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The Stabilisation Fund

– Does it live up to its name?

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To the Riksdag

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Pursuant to Section 9 of the Auditing of State Activities, etc. Act (Swedish Code of Statutes 2002:1022), we are hereby delivering the report of the following performance audit:

The Stabilisation fund: – Does it live up to its name?

The Swedish National Audit Office (NAO) has examined whether the Stabilisation Fund was designed to effectively achieve the objectives set by the Riksdag and whether it has been used in accordance with the intentions of the Riksdag. This report presents the results of the audit.

Representatives of the Ministry of Finance and National Debt Office were given the opportunity to check the facts in, and otherwise express their opinions about, the draft of the final report.

The report contains conclusions and recommendations that concern the Government.

Auditor General *Jan Landahl* had decision-making authority with regard to this matter. Audit Director *Thomas Hagberg* was responsible for presentation of the report. Audit Director *Jörgen Appelgren*, Audit Director *Bengt Lewin* and Assistant Head of the Audit Unit *Per Johansson* participated in final execution of the report.

Jan Landahl Thomas Hagberg

For your information:
Government, Ministry of Finance
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Summary

The Swedish National Audit Office (NAO) examined whether the Stabilisation Fund was designed to effectively achieve the objectives set by the Riksdag and whether it has been used in accordance with the intentions of the Riksdag.

Background to the audit

Motivation: In response to the global financial crisis of 2008, the Government proposed a number of measures for the purpose of managing the crisis, minimising the risk that new crises would arise and more efficiently managing any crises that nevertheless arose. In October 2008, the Riksdag authorised the central government to support credit institutions for the purpose of minimising the risk that the financial system would be seriously disrupted, as well as to establish a stabilisation fund. The Fund was adopted to finance central government costs associated with providing support measures to financial institutions. Given the importance of ensuring that the system works efficiently and expediently, an audit of the Stabilisation Fund is a worthwhile enterprise.

Purpose: The purpose of the audit is to examine whether the Stabilisation Fund was designed in a manner that satisfies the objectives set by the Government in various bills and other communications to the Riksdag. The audit proceeds from observations of the actual design of the Fund, its consequences for the central government's financial position and its use in connection with Nordea's new share issue in 2009.

Implementation: The audit is based first and foremost on document studies and analysis of Government bills and communications, as well as in-depth interviews with officials and previous employees of the Ministry of Finance and National Debt Office, plus representatives of Nordea. The NAO also asked Professor Wiweka Warnling-Nerep to submit an opinion concerning the compatibility of the Capital Contributions to Solvent Banks and Others Ordinance (Swedish Code of Statutes 2009:46) (the "Contributions Ordinance") and the Government Support to Credit Institutions Act (Swedish Code of Statutes 2008:814) (the "Support Act"). Her statement appears in its entirety in Appendix 1.

Results of the audit

Is the Fund an effective tool? The main objective of the Stabilisation Fund is to serve as an effective tool for financing central government support measures in case of a banking crisis. Of particular importance is that the Fund be appropriately sized and that its balance can be used in a way that minimises costs for taxpayers.

The Government has targeted the size of the Fund to 2.5 per cent of GDP in 2023. The NAO questions the relevance of aiming for a future balance in relation to GDP. Risk and risk-taking trends in the banking sector have no obvious correlation with the growth of the Swedish economy. Clear evidence of this lack of correlation is the fact that the assets of Swedish banks have increased a good deal faster than GDP in the 2000s, particularly in the wake of the banking sector's ongoing internationalisation and cross-border consolidation.

In addition to size, a central question is how to invest the balance of the Fund such that it can be used as effectively as possible in a crisis while minimising the risks and costs to which taxpayers are exposed. The Stabilisation Fund currently consists of an account with the National Debt Office.[1] It is not a fund in the sense that the central government has assets that can be used in the event of a financial crisis. Thus, the central government would have to borrow any assets required to finance support measures it provides through the Fund.

Experience in both Sweden and elsewhere shows that borrowing costs can rise dramatically when the central government has to go in and rescue the financial system. The risk is particularly evident for small open economies like Sweden's. As the Fund is currently structured, the central government's only option for financing support measures is to issue government bonds. From the point of view of risk diversification, the implementation over time of a broader investment policy would appear to be justified.

Does the Stabilisation Fund strengthen the central government's financial position? In the view of the NAO, the Stabilisation Fund can be regarded as effective only if an increase in its balance strengthens the central government's financial position. The Government has described the relationship between the Fund and central government finances in similar terms. Central government net lending admittedly strengthens when fees are paid to the Fund. The central government's financial position, however, reflects the fiscal policy framework and its surplus target, which currently requires that public sector net lending average 1 per cent of GDP over the course of a business cycle. The fees to the Stabilisation Fund are included when net lending is reconciled with the surplus target. As a result, growth of the Fund will have no impact on the central

1 Furthermore, the balance of the Fund includes the assets – such as Nordea shares – that it acquires when it is used. The proceeds recovered upon sale of these assets are to be deposited in the Debt Office account.

government's financial position. On the contrary, the stabilisation fees will be offset by lower tax revenues or higher expenditures in other areas. For the same reason, the total size of central government debt may be regarded as unaffected by the balance of the Stabilisation Fund.

Are the costs associated with a financial crisis financed borne primarily by the banking sector? The Government has emphasised on a number of occasions that the Stabilisation Fund is to ensure that costs for rescuing the financial system are borne by credit institutions; thus, they are to pay a stabilisation fee to the Fund. The Bill targets a Fund balance corresponding to 2.5 per cent of GDP by 2023. However, the Government has transferred significant assets to the Stabilisation Fund: an initial contribution of SEK 15 billion through a special appropriation, as well as authorisation for the Fund to exercise the central government's subscription rights to new Nordea shares without paying for them. The initial SEK 15 billion contribution did not constitute a genuine transfer of assets: a National Debt Office account was simply credited with the same amount – almost 0.5 per cent of GDP – that the appropriation was debited. Adding the increase in the value of the Stabilisation Fund's Nordea holdings and associated dividends, fees from credit institutions do not appear to be in line with the target that they provide primary financing. If the current rules are retained, taxpayers run the risk of providing more than half of the financing for the Fund.

Financing of Nordea's new share issue The Government's main purpose in submitting Measures to Enhance the Stability of the Swedish Financial System (Government Bill 2008/09:61) in October 2008 was to safeguard the financial system and ensure that the central government could provide credit institutions with capital contributions as needed. After the legislation had passed, concern grew that private sector financing problems would aggravate the economic downturn. As a result, the Government launched an effort in late 2008 that focused on its ability to inject capital into solvent banks.

In connection with Nordea's new share issue, the Government issued the Contributions Ordinance in February 2009. Section 1 states, "This ordinance contains provisions on capital contributions to solvent institutions provided under the Government Support to Credit Institutions Act (Swedish Code of Statutes 2008:814) so as to *strengthen the credit supply* [italics ours] in order to prevent a risk for serious disruption of the financial system in Sweden." Based on the ordinance, the Stabilisation Fund was used to finance the central government's SEK 5.6 billion holdings in connection with Nordea's new share issue. As a result, the central government wore two hats: both as a shareholder and – together with the Riksbank – as a guarantor for the stability of the financial system.

The additional goal of strengthening the credit supply has no counterpart in the Support Act. However, the comments to the statute refer to the State Support to Banks

and Other Credit Institutions Act (Swedish Code of Statutes 1993:765), now repealed, to the effect that central government support may be provided to *secure* [italics ours] the credit supply. The first paragraph of the repealed act used the verb *secure*: "To guarantee support in the payment system and secure the credit supply, state support is provided under this law to banks and certain other credit institutions. The purpose of the central government's commitment is to guarantee that the institutions can meet their obligations on time." Thus, securing and strengthening the credit supply cannot be regarded as synonymous, particularly since the central government's contribution did not affect the outcome of Nordea's new share issue. The issue was also underwritten by shareholders other than the central government, as well as two investment banks.

The NAO asked Professor Wiweka Warnling-Nerep to state her opinion concerning the compatibility of the Contributions Ordinance and the Support Act. In her assessment, the Support Act does not provide scope for the content of the Contributions Ordinance. Our interviews found that a contributing factor to the Government's actions was the desire to protect the expenditure ceiling. It comes as no surprise that the ceiling might be threatened by the steepest economic downturn in 80 years. It would have been more straightforward under the circumstances to participate in the new share issue through the central government budget and, if the need arose, to propose that the Riksdag adopt cost-saving measures or raise the expenditure ceiling.

Recommendations

The Government should submit a proposal that targets the size of the Stabilisation Fund in a way that reflects the risk level in the banking system better than the current percentage-of-GDP approach. The proposal should take the possibility that the banking sector's risks will change over time into consideration. The Government should also explore whether the assets received by the Fund can be invested in a manner that does not involve paying off the central government debt. Such an inquiry might examine whether all or part of the assets should be invested in low-risk foreign government securities that can be sold in the event that the Fund needs to be used. A supplemental directive by the Government could task the Financial Crisis Committee (Fi 2011:02) to conduct these inquiries.

The Government should also clarify the meaning of the stipulation that the Fund *average* 2.5 per cent of GDP and how the fees are going to be set after the build-up period.

If the Stabilisation Fund is to strengthen the central government's financial position for future financial crises, the Government should disregard its impact on net lending when reconciled with the surplus target.

In the NAO's view, a reasonable goal is that the financial sector assume responsibility for the direct costs associated with support measures it receives in the event of a crisis. Thus, the balance of the Stabilisation Fund should consist of fees paid by the banks. For that to be the case, the Government should explore whether the Fund can be debited in arrears for the value of its subscription rights to Nordea's new share issue, as well as whether the initial SEK 15 billion contribution, including interest, ought to be reversed.

In the opinion of the NAO, whether the Contributions Ordinance is compatible with the Support Act remains unclear. The Government should examine whether measures are required to eliminate uncertainty about the relationship between the Support Act and the Contributions Ordinance.

1 Introduction

1.1 Background and reason for the audit

In response to the global financial crisis of 2008, the Government proposed a number of measures for the purpose of managing the crisis, minimising the risk that new crises would arise and more efficiently managing any crises that nevertheless arose. In October 2008, the Riksdag authorised the central government to support credit institutions for the purpose of minimising the risk that the financial system would be seriously disrupted, as well as to establish a Stabilisation Fund, whose basic mandate comes from the Support Act. The Fund is to be financed over the long run by fees from credit institutions.

The Fund was adopted to finance central government costs associated with providing support measures to financial institutions. Given the importance of ensuring that the system works efficiently and expediently, an audit of the Stabilisation Fund is a worthwhile enterprise. The fact that many of the emergency measures were taken under great time pressure during the most acute phase of the financial crisis renders the audit that much more essential. The importance of ensuring that society learns the right lessons from the experience gained during the financial crisis cannot be overstated.

The NAO's preliminary study for the audit identified a number of questions about whether or not the Stabilisation Fund had been optimally designed to achieve its objectives of financing future support measures and minimising the risks to which taxpayers were exposed. The study found reason to evaluate differences between the intentions in setting up the Fund and its actual design. The Fund fails in several respects to meet the objectives of the preparatory work for the Support Act. The Fund was used in connection with Nordea's new share issue of February 2009. The central government was Nordea's largest shareholder at that point.

The purpose of the audit is to examine whether the Stabilisation Fund was designed in a manner that satisfies the objectives set by the Government in various bills and other communications to the Riksdag. The audit is based on observations of how the Fund has been designed in practice, its implications for the central government's financial position and its use in connection with Nordea's new share issue in February 2009.

