] At the same time, a country wishing to withdraw from the banking union (according to the SRM regulation) has a greater possibility of receiving repayment from the Single Resolution Fund if the country would otherwise not have enough funds to be able to set up a national resolution reserve. Consequently, it could be a handicap to Sweden in the event of a withdrawal if we had retained a national resolution reserve. This aspect is not taken up by the Inquiry.

Conditions for effective supervision and resolution are better within the banking union

The Inquiry writes that "the ECB is uniquely placed to assemble the resources needed to understand and examine large banks with complex business models".[29] The Riksbank agrees with the Inquiry's assessment. As the EU authorities for supervision and resolution will work with more cases than a national authority, they will be in a better position to accumulate and maintain practical competence. The EU authorities also have more resources at their disposal and are better equipped to recruit cutting-edge expertise than any national authority. As the Inquiry points out, it is often expensive to develop new working methods, at the same time as the possibilities for attracting the right skills are limited within individual Member States.[30] A concentration of resources provides economies of scale, which, according to the Inquiry, will be strengthened by the countries within the banking union.[31]

In 2019, Finansinspektionen had 160 employees within its banking function, out of a total of 570 employees. At the end of 2019, the ECB's supervisory activities employed about 1,200 people.[32] The ECB Supervisory Board also has close cooperation with the national supervisory authorities of the banking union. The Inquiry writes that the national authorities included in the banking union have also increased their supervisory resources since the establishment of the banking union.[33]

Finansinspektionen has a wider sphere of responsibility than the joint EU supervision. This is because Finansinspektionen does not just supervise the banks but also securities companies and insurance companies. In addition, Finansinspektionen's responsibility for banking supervision also covers issues such as consumer protection and money laundering. The ECB's supervisory activities only cover the supervision of banks, while responsibility for consumer protection and money laundering lies on the national level, even within the banking union. The 1,200 employees of the ECB's supervisory activities thus have a narrower area of responsibility (with many times the number of banks) than the 160 employees within the banking function of Finansinspektionen.

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[28] In the possible event of participation, funds will remain in the Swedish resolution reserve even after funds have been transferred to the Single Resolution Fund. The Inquiry notes that there is no obstacle towards retaining the resolution reserve and using the remaining funds to compensate the banks if they have to pay in ex post charges to the Resolution Fund.
[29] p. 25.
[30] p. 169.
[31] p. 377.
[32] Ibid.
[33] pp. 173 and 174.

The Inquiry highlights cybersecurity as an example of an area requiring advanced development work. IT risk, including cyber risk, has been a focus area of the ECB's banking supervision from the very start and was established as one of the supervisory priorities for 2019. In its annual report for supervisory activities, the ECB describes how cyber incidents spread rapidly due to the interconnectedness of the financial sector. Since 2017, all banks under direct supervision have reported cyber incidents to the Supervisory Board's database. According to the ECB, the database provides good insight and makes it possible for the Supervisory Board to react quickly if a major incident affects one or more significant institutions.[34] It is not possible for a national authority to match the efforts an EU-wide authority can make in a focus area. Sweden's Finansinspektionen currently has four employees working with IT, information and cyber risks.

When it comes to resolution too, it is clear that an EU authority will collect more experience than a national resolution authority and will thereby be able to accumulate greater expertise than national authorities can. There are clear economies of scale in a more unified function for resolution, so that the body responsible for managing a resolution case will have the necessary experience. One disadvantage, however, is the high probability that it will take longer to take decisions if resolution is within the banking union than if it is on the national level, as many more actors are involved.

Less risk of so-called regulatory capture within the banking union

It is very positive that supervisory and resolution decisions are made at a healthy arm's-length distance, as this reduces the risk of what is known as 'regulatory capture', namely that the proximity of the supervised entity and the supervisor makes the supervision less powerful than it would otherwise have been. There is a substantial risk in a small country like Sweden, where it is also common for employees to move between the private and public sectors. Another advantage is that, in some respects, higher demands are placed by the supervisory and resolution board than by Swedish authorities. Among other things, this means that members of the supervisory board and the resolution board (in Sweden's case, this would be the director-general or other senior management of Finansinspektionen or the Swedish National Debt Office, respectively) may not take employment at a bank falling under the responsibility of either authority for one year after leaving their post.

A further way for the banking union to ensure arm's-length distance from the supervised entity is as follows: When the ECB/Supervisory Board conducts investigations on site at a bank, this takes place in close collaboration with the national supervisory authority, but the person leading the investigation is a person who does not come from the Member State in which the investigation is being conducted (and is not involved in the ongoing supervision of the bank in question either). The IMF works according to a similar principle when it conducts its 'missions': a review of a country is never led by a person from that country.

According to the Inquiry, the disadvantage of a longer distance between the supervisory authority and the supervised entity may be that it reduces understanding of national characteristics. However, as the ECB conducts on-site inspections to a high degree, and as Finansinspektionen would continue to be involved in the supervision of the banks under the ECB's direct supervision, this risk should not be too great. National authorities are also involved in the single resolution.

[34] ECB Annual Report on supervisory activities 2019, section 1.2.5 IT and cyber risk.

The Riksbank's overall assessment is that conditions are good for the banking union to work well for Sweden.

The major Swedish banks have comprehensive operations across national borders, above all within the EU and particularly within the Nordic-Baltic region. If Sweden were to participate in the banking union, the major Swedish banks, due to their size, would be subject to the direct supervision of the ECB/Supervisory Board. The subsidiary banks of SEB and Swedbank are already under the supervision of the ECB today, as they have market-dominant positions in countries participating in the banking union, namely the Baltic countries.

According to the Riksbank, the clearest advantage of Swedish entry into the banking union is that supervision and resolution on the EU level would better suit Swedish banking operations, which have become increasingly international. In principle, this is the most efficient way of conducting supervision and resolution. Of the countries that are in the EU but not the banking union, only Sweden and Denmark have a financial market of any great significance. With its cross-border financial corporations, it would generally be an advantage for Sweden to be in line with the solutions existing abroad, particularly in the EU. The increasing number of countries entering the banking union, provide, in itself, an argument for Sweden to do so too.

The Riksbank takes no stance on the issue of whether Sweden should participate in or remain outside the banking union. This decision must be taken by politicians and requires many different advantages and disadvantages to be weighed up. Among other things, this political balancing includes the question of whether conditions are good enough for a non-euro country to participate in the banking union on equal terms to the euro countries. There are also questions that need to be clarified with the ECB before any political decision on joining the banking union is taken.

On behalf of the Executive Board:

Stefan Ingves

Amanda Johansson

Taking part in the decision: Stefan Ingves (Chairman), Anna Breman, Per Jansson, Martin Flodén, Henry Ohlsson and Cecilia Skingsley.

Reports were presented by Advisor Susanna Engdahl.

A reservation has been entered by Henry Ohlsson