Bank resolution in the Swedish context

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The Swedish economy is performing well

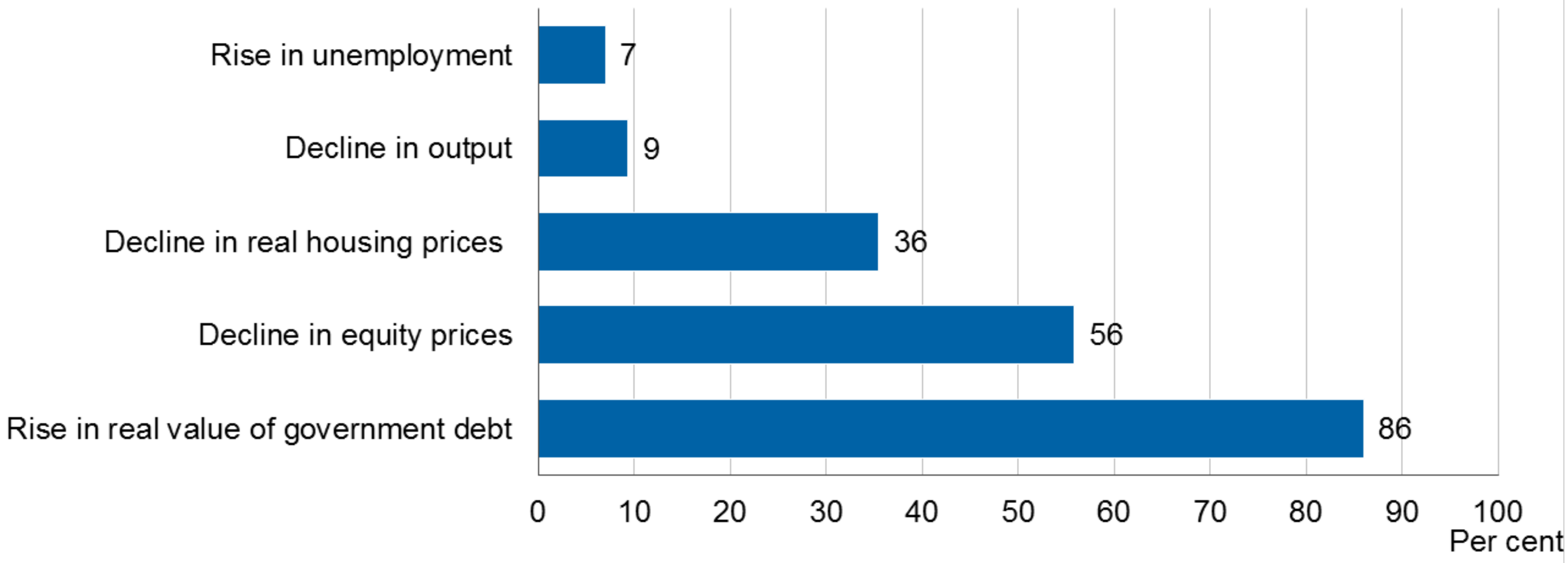
- GDP growth is strong at 3 per cent
- Employment is rising
- Unemployment has been steadily declining since the financial crisis and stands around 6 per cent
- Inflation and inflation expectations are low
- The government debt-to-GDP is 35 per cent
- The banking sector is well capitalized by international 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)