1.2 Auditing issues

The audit addressed the following auditing issues:

1. Was the Stabilisation Fund designed in an effective and expedient manner?
2. Was use of the Stabilisation Fund in connection with Nordea's new share issue in February 2009 consistent with the Riksdag's intentions in setting it up?

1.3 Norms and assessment criteria

A number of bills and communications by the Government stipulated how the Stabilisation Fund was to be set up and described its objectives. Measures to Enhance the Stability of the Swedish Financial System (Government Bill 2008/09:61) proposed the establishment of a Stabilisation Fund. The Stabilisation Fund has also been described in Stability Fee (Government Bill 2009/10:30) and The Swedish Fiscal Policy Framework (Communication 2010/11:79).

Government Bill 2008/09:61 proposed the adoption of a special Stabilisation Fund to finance support measures for financial institutions, as well as the administrative costs of the National Debt Office and Appeals Board. According to the bill, "The objective of the proposed system is to ensure that temporary expenditures for management of financial disruptions do not increase the central government's long-term expenditures."

Government Bill 2009/10:30 clarifies the objective of the Stabilisation Fund and states: "In order to achieve a financing system that is sustainable in the long term, fund holdings must eventually correspond to the total costs that could be incurred during a major banking crisis... The aim of introducing a stabilisation fee is to ensure that the support measures taken and those that may be taken under the Support Act will, in the first instance, be funded by credit institutions and consequently not charged to the central government budget and thus to taxpayers." Communication 2010/11:79 also stresses that banks rather than taxpayers are to bear the costs of any crisis that may arise: "One important ingredient [of solutions to manage future crises] is that banks defray the costs of crisis management. A stabilisation fund financed with fees paid by banks has therefore been introduced."[2]

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[2] (p. 37)

The Government's Directive to the Financial Crisis Committee (2011:6, page 13) states: "Financing of the Stabilisation Fund by credit institutions... strengthens central government finances for managing future crises."

The above overview makes it clear the objectives of the Stabilisation Fund are that

a) temporary expenditures to sustain the financial system do not generate higher long-term costs for the central government
b) financial institutions (by means of a fee paid to the Stabilisation Fund) rather than taxpayers bear most of the costs that may arise when the central government takes support measures to sustain the financial system
c) costs associated with any support measures are not charged first and foremost to the central government budget

International experience of similar funds is also used as a basis for assessment. An article by the IMF prior to the G20 meeting of June 2010 summarises the experience of stabilisation funds, including the Swedish variety. The IMF argues that a stabilisation fund can be regarded as a capital buffer for the entire financial system and can thereby promote its stability. The IMF also stresses that stabilisation funds must be able to finance the net costs of financial support measures over time but that direct gross costs can be considerably higher during an acute crisis. Thus, a stabilisation fund must have unlimited credit with the central government, as is the case in Sweden.

Based on the above documents, the NAO believes that an effective and expedient stabilisation fund should meet the following four criteria:

1) The fund must be able to finance support measures in connection with a banking crisis at the lowest possible long-term costs
2) Given that the Stabilisation Fund is to be included in central government net lending, the assets it receives should strengthen the central government's financial position
3) The Stabilisation Fund should ensure that credit institutions bear primary responsibility for the direct costs that arise in connection with a banking crisis
4) Use of the Stabilisation Fund must comply with relevant Riksdag decisions

1.4 Implementation and limits of the audit

The audit is based first and foremost on the following:

1) Document studies and analysis of Government bills and communications
2) In-depth interviews with officials and previous employees of the Ministry of Finance and National Debt Office, as well as representatives of Nordea.

The NAO also asked Professor Wiweka Warnling-Nerep to state her opinion concerning the compatibility of the Contributions Ordinance and the Government Support Act. Her statement appears in its entirety in Appendix 1.

1.5 Structure of the report

Section 2 presents the general background to the establishment of the Stabilisation Fund. Section 3 describes and analyses the fundamental questions surrounding design and function of the system. Section 4 looks at how the Fund was used in practice in connection with Nordea's new share issue in February 2009. Section 5 offers conclusions and recommendations.

Appendix 1 contains a statement prepared on behalf of the NAO by Wiweka Warnling-Nerep, Professor of Public Law, concerning the compatibility of the Contributions Ordinance and the Support Act.

2 Background

The financial crisis escalated in autumn 2008 and jeopardised the survival of financial institutions in Sweden and many other countries. Confidence is a fundamental prerequisite for a financial institution to do business in general and to refinance in particular. Banks in Sweden and around the world have become increasingly dependent on short-term market financing through the years. As a result, the banking system relies more than ever before on the confidence of financial markets. After the collapse of Lehman Brothers, an American investment bank, confidence in the banking system was extremely low. Many institutions, including those that were fundamentally solvent, faced liquidity and financing problems. A number of central governments had to take over all or part of individual banks to prevent them from becoming insolvent. Some of the banks went from being highly esteemed institutions to victims of a financing crisis in short order. The ability and scope for governments to act was quickly put to the test.

Under such circumstances, the Government concluded that Swedish legislation did not provide it with sufficient scope to support credit institutions on short notice. Measures to Enhance the Stability of the Swedish Financial System (Government Bill 2008/09:61) was submitted to the Riksdag on 23 October 2008. The Government clearly felt that the matter was urgent: it proposed that the new law take effect within a week. The Riksdag considered the bill immediately and passed the Support Act on 29 October.

Chapter 1, Section 2 of the act states that central government support may be provided to credit institutions if needed to counteract a risk for serious disruption of the Swedish financial system. According to pages 33 and 37 of the bill, the purpose of providing support is to counteract systemic risks: ”Systemic risk refers to the risk that the financial system will be exposed to extensive disruption that seriously compromises its ability to function.” Thus, the objective is not to rescue or provide relief to an individual institution that has incurred problems if deemed to be an isolated event. Only if the problems that a credit institution is suffering affect the ability of the financial system to function is the central government to intervene and provide support.

2.1 Stabilisation Fund

The bill stipulates that central government support to credit institutions is to be provided through the stabilisation fund that has been set up for that purpose. The Government argued that support should be subject to conditions under which the institution and shareholders that receive it bear the brunt of the costs associated with any losses that arise (page 41).

The bill proposed that support measures be financed by the institutions themselves, as was the case with the deposit insurance scheme (page 49). Other parts of the bill (such as page 47) state that the institutions are to be *primarily* [italics ours] responsible for financing. Thus, credit institutions and finance companies covered by the Support Act would be required to pay an annual stabilisation fee (Government Bill 2009/10:30). The fee is 0.036 per cent of a reference base consisting of the institution's obligations at the end of the financial year, less certain inter-company loans and subordinated liabilities. The fee was halved during the first two years of the Fund but is payable in full as of 2011. The target is that the balance of the Fund average 2.5 per cent of GDP as of 2023.

The central government made an initial SEK 15 billion capital contribution to the Fund in November 2008. The transfer was made by debiting the new appropriation 92:5 *Contributions to the Stabilisation Fund* in expenditure area 26 Interest on Central Government Debt, etc., while crediting the National Debt Office's net lending with the same amount.

The central government participated in Nordea's new share issue in February 2009 by contributing capital commensurate with its 20 per cent holdings at the time. The contribution was financed through the Stabilisation Fund. The central government did not touch shares held by the Stabilisation Fund when selling corresponding holdings in February 2011. As a result, the central government currently manages more than half of its 13.5 per cent interest in Nordea within the framework of the Stabilisation Fund.[3]

The Stabilisation Fund is not a fund in the true sense of the word. Revenue from stabilisation fees are used for ongoing management of the central government's payments. However, payments to the Stabilisation Fund are posted to an interest-bearing account with the National Debt Office, and the Fund itself consists of the balance in that account plus the financial instruments and other assets (such as the Fund's Nordea shares) that the

[3] The Government announced in June 2011 that any future sales of Nordea shares would proportionately reduce its holdings through the Fund (52 per cent) and other holdings (48 per cent).

central government acquires under the Support Act. Corresponding entries on the liability side of the Debt Office's balance sheet are under the funds item (see Table 2.1).

Table 2.1 Stabilisation Fund in the National Debt Office's balance sheet, 30 June 2011

Assets	Capital and liabilities
Financial assets: Nordea shares held by the Stabilisation Fund (cost), SEK 5.6 billion	Funds: Stabilisation Fund, SEK 22.2 billion
Cash and bank balances: Interest-bearing account, Stabilisation Fund, SEK 16.6 billion	
Total: SEK 22.2 billion	Total: SEK 22.2 billion

Source: National Debt Office

The Government appointed a committee in February 2011 to review Swedish regulations for the management of financial crises. The task of the Financial Crisis Committee also included studying and proposing a risk-differentiated fee for the Stabilisation Fund, one goal of which was to temper the propensity of financial institutions to take risks. The committee's report is to be ready by August 2012 (Directive 2011:6).

The Government's preparatory work for the Support Act identified long-term reasons for coordinating the Stabilisation Fund and deposit insurance scheme to ensure efficient crisis management. If the systems were coordinated, financial institutions could be charged a single fee and the assets could be used as the situation warranted during a crisis. The EU is currently conducting a harmonisation effort for both deposit insurance schemes and national bank resolution funds. As a result, the Government has been holding off on merging the Stabilisation Fund and deposit insurance scheme. The Financial Crisis Committee is to take the results of the EU effort into consideration.[4]

[4] Statements by the Government do not indicate whether or not management of the deposit insurance scheme's existing assets will affect the target for the size of the Stabilisation Fund.

Facts Deposit insurance scheme

The deposit insurance scheme is a way for the central government to guarantee deposits in banks, finance companies and securities companies that are authorised by Finansinspektionen to set up accounts for accepting money from their customers. If an institution goes bankrupt or Finansinspektionen decides that the insurance is to kick in, the central government provides compensation of up to EUR 100,000 per depositor. The purpose of the scheme is to protect the deposits of the general public and discourage bank runs, thereby enhancing the stability of the financial system. Adopted in 1996, the Swedish deposit insurance scheme is based on an EC directive. Other EU countries have similar schemes. The Swedish scheme is financed by fees from participating institutions and administered by the National Debt Office. Total fees for a year are to be 0.10 per cent of the insured deposits at the end of the previous year. The fees are invested in a fund that is managed by the Legal, Financial and Administrative Services Agency on behalf of the National Debt Office. Investment vehicles include government bonds and an interest-bearing account with the Debt Office, supplemented more recently by repurchase agreement for the purpose of boosting return. The fund had total assets of SEK 22.6 billion at the end of 2010.

2.2 Stabilisation funds in other countries

The financial crisis triggered an international debate about taxation of the banking sector. In an attempt to better manage systemic risks, a number of countries have adopted or are considering fees and taxes on financial institutions and activities. Most of these initiatives involve temporary fees for recovery of central government support to the banking sector once the crisis is over (*ex post*).

The Swedish stabilisation fee is different in nature in that the banks pay an advance (*ex ante*) premium that can be used to manage any future crises that may emerge. Germany is the only other country that has adopted the same kind of solution so far. In addition, the European Commission is recommending an EU network of national bank resolution funds that would serve a similar purpose.

2.2.1 The German restructuring fund

The German Restructuring Fund Act took effect in late 2010 and has been used since July 2011.

The basic concept of the German model is that even systemically important banks can be restructured in an orderly manner during a crisis without having serious consequences for the financial system or national economy. Troubled

banks must follow a specific restructuring process; the final recourse is that systemically important operations are temporarily taken over by a central government-owned “bridge bank,” while non-systemically important operations are liquidated. Since the focus is on restructuring, the fund will not merge with the deposit insurance scheme.

