Bank resolution in the Swedish context

Hans Lindblad
Director General

UBS Annual Nordic Financial Services Conference

Stockholm 8 september 2016
The Swedish economy is performing well

• GDP growth is strong at 3 per cent

• Employment is rising

• Unemployment has been steadily declining since the financial crisis and stands around 6 per cent

• Inflation and inflation expectations are low

• The government debt-to-GDP is 35 per cent

• The banking sector is well capitalized by international standards
A financial crisis is a debt crisis!

• A moderate amount of debt is the best protection against a financial crisis
• Public finances should be strong
• Banks should be sufficiently capitalized
• Household and corporate indebtedness should be at reasonable levels
• A well-functioning fiscal policy framework
Severe consequences of financial instability

Average effects on selected macroeconomic variables after a financial crisis

Source: Reinhart och Rogoff (2009)
Strong public finances to counterbalance macroeconomic effects

• Budget balance should not increase government debt in normal times

• Steady state government debt should be moderate enough to:
  • Perform its automatic stabilisation functions
  • While not in itself become a problem when the crisis hits

• Debt levels above 60-80 per cent tend to dampen economic growth and put upward pressure on interest rates

• A financial crisis more or less doubles the debt

• Safety margins should be in place, especially since our banking sector is large
  • An OECD study estimates the losses in the Swedish banking sector at 10-15 per cent of GDP, which is above the levels estimated for other countries*

• The SNDO’s conclusion: government debt should be 30-35 per cent in steady state

Sweden has a large banking sector

Bank's assets in relation to GDP

Source: Sveriges Riksbank
Estimates of aggregate bank resolution costs over banking sector total assets (SE)

Average = 4%

A new framework for bank crisis management: Resolution

• Objectives:
  • Maintaining critical functions
  • Minimising spill-over effects
  • Protecting public finances and minimising public support
  • Safeguarding covered deposits and clients’ assets

• Key principles
  • Shareholders and creditors to bear losses…
  • … but should not receive an outcome worse than bankruptcy (NCWO)
  • Strict rules on the use of public funds

• In a nutshell: saving the bank’s operations but not its financial stakeholders
MREL – A key pre-requisite for successful bail-in

Assets | Liabilities | Resolution
--- | --- | ---
Losses | Recapitalisation | MREL
Loss absorption

Debt | Capital
Principles underlying Swedish MREL proposal

• Level
  • Sufficient capacity to cover losses and…
  • …to restore capital to meet all applicable requirements at point of resolution

• Composition
  • Clear distinction between going and gone concern resources
  • Operability and efficiency of bail-in process
  • Avoid NCWO
  • Clarity for investors

• Preserve the function of capital buffers
SNDO’s MREL proposal (26 April 2016)

• Level
  • Loss absorption = Total capital requirements less capital buffers and Pillar 2 systemic risk add-on
  • Re-capitalisation = Total capital requirement (no deductions)
    - Zero for non-systemically significant institutions

• Composition
  • Re-capitalisation component to be met with debt instruments only
  • Subordination to be introduced later

• Internal MREL
  • Required for groups with SPE strategies

**Example:** Systemically significant bank w. 20% tot.cap.req.

<table>
<thead>
<tr>
<th></th>
<th>%RWAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Total capital requirement</td>
<td>20.0%</td>
</tr>
<tr>
<td>B. - Minus systemic risk buffer</td>
<td>-3.0%</td>
</tr>
<tr>
<td>C. - Minus countercyclical buffer</td>
<td>-0.5%</td>
</tr>
<tr>
<td>D. - Minus capital conservation buffer</td>
<td>-2.5%</td>
</tr>
<tr>
<td>E. - Minus Pillar 2 systemic risk add-on</td>
<td>-2.0%</td>
</tr>
<tr>
<td>F. Loss absorption amount (A-B-C-D-E)</td>
<td>12.0%</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>G. Total capital requirement (no deductions)</td>
<td>20.0%</td>
</tr>
<tr>
<td>H. Recapitalisation amount</td>
<td>20.0%</td>
</tr>
<tr>
<td>I. MREL requirement (F+H)</td>
<td>32.0%</td>
</tr>
</tbody>
</table>
MREL Illustration

Buffers sit on top due to debt requirement

MREL Illustration

% RWEs

45%
40%
35%
30%
25%
20%
15%
10%
5%
0%

Capital requirements

MREL

MREL compatible instruments

Minimum liabilities proportion

6,0%
12,0%
14,0%

6,0%
20,0%
20,0%

MREL compatible liabilities
Pillar 1 minimum + Pillar 2
Buffers
Recap amount
Loss absorb amount
Current MREL levels

• Consultation paper propose around 32 per cent in our example
• This corresponds to 8-10 per cent in Gross balance sheet terms
• The 10 largest Swedish banks would meet the proposed MREL levels if set today
• 7 out of 10 would meet the requirement that the re-capitalisation amount should be met only with debt instruments issued at parent level.
• Today, none would meet a 100 per cent subordination requirement
Next steps and outstanding issues

• Policy paper on MREL-level to be finalised before end 2016
  • MREL levels to apply from Q4 2017

• Issues for further consideration
  • Calibration and phase in of subordination requirement (consultation Q1 2017)
  • Maturity profile of MREL debt
  • Precise characteristics of internal MREL instruments
  • Treatment of cross-holdings
  • MREL disclosure requirements

• TLAC adjustments?
  • SNDO model broadly consistent with TLAC framework
  • Need for adjustments will depend on EU implementation
A new framework: Implications for investors

• The era of public bail-outs is over

• Tax payers will be protected
  • Shareholders to bear losses first (and in full)
  • Non-exempted creditors next in line

• The Italian lesson: problematic if bail-in comes as a surprise
  • The resolution framework and the creditor waterfall has to be transparent and predictable

• Asset managers should inform their clients about the new risks associated with holding bank equity and debt going forward

• The SNDO’s role as the Swedish resolution authority
  • Protecting tax payers
  • Preventing spill-over effects
  • Minimising effects on the Swedish economy