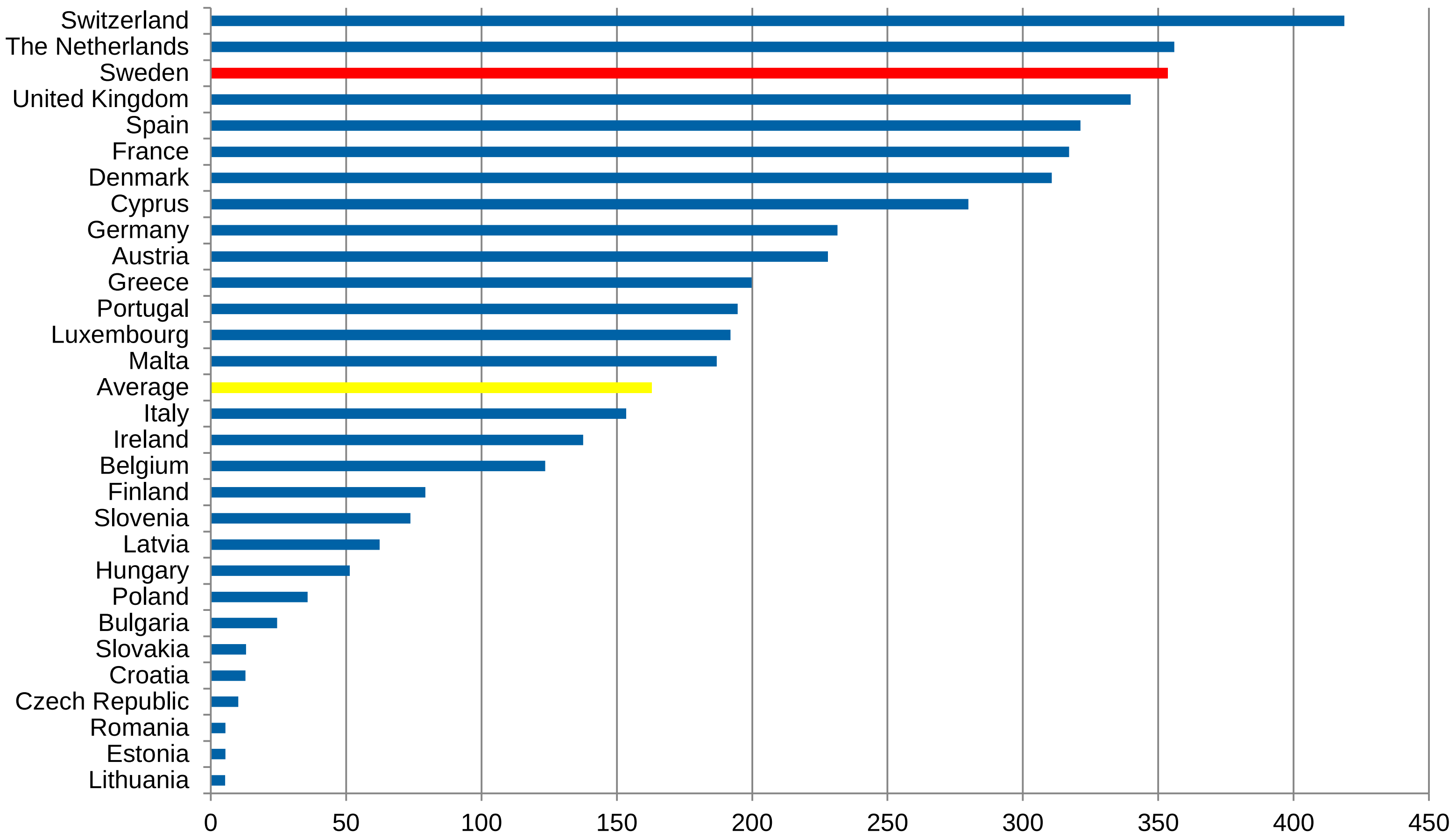
Strong public finances to counterbalance macroeconomic effects

- 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

* "Estimating the size and incidence of bank resolution costs for selected banks in a sample of OECD countries", OECD 2016/7, available at http://www.oecd.org/daf/fin/financial-markets/financialsectorguarantees.htm in addition to www.oecd.org/daf/fmt