The restructuring fund, which is administered by the Federal Agency for Financial Market Stabilisation, targets a size of EUR 70 billion (approximately 2.8 per cent of 2010 GDP) and has guarantees permitting it to borrow an additional EUR 120 billion. Fund assets are to be invested in accordance with special guidelines that mandate low risk and adequate liquidity. The guidelines have not been made more specific at this point.

2.2.2 EU network of national bank resolution funds

The European Commission advocates the adoption of national bank resolution funds to be financed by bank levies. The funds are intended to be part of the EU’s crisis management framework to minimise the costs borne by taxpayers in connection with future crises. The Commission is expected to present a legislative proposal in late 2011 that includes a proposal for a network of national bank resolution funds. The idea is that a harmonised framework is better positioned to deal with problem banks that do business in more than one Member State. The intention is to review the framework later on with the long-term goal of creating a joint EU bank resolution fund. Talks are also under way in the European Parliament and Council concerning amendments to the Deposit Insurance Directive that would also permit Member States to use the insurance under certain conditions to finance crisis prevention measures and bank resolution.

According to the Commission, the national bank resolution funds should invest their assets in a geographically diversified portfolio aimed at spreading the risk. The holdings are to be liquid, non-bank assets. The Commission also feels that the funds should target a size that is defined as a percentage of the “eligible liabilities” of the institutions, i.e., the items in their balance sheets that the funds are to cover.

2.2.3 Discussion at the IMF and OECD

The 2009 G20 meeting in Pittsburgh tasked the IMF with exploring existing and conceivable alternative methods for taxing the financial sector in the wake of the financial crisis. The IMF presented a report to the following G20 meeting in June 2010 that contained two main alternatives: *financial activities taxes*, to be paid to the central government budget, and *financial stability contributions*, payable either to the central government budget or to a special fund.[5]

[5] According to the IMF, it makes no difference if the fees go to the budget or to a fund as long as the assets are invested in domestic government securities. However, the IMF does not address the issue of how the fund assets should be invested. IMF (2010) *A Fair and Substantial Contribution by the Financial Sector*, Final report for the G-20, June 2010.

The OECD has studied various alternatives as well. Like the IMF, the OECD argues that the financial sector should bear a reasonable share of the public costs associated with a financial crisis. However, delegates to the OECD Committee on Financial Markets (CMF) disagree about the best way of achieving that goal.[6] The OECD regards *ex ante* solutions as an appropriate option for managing systemic risks but points to a number of key unanswered questions – including the size of the fees to be collected, whether they go to the budget or a special fund, and how the assets of a possible fund are to be invested.

6 See OECD (2010) *Systemic Financial Crises: How to Fund Resolution,* OECD Journal: Financial Market Trends, Volume 2010 – Issue 2. The article is based on a previous report prepared for a CMF meeting in April 2010 and takes the discussion at the meeting into consideration.

3 Design of the Stabilisation Fund

3.1 Size of the Fund

The Government's target for the Stabilisation Fund is that the balance eventually be large enough to cover all costs associated with a significant banking crisis. According to the preparatory work for the Support Act, the method of estimating those costs should be based on the following factors:[7]

1. the risk that the support system will have to be used
2. the charges that the system will have to bear after recovery

The Government stresses that both factors are very difficult to estimate. After performing comparisons with the Swedish banking crisis of the 1990s – which generated central government expenditures of 3-4 per cent of GDP – and international experience, the Government settled on a target of 2.5 per cent of GDP for the Stabilisation Fund's average value as of 2023. Based on the desired future balance of the Fund as a percentage of GDP, the stabilisation fee was set at 0.036 per cent of an institution's balance sheet less certain inter-company loans and subordinated liabilities. The assessment of the National Debt Office is that the balance of the Fund will grow to 2.5 per cent of GDP by 2025.[8] A previous assessment, which credited the Stabilisation Fund with the SEK 24 billion in the deposit insurance scheme as well, concluded that the target would be reached as early as 2016.[9] Due to the harmonisation effort under way in the EU, the question of if and when the deposit insurance scheme and Stabilisation Fund will merge remains unresolved. However the National Debt Office no longer includes the deposit insurance scheme when forecasting how long it will take to reach the target, which casts doubt on whether the Government still believes that the scheme's existing assets should affect the size of the target.

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7 Government Bill 2008/09:61, p. 48.

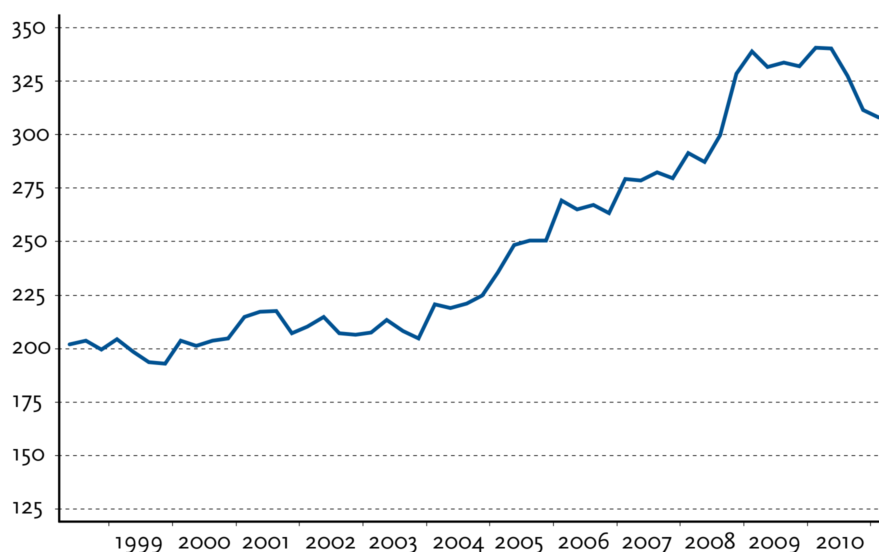
8 Swedish National Debt Office (2011), *Riksgäldens åtgärder för att stärka stabiliteten i det finansiella systemet (Measures by the National Debt Office to Enhance Stability in the Financial System) (2011:2)*, p. 8.

9 Government Bill 2008/09/61, p. 48. proposes a target for the balance of the Stabilisation Fund, *including* the estimated assets that can be transferred from the interest-bearing account set up under Section 15 of the Deposit Insurance Act, of an average of 2.5 per cent of GDP by 2023.

The Government has not clarified what it means by an *average* of 2.5 per cent of GDP or whether the stabilisation fees are to remain unchanged once the Fund reaches that target. However, one task of the Financial Crisis Committee is to evaluate the advantages and disadvantages of targeting a particular size for the Stabilisation Fund.

The NAO has no grounds for making an assessment that differs from that of the Government in terms of the costs associated with a future banking crisis. Predicting such costs is not feasible in practice, and the Government's assessment appears to be reasonable on the basis of the data currently available. However, the NAO is sceptical as to the wisdom of relating the desired future balance of the Fund to GDP. The implied assumption is that the banking system's risks grow at the same rate as GDP, which is not necessarily the case. Figure 2.1 shows that the total assets of the Swedish banking sector rose from approximately 200 per cent of GDP in 2000 to more than 300 per cent in 2010. A reasonable assumption is that systemic risks also outpaced GDP during the period.[10]

Figure 2.1 Total assets of the Swedish banking sector as a percentage of GDP, 2000-2010



Note: The diagram shows the total assets of Swedish monetary institutions in accordance with Financial Market Statistics, which include foreign branches but not foreign subsidiaries.

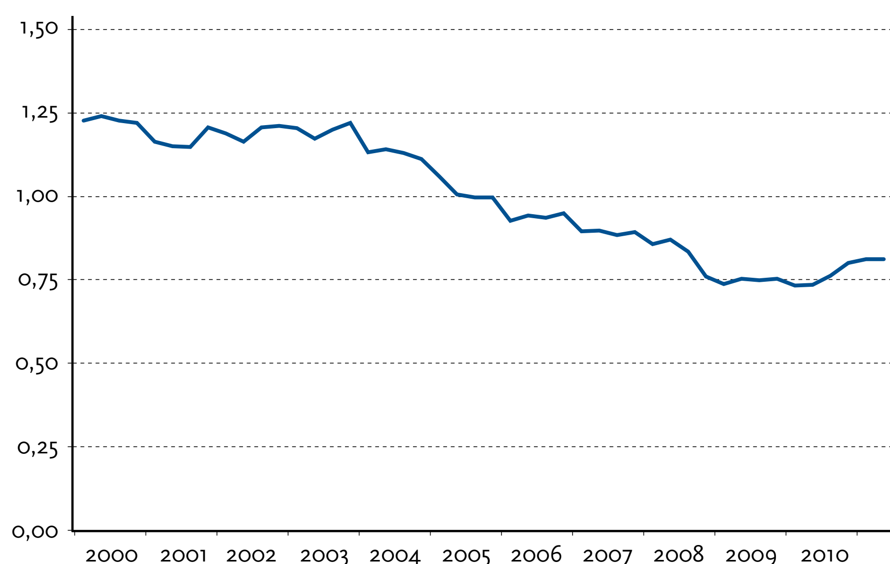
Source: Macrobond

[10] The statistics include foreign branches but not foreign subsidiaries. If the subsidiaries had been considered as well, the assets would have been a good deal greater, particularly in the case of Nordea. The consolidated assets of the four biggest banks alone were more than four times as large as GDP in June 2010. However, foreign subsidiaries are under the supervisory authorities of the countries in which they are located.

If the banking sector grows faster than GDP because credit institutions expand abroad or for other reasons, its risks will do so as well. Under that kind of scenario, the Fund will be too small in relation to the original assessment of risk and the costs to be borne by the system. If the banking system grows slower than GDP, the relative balance of the Fund will be larger.

In other words: Assume that Sweden had set up a stabilisation fund after the banking crisis in the early 1990s and that the fund grew to 2.5 per cent of GDP in 2000. In that case, the fund would have corresponded to 1.2 per cent of the banking sector's assets. If the ratio held steady at 2.5 per cent, the balance of the Fund would have declined to 0.8 per cent of the banking sector's assets by 2010.

Figure 2.2 Target for the Stabilisation Fund of 2.5 per cent of GDP as a percentage of the banking sector's total assets, 2000-2010



Source: Macrobond and NAO calculations

The above example reveals the hazards of targeting the future balance of the fund in relation to GDP. That is not to say that the total assets of the banking sector represent the best possible yardstick in this connection. The ideal solution would be to quantify the central government's implicit guarantee to the banking system, but it is very difficult to measure and presumably varies a great deal over time.

As previously mentioned, the European Commission is preparing a proposal for national bank resolution funds in the Member States. The Commission feels that the funds should target a size that is defined as a percentage of the "eligible liabilities" of the institutions, i.e., the items in their balance sheets that

the funds are to cover.[11] Although the Swedish Stabilisation Fund is more far-reaching than what the EU is discussing, it makes sense to target its size in the same way – most simply as a percentage of its total reference base. That way the size of the Fund will come to be proportionate to that which it is intended to cover, i.e., the costs that the system is expected to bear after recovery from a banking crisis.

3.2 Relationship to the surplus target

The Stabilisation Fund should ensure that the central government's financial position is better when the next financial crisis occurs than if it had not been set up.[12] As discussed previously, banks pay fees to the central government, thereby reducing central government debt and borrowing requirements. All else being equal, the central government's financial position improves accordingly.

However, the impact of the Stabilisation Fund on central government finances must be viewed from a wider perspective. Since 2000, Swedish fiscal policy has focused on a (medium-term) surplus target, which currently requires net lending to average 1 per cent of public sector GDP over the course of a business cycle.[13] Given that central government revenues from stabilisation fees are included when net lending is reconciled with the surplus target, growth of the Fund eases demands on the primary sources of central government surpluses, all else being equal. As a result, growth of the Stabilisation Fund has no impact on the central government's financial position over time.[14] Stabilisation fees will be offset by lower tax revenues or higher expenditures instead.[15] For the same reason, it may be safely assumed that the impact on central government debt will also be negligible.

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11 European Commission (2010), Consultation paper, DG Internal Market and Services working document, *Technical details of a possible EU framework for bank recovery and resolution*, p. 83. Eligible liabilities are liabilities above and beyond Tier 1 capital and the deposits covered under the Deposit Insurance Directive.

12 See Directive 2011:6 p. 13 and Government Bill 2009/10:30 p. 31

13 The original target of 2 per cent of GDP was lowered to 1 per cent after accounting for the premium pension system was transferred from the public to household sector in 2007.

14 The line of reasoning assumes that higher central government net lending does not affect net lending in the municipal sector or the pension system.

15 Given that the central government expenditure ceiling is binding, stabilisation fees ease the tax burden on some other sector compared to what would have been the case without the Fund. Thus the impact of the Stabilisation Fund on the real economy is that the banks are taxed to the advantage of another sector.

Although the stabilisation fees contribute to central government net lending, the Stabilisation Fund has no impact on the central government's financial position given that fiscal policy is controlled by the surplus target. In the NAO's view, the Stabilisation Fund can be regarded as effective only if it better equips the central government to deal with the next financial crisis. However, that is not currently the case, as the fees to the Stabilisation Fund are included when net lending is reconciled with the surplus target.

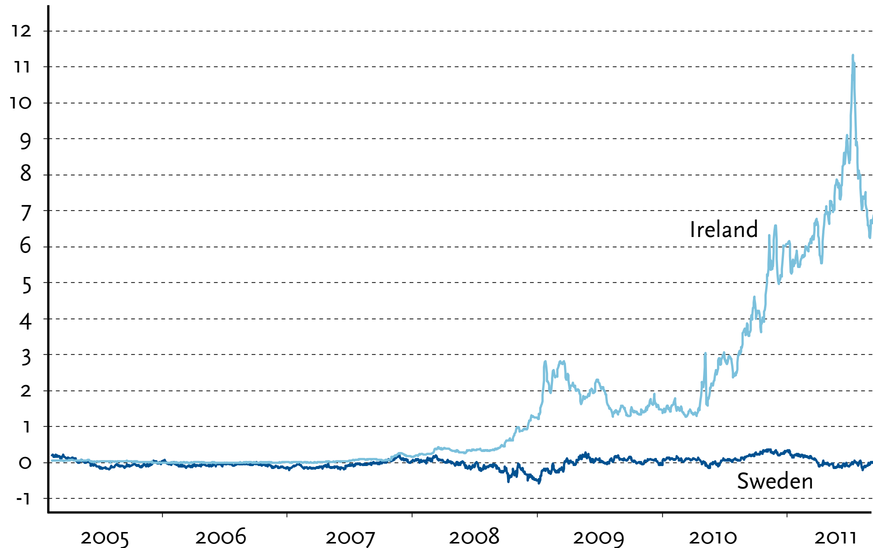
3.3 Investment policy

As pointed out above, the Stabilisation Fund is not a fund in the true sense of the word but consists simply of the balance of an interest-bearing account with the National Debt Office. Nothing in the bill suggests that another arrangement had been either discussed or considered. An EU effort is under way to adopt common regulations for bank resolution funds. In the interim, the Commission's view is that the fees cannot be included in the central government budget but should be managed in separate funds.[16]

If the Stabilisation Fund were managed as a "real" fund, total central government debt would be higher, as well as consolidated central government debt unless all assets were invested in Swedish government securities. Assuming that the assets are invested in low-risk, liquid foreign securities, keeping them all in one fund would have the advantage of making them available at a moment's notice. The central government could accumulate liquid reserves during economic booms and sell them if the country experienced a financial crisis. The current system requires the central government to borrow assets when the Stabilisation Fund is to be used.

[16] Government Offices Fact Memorandum 2009/10:FPM105 p. 5.

Figure 3.3 Spread between Swedish/Irish and German 10-year government bond yields, percentage points



Source: Macrobond

There is good reason to consider the various options for investing the balance of the Stabilisation Fund from the perspective of risk diversification. The current arrangement compels the central government to borrow assets in the market just at the point that the Fund needs to be used. The practical implication of that approach is faith that taxpayers will end up bearing the lowest cost if government bonds are issued in response to a financial crisis. Experience shows, however, that borrowing costs may be considerably higher than normal at such times. Figure 3.3 illustrates the phenomenon based on what happened in Ireland. The country was regarded as enjoying strong public finances and had a comparatively low central government debt to GDP ratio of 29 per cent (as opposed to 71 per cent for the Euro area as a whole) before the crisis. Nevertheless, the bond spread between Ireland and Germany widened dramatically right after the crisis, and the trend continued afterwards as central government finances deteriorated. The spread was widest at more than 1110 bps in July 2011, as opposed to less than 10 bps when financial market turbulence began in spring 2007. Sweden, which did not have to take extensive support measures or substantially increase its borrowing, saw its spread with Germany narrow and even become negative.

Thus, being at the mercy of the capital markets during periods of financial turbulence can be a much more expensive proposition than setting aside regular provisions to a fund containing liquid assets that can be sold when they are needed. A fund consisting of Swedish government securities that must be solid in turbulent times may have an impact similar to the current

system, which requires the central government to issue new bonds when the Stabilisation Fund is to be used. To avoid any impact on Swedish bond yields when the assets of the Fund are sold, they can be invested in foreign liquid securities. In other words, whether the current set-up of an interest-bearing account with the National Debt Offices minimises the costs that taxpayers bear over time is an open question.

3.4 Financing the Fund

The central government made an initial SEK 15 billion capital contribution to the Fund in November 2008. The transfer was made by debiting the new appropriation 92:5 *Contributions to the Stabilisation Fund* in expenditure area 26 Interest on Central Government Debt, etc., while crediting the National Debt Office's net lending with the same amount. The transaction was intra-governmental and did not affect central government budget balance, net lending or consolidated debt. Because expenditure area 26 is not subject to the expenditure ceiling, the budgeting margin was not affected either.

However, the stabilisation fees paid by the banks do have an impact on budget balance, net lending and debt. By the same token, budget balance and debt are affected when Fund assets are used, whereas the impact on net lending varies according to the type of support measure involved. The redemption of guarantees has a negative impact on net lending, whereas initiatives like the central government's participation in Nordea's February 2009 new share issue have no effect whatsoever because they increase the central government's shareholdings at the same time.

The central government's initial contribution to the Stabilisation Fund has been justified as an attempt to provide "muscle" and credibility. In practice, however, the move was simply an accounting device that made no difference to the financial position of either the central government or the Fund. The economic significance of the initial contribution was thereby a reduction of the assets to be financed through stabilisation fees by SEK 15 billion, or approximately 0.5 per cent of GDP.[17] If the Nordea shares – including dividends and increase in value – and interest on the account with the National Debt Office are included, stabilisation fees account for a relatively small percentage of the balance of the Fund. The Debt Office expects that the Fund will grow to 2.5 per cent of GDP by 2025. The forecast of a SEK 156 billion (2.6 per cent of GDP) closing balance in 2025 assumes accumulated fees of just over SEK 53 billion, which

[17] Assuming that interest on the account with the National Debt Office is equal to the nominal GDP growth rate. As a result, the initial contribution will increase such that it always represents approximately 0.5 per cent of GDP.

corresponds to less than 0.9 per cent of GDP or approximately one-third of the balance. Including interest on stabilisation fees, financing is expected to account for approximately 48 per cent of the balance.[18] According to one of the assessment criteria discussed in the first section, however, an effective and expedient stabilisation fund must ensure that the banking sector bears most of the direct costs associated with a crisis. The criterion that contributions to the Fund strengthen the central government's financial position has not been met either, since the original contribution was essentially an accounting device.

[18] The figures are based on the Debt Office's forecast in its *Atgärder för att stärka stabiliteten i det finansiella systemet* (Measures for Enhancing the Stability of the Financial System) (2011:1). Nordea's share price has declined substantially since the report was published. Given the Government's announcement that it is not planning to sell its Nordea holdings under current market conditions, the analysis remains relevant.

4 Capital contribution to Nordea

Confidence in credit institutions was an extremely important factor during the financial crisis. The capital ratio of many banks was far above the legislative requirement, but they still had trouble refinancing in the market. Due to lack of transparency and genuine uncertainty about the loan losses that might arise, even strong banks felt the need to increase their capital cover. In times of uncertainty, investors tend to focus more on relative than absolute positions. Why invest in a bank whose capital adequacy is uncertain when there are others that enjoy just as good prospects and have a stronger capital base? As a result, banks had to consider how competitors were dealing with their capital when making decisions on the matter. For this and other reasons, even well capitalised banks sought to strengthen their capital base. Swedbank and SEB were the most vulnerable Swedish institutions due to their large loan losses in the Baltic countries. But Handelsbanken and Nordea also took measures during the crisis to strengthen their capital position.

Nordea launched a new share issue of approximately EUR 2.5 billion on 10 February 2009 even though it had one of the strongest capital bases in Europe. All large shareholders, including the central government with its 19.9 per cent interest, participated with their pro rata share.

Nordea described the issue as proactive measure intended to better position it for both risks and opportunities. Its chief arguments were as follows[19]:

- to remain one of the best capitalised European banks and retain its AA rating
- to establish an extra capital buffer in view of the uncertain economic outlook
- to create latitude for taking advantage of the business opportunities that imbalances in the market offered

It goes without saying that these justifications were partly a reflection of the impression that the bank wanted to convey to investors and the general public. Nevertheless, it is true that Nordea referred to expansion opportunities in the

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[19] See www.nordea.com/Investor+Relations/Nyemission/Bakgrund+och+motiv/1208042.html

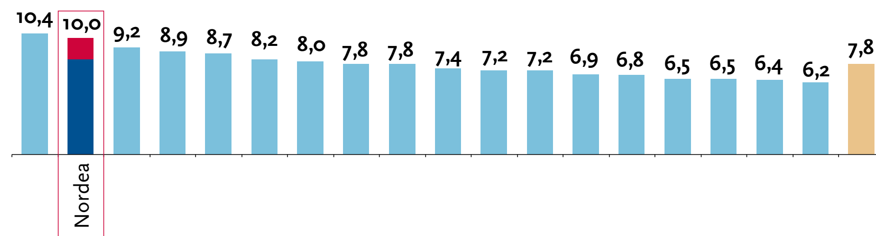
light of the problems that other banks were experiencing and the steps that some foreign actors were taking to reduce their lending in the Nordic market.

Nordea's prospectus compared its capital cover with that of its peers on the Continent (see Figure 4.1). The bank was clearly in a relative strong position. It was far above average and one of the best capitalised banks in Europe. The title of the diagram stresses that the main reason for the issue may have been to retain that relative advantage.