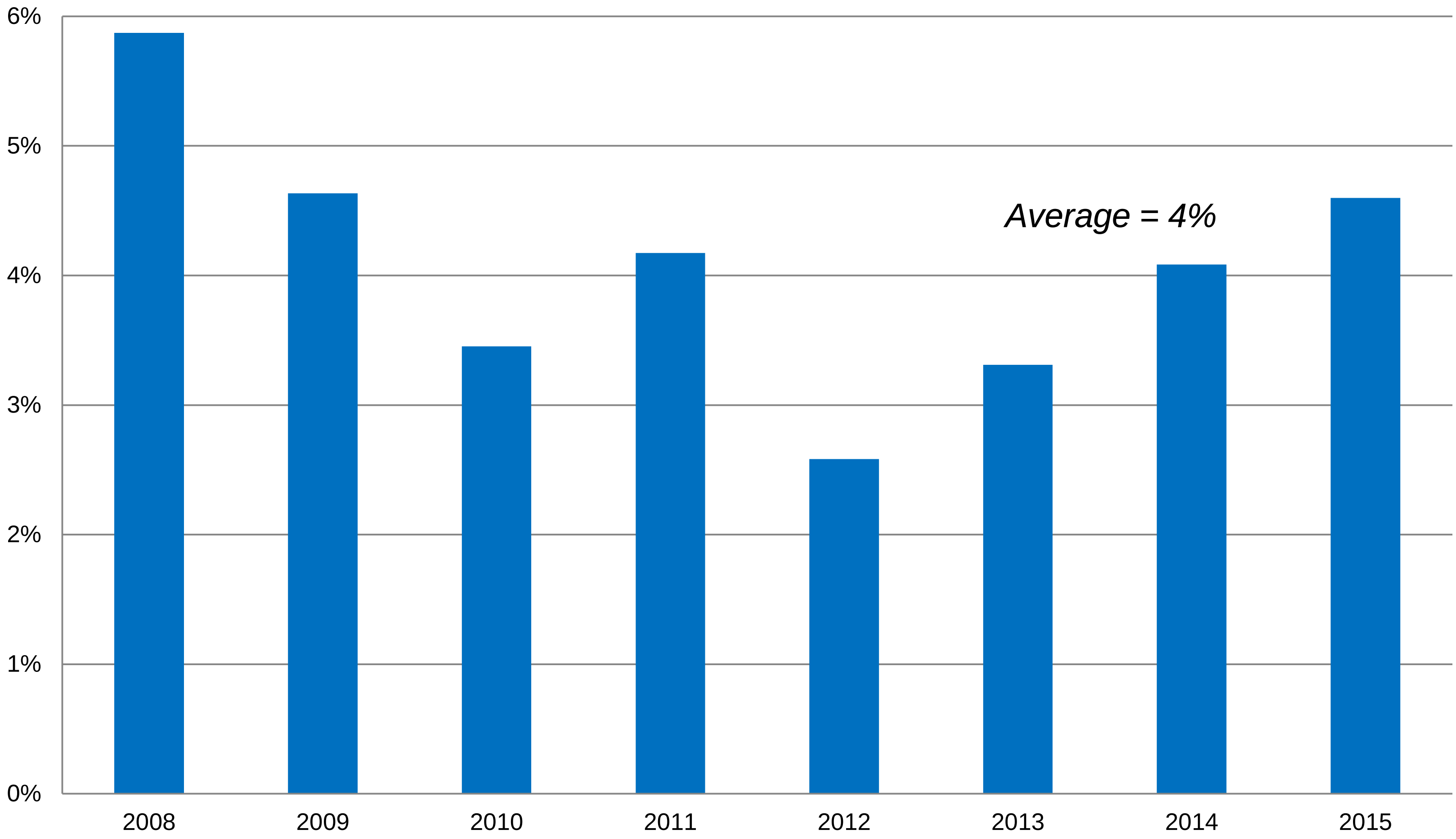
Sweden has a large banking sector

Bank's assets in relation to GDP



Source: Sveriges Riksbank

Estimates of aggregate bank resolution costs over banking sector total assets (SE)