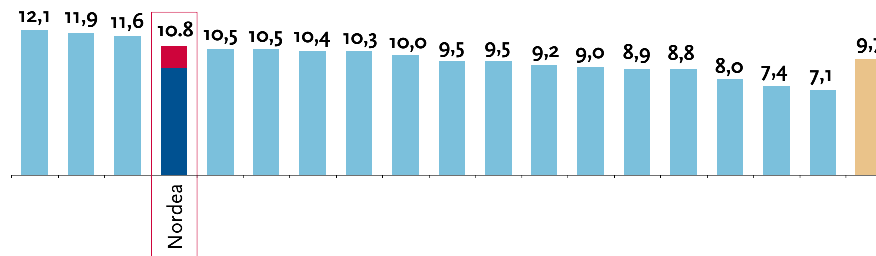
Figure 4.1. Nordea's presentation of its capital base compared to other European banks prior to the new share issue

Main rationale – keep position as one of the strongest banks in Europe

Core Tier 1 capital ratio excluding transition rules Nordea compared with its European peer group, %



Tier 1 capital ratio excluding transition rules Nordea compared with its European peer group, %



Capital measures

Reported ratios excluding impact from new dividend proposal

Source: Nordea

Nordea was already in a strong position with respect to earnings as well as capital cover. The group had reported an operating profit of EUR 3.4 billion in 2008. The bank forecast that its loan losses[20], a major source of concern at that point, would be in line with the fourth quarter of 2008, i.e., EUR 320 million, as opposed to operating earnings of EUR 1.1 billion before the losses. The forecast

[20] Nordea, Annual Report 2008, p. 36

turned out to be astute: loan losses for all of 2009 were just under EUR 1.5 billion.

Both Nordea and the central government emphasised the bank's strong position. For example, a 10 February press release by Minister for Local Government and Financial Markets Mats Odell "welcomed Nordea's decision to seek new capital from a position of strength." Granted that both senior management and the Government in its capacity as the largest shareholder had good reason to underscore the bank's soundness, a reasonable conclusion from the above data is that Nordea was not in any kind of trouble when it decided to carry out a new share issue. However, the economic outlook was uncertain, and there was a greater than negligible risk that even banks that were well capitalised at that point would face refinancing problems. Many market analysts foresaw extreme loan losses in 2009-2011 and a need to acquire capital.[21] In a climate of uncertainty, caution dictated that well capitalised banks also consider whether they had sufficient capital to persuade the market rather than to satisfy official regulations.

4.1 Nordea's options

Prior to a new share issue, the board and senior management ordinarily talk to the largest shareholders in order to secure their participation. In this case, management made sure that the three largest shareholders (36.1 per cent total) – the central government, Sampo Oyj and Nordeafonden – would subscribe for their respective percentages of the new shares. Moreover, Sampo Oyj committed to underwriting 13 per cent of the issue. In other words, 49 per cent of the new shares were subscribed for or underwritten by Nordea's three largest shareholders. Two investment banks each underwrote half of the remaining 51 per cent.

A decision by the central government not to participate would have sent a very strong negative signal unless other investors were willing to commit to acquiring its subscription rights before the issue was made public. The bank's spokespeople maintain, however, that it had been prepared to carry out the issue whether or not the central government participated.[22]

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[21] HQ Bank predicted in March 2009 that the four biggest banks would suffer approximately SEK 140 billion in loan losses for 2010. The actual figure was SEK 14.6 billion.

[22] Interviews with former Chairman of the Board Hans Dalborg, CEO Christian Clausen and CFO Fredrik Rystedt on 14 April 2011

4.2 The Government's options

The Government could simply have declined to subscribe for new shares. Given the highly unstable market and uncertain economic prospects, however, neither management nor shareholders wanted to send that kind of signal. According to our information,[23] the Government never considered the option of not participating.

Capital contributions to central government-owned enterprises are normally financed through appropriations from expenditure area 24, Foreign Trade and Promotion of Trade and Investment, in the central government budget. If the budget had been used in that manner, the central government would have retained its Nordea holdings. Expenditures from area 24 and central government borrowing requirements would each have increased by SEK 5.6 billion, while central government assets would have increased by the value of the new shares after the issue. The value could be calculated as the cost of the shares (SEK 5.6 billion) plus what the subscription rights were worth (SEK 4.7-5.9 billion) – see box – for a total of approximately SEK 11 billion. Any subsequent increase in value would have affected the proceeds of a future sale of the shares. Solid share price performance would ultimately have benefited shareholders.

Nevertheless, the Government decided to finance its participation in the share issue through the newly established Stabilisation Fund. Some of the effects of using the Fund differed from those described above. Since the Stabilisation Fund does not have any assets but is no more than an interest-bearing account with the National Debt Office, the central government had to borrow SEK 5.6 million to pay for the new Nordea shares. In that sense, the result was the same as if the central government budget had been used. The differences arise because the central government did not charge the Stabilisation Fund for use of its subscription rights and because the increase in value of the Nordea shares indirectly accrues to the banking system rather than taxpayers. Moreover, the expenditures of the Stabilisation Fund are not subject to the ceiling for central government expenditures. Thus, participation in the new share issue did not affect the Government's ability to increase other expenditures in 2009.

[23] Interview with Mats Odell on 2 May 2011

Value of the central government's subscription rights
Assigning an unambiguous value to the central government's subscription rights would be an impossible task. They were traded on the stock exchange for eight sessions between 20 and 31 March 2009. The central government's original Nordea holdings entitled it to 5.672 billion subscription rights. If they had been sold on the stock exchange, they might have been valued as follows:

– The average price of 1.0438 during the period they were traded indicates a value of SEK 5.9 billion.
– The volume-weighted average price of 1.0088 indicates a value of SEK 5.7 billion.
– The closing price of 0.94 indicates a value of SEK 5.3 billion.
– The average price during the final session of 0.8273 indicates a value of SEK 4.7 billion.

However, the central government's holdings of subscription rights were so large that they could have commanded a different price than the stock exchange figures suggest. If large investors had wanted to increase their Nordea holdings at that point, the subscription rights could have sold for more than the price on the exchange. If the central government had sold all of its subscription rights on the stock exchange, however, trading volumes would have doubled and the price might have declined unless big investors had stepped up.

The central government has applied the fourth valuation method in several different connections, including the National Debt Office report *Åtgärder för att stärka stabiliteten i det finansiella systemet* (Measures to Enhance Stability in the Financial System) (2010:2). It is difficult to pick a calculation method on objective grounds. We tend to think that the first method (average price throughout the subscription period) is the most accurate. This report, however, uses an interval of SEK 4.7-5.9 billion that includes all four calculation methods or its midpoint of SEK 5.3 billion.

The Government's target is that the Stabilisation Fund grow to and subsequently *average* 2.5 per cent of GDP. The target is not clearly defined and its implications for the fees when the balance of the Fund exceeds 2.5 per cent of GDP need to be specified. As a matter of principle, however, central government contributions to strengthen the Fund reduce the requirement for contributions from the financial sector. Not charging for exercising the subscription rights meant an indirect transfer of SEK 5.3 billion from taxpayers to the financial sector even though it was entered as an intra-governmental transaction. Similarly, dividends and an increase in value of the Fund's Nordea shares will involve a commensurate reduction in the fees that credit institutions have to pay.

4.3 Reasons for the decision

The interviews have revealed three different reasons that the central government decided to finance its purchase of new Nordea shares through the Stabilisation Fund: 1) apprehensions about exceeding the expenditure ceiling; 2) the perception that the Support Act was intended to be used in such situations; 3) as a means for the Government, acting through the National Debt Office, to demand limitations on compensation for Nordea executives.

4.3.1 Expenditure ceiling

Financing purchase of the new shares through budget appropriations would have boosted central government expenditures by SEK 5.6 billion and increased the risk that the expenditure ceiling would be exceeded. There was considerable concern about the budget at that point. Minister of Finance Anders Borg used the word “monster” to characterise the increasingly gloomy predictions for the budget deficit. Meanwhile, various segments of society were demanding additional expenditures, feeding worries that the ceiling would not hold. Government spokespeople and Ministry of Finance employees recall that this concern was one ingredient of the overall assessment that was performed in connection with the decision to use the Stabilisation Fund for purchase of the new Nordea shares.

One objection can be made to employing the expenditure ceiling as an argument for the decision. The purpose of the ceiling is to limit central government expenditures. A number of Governments have used various accounting devices to formally preserve the ceiling. They have frequently done so towards the end of a year when their ability to implement cost-saving measures that would have an impact during the year was extremely limited. In this case, the decision was made in early February at a point when there was plenty of time to take corrective measures that would counteract the risk of exceeding the expenditure ceiling. A key reason was concern that the financial crisis would drive central government expenditures above the ceiling. It comes as no surprise that the ceiling might be threatened by the steepest economic downturn in 80 years. It would have been more straightforward under these circumstances to participate in the new share issue through appropriations from the central government budget and, if the need arose, to propose that the Riksdag adopt cost-saving measures or raise the ceiling.

In the short run, respecting the ceiling is above all a powerful signal that central government finances are under control. The NAO’s sense is that the Government looked at the uncertain economic prospects at the time and concluded that it was extraordinarily important to maintain the expenditure ceiling that had previously been set.

A political discussion was also under way concerning the best measures to adopt in order to cushion the impact of the financial crisis on the real economy. Using available resources within the expenditure ceiling to make a capital contribution to a bank instead of supporting a municipality's attempt to combat rising unemployment or a similar initiative was deemed to be politically impracticable considering that the Stabilisation Fund was regarded as an alternative source of financing.[24] Taking advantage of the Fund to finance central government holdings in Nordea broadened the perceived scope for counteracting the economic downturn by fiscal measures, presuming that the expenditure ceiling could not be raised.

4.3.2 *Use of the Stabilisation Fund*

Chapter 1, Section 2 of the Support Act states that central government support may be provided to credit institutions "if needed to counteract a risk for serious disruption of the Swedish financial system." According to the preparatory work, central government support is to counteract systemic risks.[25] The Government clarifies that "systemic risk refers to the risk that the financial system will be exposed to extensive disruption that seriously compromises its ability to function. The risk may also be defined as the danger that a sudden and unexpected crisis at one or more financial firms will trigger a chain reaction that has serious consequences for all or central components of the financial system." Thus, the objective is not to rescue or provide relief to an individual institution that has incurred problems if deemed to be an isolated event. Only if the problems that a credit institution is suffering affect the ability of the financial system to function is the central government to intervene and provide support.

The Government and Riksbank do not believe that it is possible to identify systemically important institutions in advance. Both Carnegie and Kaupthing were deemed to be systemically important and received liquidity support during the crisis. HQ Bank was not subsequently considered to be systemically important even though its focus and size were reminiscent of Carnegie in many ways. However, the decision was guided by the fact that the financial system was a good deal more stable in spring 2010 when HQ Bank ran into trouble.

As mentioned above, Nordea was not experiencing a crisis and by its own admission would have proceeded with a new share issue even in the absence of the central government. Determining what constitutes a risk for serious

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24 Interview with Mats Odell on 2 May 2011

25 Government Bill 2008/09:61, p. 33.

disruption is ultimately a matter of judgement, but the Government's contribution to Nordea gives the impression of having been based on its shareholder status rather than a need to protect the financial system. The National Debt Office concluded that "Nordea would most likely have taken the same course of action in the credit market (and by all accounts received just as much capital) if the central government had decided not to subscribe for new shares through the capital contribution programme."[26] From that point of view, whether the Support Act offered a legitimate rationale for using the Stability Fund remains an open question.