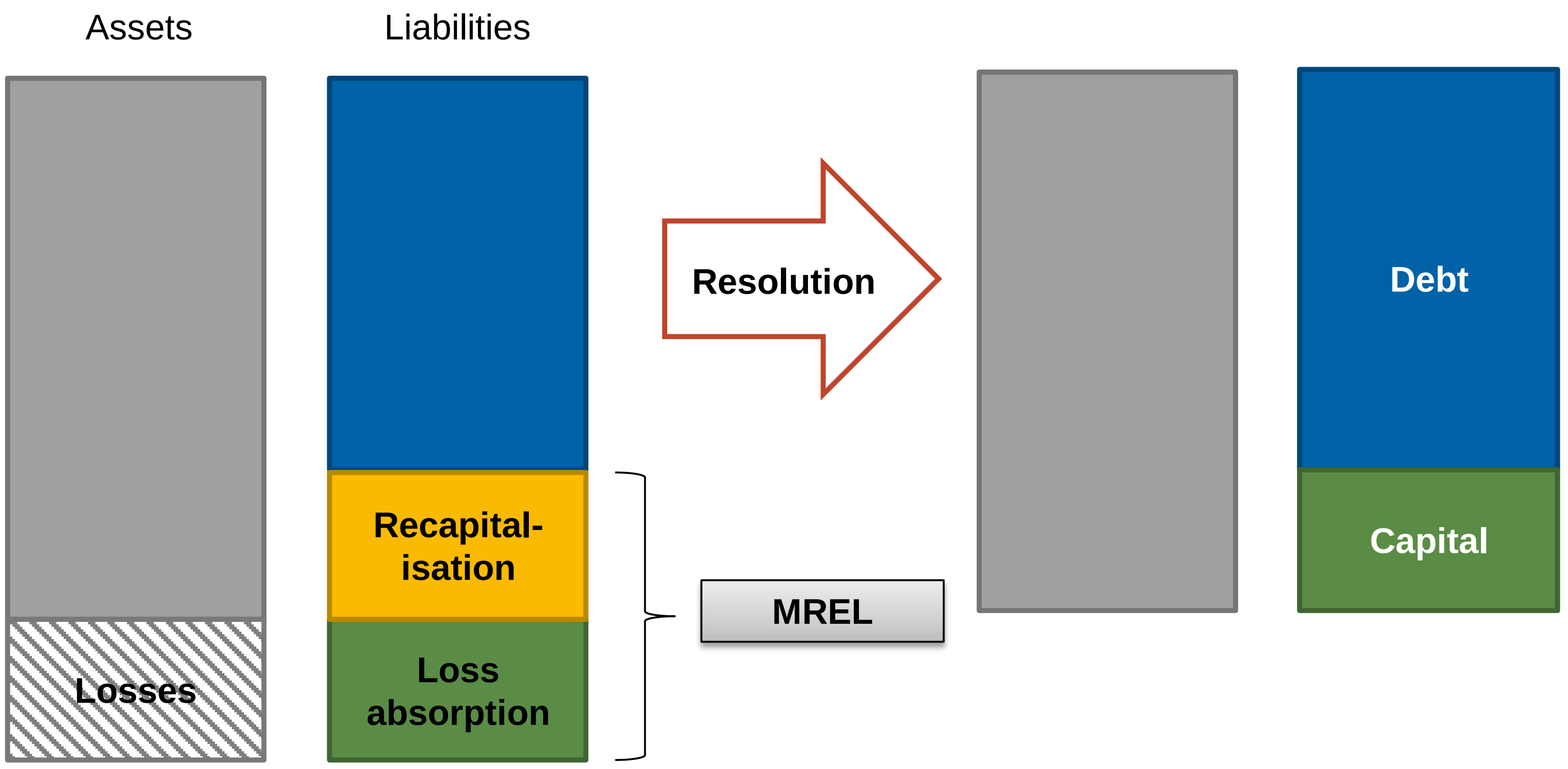
Source: OECD Journal: Financial Market Tends 2016/1 and SNDO calculations