On 9 February 2009, the day before Minister for Local Government and Financial Markets Mats Odell announced that the central government would participate in the new share issue and that financing would go through the Stabilisation Fund, the Government issued the Contributions Ordinance. Section 1 reads, " This ordinance contains provisions on capital contributions to solvent institutions provided under the Government Support to Credit Institutions Act (2008:814) so as to *strengthen the credit supply* [italics ours] in order to prevent a risk for serious disruption of the financial system in Sweden."

The additional goal of strengthening the credit supply has no counterpart in the Support Act. However, the comments to the statute refer to the State Support to Banks and Other Credit Institutions Act (Swedish Code of Statutes 1993:765), now repealed, to the effect that central government support may be provided to *secure* [italics ours] the credit supply. Securing and strengthening the credit supply cannot be regarded as synonymous, particularly given that the contribution did not affect the outcome of Nordea's new share issue. The issue was also underwritten by shareholders other than the central government, as well as two investment banks. The first section of the repealed act used the verb secure: "To guarantee support in the payment system and secure the credit supply, state support may be provided under this law to banks and certain other credit institutions. The purpose of the central government's commitment is to guarantee that the institutions can meet their obligations on time."

An ordinance is to be a set of directions within the legal framework constituted by the act on which it is based. Whether the Contributions Ordinance is compatible with the Support Act has not been fully established. Strengthening the credit supply is not a clearly defined concept. The implication in this connection is that capital contributions to a bank are, all else being equal, to increase the availability of credit throughout society. The crisis was accompanied by worries that banks would cut back on their lending in order to

[26] National Debt Office, *Utvärdering av regeringens åtgärder till stöd för kreditförsörjningen* (Evaluation of Government Measures to Support the Credit Supply), 31 January 2010.

strengthen their capital ratio. Businesses might have been forced to ramp down production or refrain from expanding as a result. In either case, economic activity and employment would have suffered. Thus, stricter lending policies would have aggravated the economic downturn. Nonetheless, slower growth is not synonymous with a risk for serious disruption of the financial system. The statement in the bill that "the risk may also be defined as the danger that a sudden and unexpected crisis at one or more financial firms will trigger a chain reaction that has serious consequences for all or central components of the financial system" would appear to be fundamentally different from the desire to strengthen lending.[27]

The Government broadened the interpretation of "serious disruption of the financial system" to include strengthening the credit supply. The bill was written in autumn 2008 to address the need for the central government to be able to provide various types of support aimed at counteracting the risk that credit institutions would run into acute problems. There was widespread concern in late 2008 that banks would cut back on lending in order to strengthen their capital adequacy. The subsequent Contributions Ordinance used credit supply as an argument for the central government to support credit institutions. Spokespeople for the Department of Finance have referred to the following paragraph in the bill (see p. 31) under the heading of "Preparedness for Additional Measures":

"Turbulence in the financial markets has made it considerably more difficult for Swedish businesses to finance their operations. The Government believes that Swedish businesses need rapid access to capital and that it is essential that they have better opportunities for financing their operations. The Government intends to submit a proposal in the near future for measures to improve the financing prospects of Swedish businesses. One possible measure would be to strengthen AB Svensk Exportkredit by transferring the shares of Venantius AB and other central government actors to it."

The assessment of the NAO, however, is that there is a big difference between this general description of measures that might be needed in the future and the concept of "strengthening the credit supply" as articulated in the Contributions Ordinance. The State Support to Banks and Other Credit Institutions Act (Swedish Code of Statutes 1993:765), now repealed, specified that support

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[27] Comments on the bill by the Swedish Investment Fund Association worried that finance companies would not be regarded as systemically important and thereby not be covered by the law. The Government replied that "the opinions of the Investment Fund Association do not provide any grounds for altering the basic premise that there must always be a risk for serious disruption of the financial system before the interventionist central government support measures for which the new law provides are actually used." (Government Bill 2008/09:61 p. 36).

may be provided to secure the credit supply. Securing the credit supply can be interpreted as ensuring that it works properly.[28] The Contributions Ordinance uses the phrase "strengthen the credit supply," which means that it is to increase, all else being equal. That would appear to be an expansion of the original concept. The Government's use of the Contributions Ordinance to participate in the new share issue of a partly owned company that was not experiencing a crisis would seem to be an additional expansion of the concept of securing the credit supply.[29]

Thus, the NAO assigned Wiweka Warnling-Nerep, Professor of Public Law, the task of assessing whether the Contributions Ordinance is compatible with the Support Act.

According to Professor Warnling-Nerep, the Support Act does not provide scope for the content of the Contributions Ordinance. Her view is that it is difficult to avoid the impression that the Government was acting as a Nordea shareholder when it issued the Contributions Ordinance rather than intervening to "counteract a risk for serious disruption of the financial system" (Chapter 1, Section 2 of the Support Act).

The Government did not use the Contributions Ordinance to help any other banks even though Swedbank and SEB posed a much greater risk to the credit supply due to their large loan losses in the Baltic countries. The Contributions Ordinance was used only to finance the Government's participation in Nordea's new share issue. In short, the compatibility of the Contributions Ordinance with the Support Act remains an open question, given that the objective of *strengthening the credit supply* was not mentioned in either the bill or the law itself.

4.4 Decision on subscription rights

The Government authorised the Stabilisation Fund to exercise the subscription rights that accrued to the central government through its Nordea shareholdings. As mentioned above, the holdings had a market value of approximately SEK 5.3 billion. The Fund was not required to pay any compensation for exercising the rights. As the Fund is in the central

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[28] The first section of the State Support to Banks and Other Credit Institutions Act (Swedish Code of Statutes 1993:765) stated: "To guarantee support in the payment system and secure the credit supply, state support is provided under this law to banks and certain other credit institutions. The purpose of the state's commitment is to guarantee that the institutions can meet their obligations on time."

[29] See Ministry of Finance press release of 10 February 2009.

government sector, the move can be regarded as an intra-governmental transaction. Because the Fund was intended to be financed primarily by the credit institutions covered by the Support Act until its average balance grew to 2.5 per cent of GDP, the transfer of subscription rights ultimately translates into a commensurate reduction in the fees that the institutions need to pay. The arrangement represents indirect support for the financial sector, more specifically for the credit institutions on which the stabilisation fee had been imposed.

The NAO has tried to reconstruct the process surrounding the decision that the Stabilisation Fund would not have to pay for exercising the subscription rights. Minister for Local Government and Financial Markets Mats Odell announced at a 10 February 2009 press release that the central government would participate in Nordea's new share issue. He also mentioned that the central government's capital contribution would be financed by the Stabilisation Fund. No information about the subscription rights was provided at that point. The Government had decided the day before to issue an ordinance enabling it to use the Fund in connection with the new share issue.

On 26 February the Government formally authorised the National Debt Office to exercise the subscription rights that the central government would receive in connection with the new share issue. The decision did not go into the question of compensation for exercising the rights. Göran Haag, Director-General for Legal Affairs at the Financial Markets Department, notes that ”the authorization is not tied to any condition that assets are to be withdrawn from the Stabilisation Fund for exercising the subscription rights.”[30] The absence of such a connection constituted an implicit statement that no compensation was to be paid. The NAO has tried in vain to identify the grounds on which the Ministry of Finance decided that the Stabilisation Fund would not pay any compensation for exercising the subscription rights. Spokespeople for the ministry refer to the internal drafting process without explaining the thinking on this matter.

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[30] Memo concerning the Stabilisation Fund and Nordea's New Share Issue 2009, 9 May 2011.

Table 4.1. Decision concerning Nordea's new share issue 2009

Date	Event
Late January	Government issues a confidential communication that the central government will participate in the new share issue
9 February	Government issues the Contributions Ordinance
10 February	Press release: Mats Odell comments on Nordea's new share issue
26 February	Government decision: National Debt Office is authorised to exercise the subscription rights

5 Conclusions and recommendations

The purpose of auditing the Stabilisation Fund was to address the questions of whether its design is effective and expedient, as well as whether its use in connection with Nordea's new share issue in February 2009 was consistent with the Riksdag's intentions according to the Support Act. The questions will be addressed below by juxtaposing the observations made by the audit with the assessment criteria listed in Section 1.

5.1 Is the Fund an effective tool?

The main objective of the Stabilisation Fund is to serve as an effective tool for financing central government support measures in case of a banking crisis. Of particular importance is that the Fund be appropriately sized and that its balance can be used in a way that minimises costs for taxpayers in the event of a crisis.

5.1.1 Size of the Stabilisation Fund

The Government has targeted growth of the Fund to 2.5 per cent of GDP in 2023. The NAO questions the relevance of aiming for a future balance in relation to GDP. Risk and risk-taking trends in the banking sector have no obvious correlation with the growth of the Swedish economy. Clear evidence of this lack of correlation is the fact that the assets of Swedish banks have increased a good deal faster than GDP in the 2000s, particularly in the wake of the banking sector's ongoing internationalisation and cross-border consolidation.

The NAO finds that the target of 2.5 per cent of GDP does not consider the evolution of the banking system's risks over time and is thereby in danger of failing to contribute to effective management of a future banking crisis. In the best of worlds the targeted size of the Stabilisation Fund would reflect the central government's implicit guarantee to the banking system. Given that perceptions of the scope of the implicit guarantee can vary substantially over time, the desired size of the Fund should be related to a more stable parameter.

Such a parameter may be some form of the balance sheet totals of the banks, such as the total reference base of the various institutions.

The NAO also believes that the target for the balance of the Fund to reach and subsequently average 2.5 per cent of GDP is unclear. The audit has been unable to pin down the implications for the fees when the balance exceeds 2.5 per cent. Nor is it clear whether the balance is to remain at 2.5 per cent of GDP if and when it merges with the balance in the deposit insurance scheme.

5.1.2 *Interest-bearing account or fund?*

The Stabilisation Fund is simply an account with the National Debt Office and is not a fund in the sense that the central government holds assets that can be used in the event of a financial crisis. Thus, the central government would have to borrow any assets required to finance support measures through the Fund. Experience shows that borrowing costs can rise dramatically when the central government has to go in and rescue the financial system. The risk is particularly evident for small economies like Sweden. From the point of view of risk diversification, establishing a fund would thus appear to be justified. The fund should have a broader investment policy than Swedish government securities only, given that their sale may be inappropriate or unfavourable when the economy is in a vulnerable position.

5.1.3 *Recommendations*

The Government should submit a proposal that targets the size of the Stabilisation Fund in a way that reflects the risk level in the banking system better than the current percentage-of-GDP approach. The proposal should take the possibility that the banking sector's risks will change over time into consideration. The Government should also explore whether the assets received by the Fund can be invested in a manner that does not involve paying off the central government debt. Such an inquiry might examine whether all or part of the assets should be invested in low-risk foreign government securities that can be sold in the event that the Fund needs to be used. A supplemental directive by the Government could task the Financial Crisis Committee (Fi 2011:02) to conduct these inquiries.

The Government should also clarify the meaning of the stipulation that the Fund *average* 2.5 per cent of GDP and how the fees are going to be set after the build-up period.

5.2 Does the Stabilisation Fund strengthen the central government's financial position?

In the view of the NAO, the Stabilisation Fund can be regarded as effective only if an increase in its balance strengthens the central government's financial position. The Government has described the relationship between the Fund and central government finances in similar terms (see Directive 2011:6, p. 13). The IMF also argues that a stabilisation fund should be regarded as a capital buffer. Thus, the idea is that the Stabilisation Fund equip the central government to better manage a financial crisis.

As Section 3 demonstrates, central government net lending strengthens when fees are paid to the Fund. The central government's financial position, however, reflects the fiscal policy framework and the surplus target that net lending average 1 per cent of public sector GDP over the course of a business cycle. The fees to the Stabilisation Fund are included when net lending is reconciled with the surplus target. As a result, growth of the Fund will have no impact on the central government's financial position. On the contrary, the stabilisation fees will be offset by lower tax revenues or higher expenditures in other areas. For the same reason, the total size of central government debt may be regarded as unaffected by the balance of the Stabilisation Fund.

5.2.1 Recommendations

If the Stabilisation Fund is to strengthen the central government's financial position for future financial crises, the Government should disregard its impact on net lending when reconciled with the surplus target.

5.3 Are the costs associated with a financial crisis financed primarily by the banking sector?

The Government has emphasised on a number of occasions that the Stabilisation Fund is to ensure that costs for rescuing the financial system are to be borne by credit institutions; thus, they are to pay a stabilisation fee to the Fund. The bill targets a Fund balance corresponding to 2.5 per cent of GDP in 2023. However, the Government has transferred significant assets to the Stabilisation Fund: an initial contribution of SEK 15 billion through an appropriation, as well as transfer of subscription rights to new Nordea shares to the Stabilisation Fund without the Fund having to pay for them (see below). As shown in Chapter 3, the initial SEK 15 billion contribution did not constitute a genuine transfer of assets: a National Debt Office account was simply credited with the same amount – almost 0.5 per cent of GDP – that the appropriation

was debited. Adding the increase in the value of the Stabilisation Fund's Nordea holdings and associated dividends, fees from credit institutions do not appear to be in line with the target that they provide primary financing. If the current rules are retained, taxpayers run the risk of providing more than half of the financing for the Fund.

5.3.1 *Decision not to charge for the Nordea prescription rights*

In its capacity of shareholder, the Government received 5.672 billion subscription rights to Nordea's new share issue. The Government authorised the Stabilisation Fund to exercise the subscription rights without having to pay for them. The subscription rights were worth approximately SEK 5.3 billion. Thus, their value was transferred to the Stabilisation Fund. According to the bill, the Fund is ultimately to be self-financing, primarily through premiums from credit institutions. The transfer meant that the central government took over commensurate financing of the Stabilisation Fund from the financial sector.

Government spokespeople have been unable to explain why the Fund was not charged. The lack of any terms for exercising the subscription rights in the 26 February 2009 Government decision may be interpreted as meaning that no compensation was to be paid. No active decision has been presented to the effect that – and on what grounds – compensation was not to be paid.

The Government's actions departed from its express intention that the financial sector assume responsibility for financing the Stabilisation Fund. The ultimate result is that taxpayers will bear a greater percentage of the costs that the financial sector generates.

5.3.2 *Recommendations*

In the NAO's view, a reasonable goal is that the financial sector assume responsibility for the direct costs associated with support measures it receives in the event of a crisis. Thus, the central government should not contribute to the balance of the Stabilisation Fund. For that to be the case, the Government should explore whether the Fund can be debited in arrears for the value of its subscription rights to Nordea's new share issue, as well as whether the initial SEK 15 billion contribution, including interest, ought to be reversed.

5.4 Financing of Nordea's new share issue

The Government's main purpose in submitting Measures to Enhance the Stability of the Swedish Financial System (Government Bill 2008/09:61) in

October 2008 was to safeguard financing of financial actors and ensure that the central government could provide capital contributions as needed. After the legislation had passed, concern grew that private sector financing problems would aggravate the economic downturn. As a result, the Government launched an effort in late 2008 that focused on its ability to inject capital into solvent banks.

In connection with Nordea's new share issue, the Government issued the Contributions Ordinance. . Section 1 states, "This ordinance contains provisions on capital contributions to solvent institutions provided under the Government Support to Credit Institutions Act (Swedish Code of Statutes 2008:814) so as to *strengthen the credit supply* [italics ours] in order to prevent a risk for serious disruption of the financial system in Sweden." Based on the Contributions Ordinance, the Stabilisation Fund was used to finance the central government's holdings in connection with Nordea's new share issue. As a result, the Government wore two hats: both as a shareholder and – together with the Riksbank – as responsible for measures to protect the stability of the financial system.

The additional goal of strengthening the credit supply has no counterpart in the Support Act. It is true that the comments to the statute refer to the bill for the State Support to Banks and Other Credit Institutions Act (Swedish Code of Statutes 1993:765) with respect to securing the credit supply. However, that should be interpreted as an injunction to maintain the system and its functionality in the broad sense and cannot be translated to initiatives aimed at strengthening the credit supply. Under the heading of "Preparedness for additional measures," the bill mentions the need to improve the financing prospects of the institutions. However, using the Stabilisation Fund to finance the central government's holdings in Nordea's new share issue is a much different concept. An ordinance is to be a set of directions within the legal framework constituted by the act on which it is based.

In the assessment of Professor Wiweka Warnling-Nerep (see Appendix 1), the Support Act does not provide scope for the content of the Contributions Ordinance.

Our interviews found that the desire to protect the expenditure ceiling was a contributing factor to the Government's actions. It comes as no surprise that the ceiling might be threatened by the steepest economic downturn in 80 years. It would have been more straightforward under the circumstances to participate in the new share issue through the central government budget and, if the need arose, to propose that the Riksdag adopt cost-saving measures or raise the expenditure ceiling.

5.4.1 *Recommendations*

In the opinion of the NAO, whether the Contributions Ordinance is compatible with the Support Act remains unclear. The Government should examine whether measures are required to eliminate uncertainty about the relationship between the Support Act and the Contributions Ordinance.

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Interviewees

Former Minister for Local Government and Financial Markets Mats Odell

State Secretary at the Ministry of Finance Hans Lindblad

State Secretary at the Ministry of Finance Johanna Lybeck Lilja

Assistant Undersecretary at the Ministry of Finance Sonja Daltung

Former Chairman of the Board of Nordea Hans Dalborg

President and CEO of Nordea Christian Clausen

CFO of Nordea Fredrik Rystedt

Appendix 1. Statement of opinion by Professor Wiweka Warnling-Nerep

The NAO asked Professor Wiweka Warnling-Nerep to assess the compatibility of the Contributions Ordinance and the Support to Act. The assessment is presented in its entirety below.

EWN Opinio Juris AB
Breitenfeldsgatan 1
115 24 Stockholm

Stockholm den 13 augusti 2011

Professor Wiweka Warnling – Nerep

Question as to whether the Capital Contributions to Solvent Banks and Others Ordinance (Swedish Code of Statutes 2009:46) – the "Contributions Ordinance" – is compatible with the Government Support to Credit Institutions Act (Swedish Code of Statutes 2008:814) – the "Support Act"

The Swedish National Audit Office (NAO) has asked me to state my opinion about whether the Contributions Ordinance is compatible with the Support Act. The question is to be subject to a purely constitutional scrutiny, i.e., I am to determine whether Chapter 8, "Acts of Law and Other Provisions," of the Instrument of Government (the "Instrument") contains support for the Contributions Ordinance. Such an assessment, however, requires that I first present the background to the measures that are presumed to have led up to the Contributions Ordinance. It will also be necessary to touch upon Chapter 9, "Financial Power," of the Instrument and its allocation of responsibilities between the Riksdag and the Government.

1. Nordea's new share issue in 2009 and participation by the central government

A Nordea press release on *10 February 2009* announced that the *bank intended to strengthen its capital base by EUR 3 billion*. The board had decided to increase the group's share capital by means of a guaranteed *issue* of new ordinary shares of *approximately EUR 2.5 billion* with preferential rights for existing shareholders, as well as by *lowering its dividend*. The new share issue was conditional on approval by an extraordinary general meeting scheduled for *12 March 2009* (see www.nordea.se/pressmeddelanden). The press release quoted Christian Clausen, President and CEO, who expressed his satisfaction with the strong support that existing shareholders, including the central government in its capacity as a significant shareholder, had shown and presented the planned transaction as follows[31]:

> ”Nordea's three largest shareholders – the central government, Sampo Oyj and Nordeafonden (the former Nordea Danmark-fonden) – which together hold 36.1 of Nordea's shares – will each subscribe for its pro rata share of the new issue. As a result, *a total of 49 per cent of the new share issue will be subscribed for or underwritten by Nordea's largest shareholders*. J.P. Morgan and Merrill Lynch International have committed to underwriting the remainder of the issue (corresponding to 51 per cent) on customary terms.” (italics mine)

Nordea's website also described the *background to the new share issue*. The bank dismissed the idea that it "had some kind of problem." On the contrary, it presented itself as "one of the strongest banks in Europe." The new share issue was essentially *a preventive measure* to ensure that Nordea could "retain its position in the future as well." By acquiring new capital, Nordea wanted to prepare "for both risks and opportunities" and obtain a "buffer that may be needed in view of the uncertain economic outlook."

The *Government's website* made the announcement under the heading, ”Staten deltar i Nordeas nyemission" (The central government will participate in Nordea's new share issue). Financing was to be provided ”through *capital contribution programmes with capital from the Stabilisation Fund*", whereby the holdings would be allocated between the Fund (35.5%) and the central government (64.5%) (see www.regeringen.se). On *9 February 2009*, the day before Nordea announced its plans (see above), the Government issued the Contributions Ordinance, to take effect on *17 February 2009*.

[31] See www.regeringen.se Historisk utveckling av statens ägande i Nordea (Central government's historic Nordea holdings) The Government indicated in 2007 that it intended to reduce its holdings but subsequently decided to increase them instead by participating in the 2009 new share issue.

Please note:

- When Nordea announced on 10 February 2009 that it would be carrying out a new share issue, the central government (presumably through the Government) had already guaranteed its participation.
- According to Nordea's statement, it had no financial problems at that point; rather the new share issue was a preventive measure to ensure that it would retain its position as one of Europe's strongest banks.
- The Government announced that it would participate in the new share issue by using the Stabilisation Fund. The synchronicity of the Contributions Ordinance, as it was designed, and that participation deserves examination. The Contributions Ordinance was issued the day before Nordea announced the issue, was designed in a way that suited its purpose (see Section 3.3) and took effect a week later. Thus, it became the vehicle that the Government needed to carry out its plans in a simple manner and independent of the Riksdag.

2. Central government participation in a new share issue – Chapter 9 of the Instrument

The question of what the Government was constitutionally authorised to decide on its own, i.e., without the involvement of the Riksdag, in the aforementioned situation touches upon both regulatory power in Chapter 8, "Acts of Law and Other Provisions," and Chapter 9, "Financial Power," of the Instrument. From now on I will refer to the articles that were in effect in 2009, but the Instrument was amended as of 1 January. 2011 (Swedish Code of Statutes 2010:1408).[32] For updating purposes, I will cite the current articles in the footnotes. Chapter 9 of the Instrument raises the question as to whether the central government could have *protected its Nordea holdings* (assuming that can be shown to have been one of its purposes)[33] *in another manner* or at least participated in the new share issue other than by using the Stabilisation Fund.

The Instrument's rules concerning financial power in Chapter 9 are very brief, particularly in view of the central and complicated nature of the matter.[34]

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32 However, the changes to Chapter 9 of the Instrument are more marginal.

33 Nevertheless, the central government sold 255 million shares, or 32 per cent, of its Nordea holdings in 2011, reducing its interest from 19.8 to 13.5 per cent. A Government press release of 21 June 2011 stated that its "basic intention is to liquidate all or some of the central government's Nordea holdings."