RIKSGÄLDEN
SWEDISH NATIONAL DEBT OFFICE

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



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

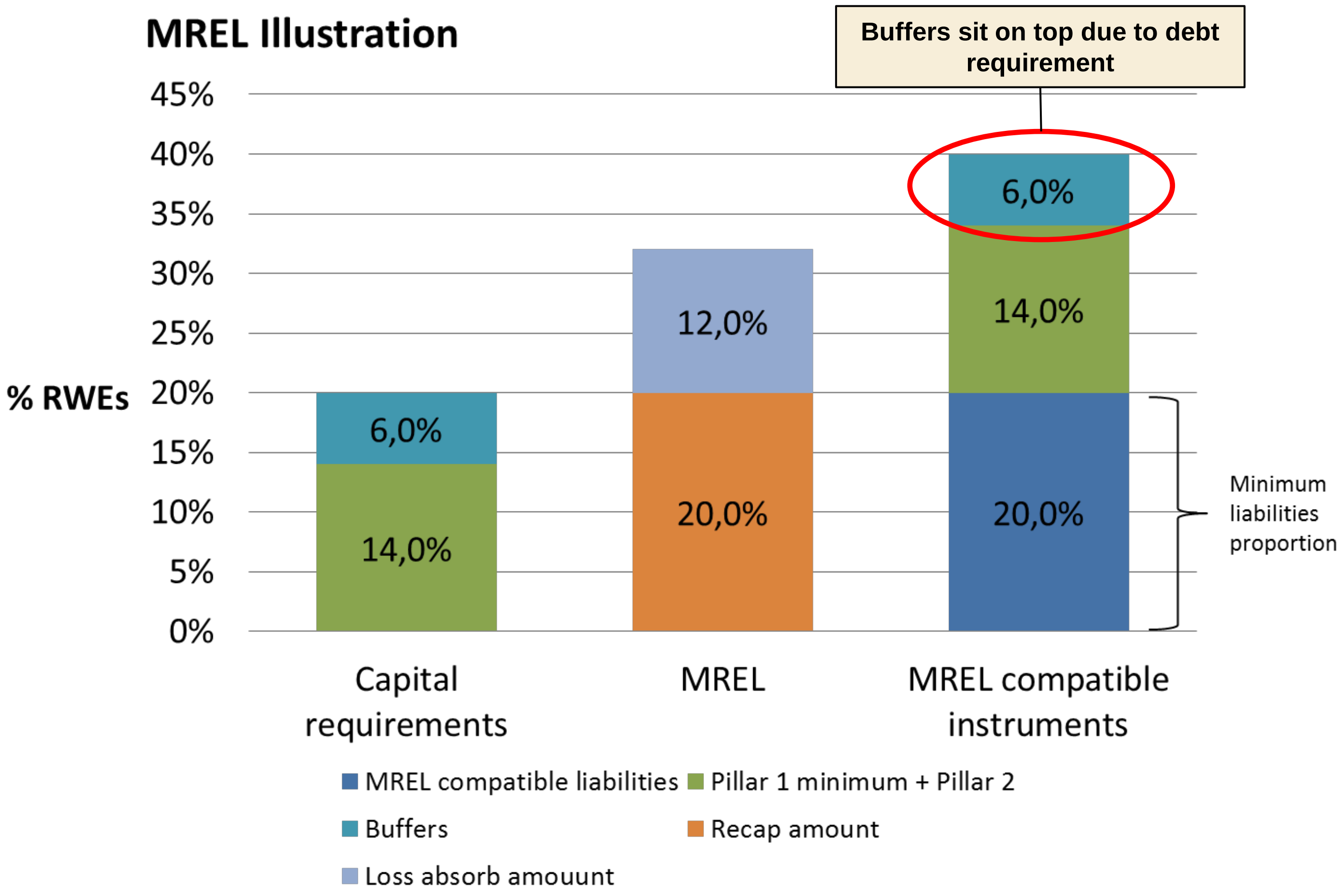
SNDO’s MREL proposal (26 April 2016)

- 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

<u>Example</u>: Systemically significant bank w. 20 % tot.cap.req.

		%RWAs
A.	Total capital requirement	20.0%
B.	- Minus systemic risk buffer	-3.0%
C.	- Minus countercyclical buffer	-0.5%
D.	- Minus capital conservation buffer	-2.5%
E.	- Minus Pillar 2 systemic risk add-on	-2.0%
F.	**Loss absorption amount (A-B-C-D-E)**	**12.0%**
G.	Total capital requirement	20.0%
	(no deductions)	
H.	**Recapitalisation amount**	**20.0%**
I.	MREL requirement (F+H)	32.0%

MREL Illustration



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