34 With regard to these questions in general, see Warnling-Nerep et al., Statsrättens grunder, 3rd edition, 2010, p. 139 ff., Bull, Thomas & Sterzel, Fredrik, Regeringsformen – en kommentar, 2010, p. 220 ff., Sterzel, F. Finansmakten - i konstitutionens centrum och periferi, in Konstitutionell demokrati (ed. Petersson, Olof och Smith, Eivind) 2004 0. 90 ff. and Mattson, Ingvar, Finansmakten i Svensk författningspolitik, 3rd edition, 2011 (ed. Mattson &Petersson), p. 241 ff.

Financial power, especially taxation, has traditionally been the sole province of the Riksdag. The 1974 Instrument took the approach of leaving the *power of appropriation* (Chapter 9, Articles 2-3)[35] with the Riksdag and implementation, i.e., *right of disposal* (Chapter 9, Article 8) to the budget adopted by the Riksdag with the Government. Meanwhile, the budget is adopted on the basis of the Government's annual budget bill. Thus far financial power can be regarded as a kind of interplay between the Government and Riksdag even though the latter performs the actual function.

A remaining *problem* was resolved through constitutional practice. The question was the proper parliamentary procedure for dealing with a situation in which the Government *did not use an appropriation* that the Riksdag had approved as part of the budget. Did that represent an unacceptable refusal on the part of the Government to implement a decision that had been democratically arrived at? Through practice, however, appropriations came to be regarded as *invitations* for the Government to utilise them. It should be pointed out in this connection that, according to Chapter 9, Article 10 of the Instrument, "The Government may not take up loans or otherwise assume financial obligations on behalf of the State unless authorised by the Riksdag."[36]

The Riksdag determines both the *amount and purpose of an appropriation*. The breakdown into three different types of appropriation decisions, each with its own level of control and bindingness under the Central Government Budget Act (Swedish Code of Statutes 1996:1059) in effect at the time, was replaced as of 1 January 2011 by one type only: the *appropriation*.[37] According to the framework model adopted in 1996, the Government makes decisions about *expenditure ceilings and expenditure frameworks* for various areas and presents them in the budget bill. The immediate background to the 1996 reform was a series of crises that had been traumatic for the central government: the real estate, banking and foreign exchange crises. The budget deficit had grown considerably, triggering a greater need for the central government to borrow.

The situation can be summed up such that the top priority in the area of financial power in recent years has been *efficiency and a desire for political freedom of action*. Central government finances must be managed regardless of political circumstances. Thus far the justification for the 1996 budget reform is worth noting, i.e., strengthening the position of minority governments;

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35 Now primarily Articles 3 and 7.

36 The aforementioned articles are now covered essentially by Article 8.

37 Chapter 3, Section 2 of the Budget Act (Swedish Code of Statutes 2011:203) refers only to one kind of appropriation: " When budgeting expenditures for specified purposes, appropriations shall be used." An appropriation may be exceeded (credit of no more than 10 per cent of the allocation) or used for expenditures that were unknown when it was allocated if needed for its purpose to be achieved.

the consequence was that the Riksdag lost some of its power. The 1996 budget reform was accompanied by stricter requirements for monitoring and controlling the budget. *The Government is to carefully monitor central government revenues and expenditures in relation to the budgeted amounts, as well as take borrowing into consideration.* If the expenditure ceiling is at risk of being exceeded, the Government shall either take "the measures for which it is authorised" or propose that the Riksdag take "necessary measures" (Section 42 of the Act on the Central Government Budget).

Please note:

- Chapter 9 of the Instrument combines control of, and freedom for, the Government, which can cause problems. In the wake of the new Budget Act (Swedish Code of Statutes 2011:103), the Government has greater freedom when it comes to appropriations than it had in 2009.
- The question arises as to whether the Government had any genuine options other than to utilise the Stabilisation Fund. It is possible that existing appropriations were inadequate or that the expenditure ceiling had been reached, in which case the Riksdag may have been required to take "necessary measures" (see above). A new loan would have also demanded the Riksdag's participation. To that extent, use of the Contributions Ordinance to stretch the limits of the Support Act may appear to be an advantageous and quick option (see below).

3. Regulation on support to credit institutions

As is the case with financial power in Chapter 9 of the Instrument, regulatory power in Chapter 8 (as well as a number of articles in other chapters) is based on *distribution of power between the Riksdag and Government*. The basic idea is that the Riksdag makes decisions by passing laws but can *authorise the Government to issue directives* concerning matters that do not fall within the Riksdag's mandatory area (such as taxation and imprisonment). The Government also has its *own direct regulatory power based on Chapter 8, Article 13* [38]*of the Instrument* with respect to *"provisions relating to the implementation of laws"* (1) and *"provisions which do not under fundamental law fall to be adopted by the Riksdag"* (2) (the Government 's "residual competence"). The second power is normally characterised as "other" than onerous public law, i.e., essentially *public law* that is *favouring, neutral or voluntary*. It may be noted that the 2010 reform made fairly large changes to Chapter 8 of the Instrument. The previous list of delegatable matters in Article 7 – a rather clumsy regulatory method –

[38] Now Chapter 8, Article 7 of the Instrument

was replaced by clear specifications in Article 3:1-3, of what the Riksdag *cannot* delegate. The area for delegation is thus assumed to have expanded. Most of the other changes involve restructuring or style.[39]

3.1 Question as to what "matter" the Support Act regulates

The matter that the Support Act regulates, i.e., provisions "concerning support to credit institutions as referred to in the Banking and Financing Business Act (Swedish Code of Statutes 2004:297), redemption of shares of such institutions and a special fund for stability in the credit market" (Chapter 1, Section 1), is of *mixed nature*. It is primarily a question of *favouring public law*, i.e., the central government is to pay assets to credit institutions, and is therefore something about which the Government is essentially entitled to issue *orders* solely on the basis of its residual competence (Chapter 9, Article 13:2 of the Instrument). However, the Support Act also concerns *clearly civil matters* – for example, that agreements are considered to be the normal procedure between the central government and the recipient of support (Chapter 1, Section 4) and that a Review Board system is to be established to examine the reasonableness of terms that are offered (Chapter 3). A civil regulation falls almost exclusively under the Riksdag's competence pursuant to Chapter 8, Article 2 of the Instrument, i.e., a *law* is required and the options for *delegation are minimal*.[40] In this case, residual competence pursuant to Chapter 18, Article 3:2 of the Instrument *cannot* be utilised, but the only constitutionally acceptable justification is the implementation provisions (Chapter 8, Article 13:1 of the Instrument) (see Section 3.3 below) Finally the Support Act contains *public law stipulations* that are of an *onerous* nature (Chapter 4 on the redemption of shares). The central government is authorised to "redeem holdings in a credit institution if it is of extraordinary significance from a public point of view," provided that certain other conditions have been met (Chapter 4, Section 1). There are also other regulations concerning the "size of the redemption amount" (Section 3) and the right of the central government to redeem warrants as well, etc. (Section 7), along with stipulations in Chapter 5 to the effect that the value of redeemed shares is to be assigned in the event of a dispute as if the institution had not been covered by central government support (Section 1). These onerous regulations require *law* pursuant to Chapter 8, Article 3 of the Instrument but should find support in the very

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39 See Government Bill 2009/10:80 p. 217, p. 219 and p. 225 ff. With regard to these questions in general, see Warnling-Nerep et al. a.a. p. 206 ff., Bull & Sterzel a.a. p. 189 ff. and Isberg, Magnus, Lagstiftningsmakten in Svensk författningspolitik, edition 3, 2011 (ed. Mattson &Petersson), p. 220 ff.

40 Current Chapter 8, Article 2:1 of the Instrument compared with Chapter 8, Article 4, which exclusively refers to "respite for fulfilment of an obligation."

broad *delegation regulation of Chapter 8, Article 7:3*.[41] However, it is important to bear in mind the *property perspective* contained in Chapter 2, Article 18 of the Instrument[42] and in the European Convention for the Protection of Human Rights.

The question of how *the matter is to be classified* may seem theoretical, but it is of real significance for assessment of *how the Government has acted from a regulatory point of view*. A *quick recapitulation* reveals the following:

1) *Favouring public law* – the Government has its own regulatory power under Chapter 8, Article 13:2 of the Instrument, subject to certain economic reservations (i.e., some type of participation is required by the Riksdag through appropriations or consent for loans – see above, Chapter 9 of the Instrument).
1) *Onerous public law* – the Riksdag must decide pursuant to Chapter 8, Article 3 of the Instrument, but far-reaching delegation to the Government is possible under Chapter 8, Article 7:3 of the Instrument.
1) Civil law – the Riksdag must *decide alone* pursuant to Chapter 8, Article 2 of the Instrument and delegation is thereby not relevant. However, the Government can supplement the law through the implementation provisions in Chapter 8, Article 13:1 of the Instrument.

Thus, this is the *allocation of regulatory power* that the Instrument prescribes for the Riksdag and Government, and it should be kept in mind when I return to the implementation provisions below. If the content of a law – which is applicable to the Support Act – *falls partially within the Riksdag's mandatory area* and partly within its *optional area, special attention* should – as Håkan Strömberg argues – be paid to the design of an authorisation.[43] That can hardly be said to have been the case when the Support Act was written (see below concerning the content of Chapter 8, Section 4 of the Support Act) and renders an assessment of the constitutional support for the Government's actions that much more difficult.

Irrespective of the deliberations that the Government and Riksdag may have engaged in with respect to regulatory power, the following is clear: When – as in the present case – the *Riksdag has chosen on its own to regulate the matter in its entirety through the Support Act*, which it can always do by virtue of its *sovereignty as a legislative body* regardless of previously specified rules for allocation of

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[41] Now – after restructuring – instead in Chapter 8, Article 3 of the Instrument, which assumes that delegation is permitted, except in specified cases, such as taxation. With respect to the older system, see Strömberg, Håkan, Normgivningsmakten enligt 1974 års regeringsform, edition 2, 1989, p. 106 f.

[42] Currently Chapter 8, Article 15 of the Instrument but with extended protection.

[43] See Strömberg a.a. p. 121.

competence, the situation nevertheless changes. Chapter 8, Article 14 of the Instrument states: *”The power conferred on the Government to adopt provisions in a particular matter does not preclude the Riksdag from adopting provisions in the same matter in an act of law”*. If the Riksdag has thus regulated certain questions, they are withheld from the Government accordingly – as specified in Chapter 8, Article 17 of the Instrument: *”No law may be amended or abrogated other than by an act of law”* (the principle of formal legal validity).[44]

Even if the Government had been able to issue its own ordinance concerning capital adequacy requirements based on Section 8, Article 13:2 of the Instrument (assuming that the Riksdag had provided requisite funds – see Section 2 above), the existence of the Support Act precludes such a measure.

As suggested above, the Riksdag has nevertheless *authorised the Government to issue directives* “concerning support pursuant to this act” (Chapter 8, Section 4). I am presuming that the Riksdag acted correctly and that the authorisation does not concern matters of civil law that cannot be delegated to the Government (see above). With respect to the Contributions Ordinance, a determination must always be made first and foremost as to whether it is within the constitutional framework that can be shown to apply to the authorisation or that the regulation is regarded as an implementation provision (see below). Generally speaking, however – as shown above – *the Government lacks regulatory authority to reduce the content of a law passed by the Riksdag.*

3.2 Purpose and design of the Support Act

The background to the Support Act was international turbulence in the financial market in 2008 and the quest for a ”strategy for stability and confidence in the financial market” (Government Bill 2008/09:61 p. 18). Although Finansinspektionen’s stability report showed that Swedish banks were solvent and met capital adequacy requirements with room to spare, a sense of uneasiness prevailed (p. 20). The global crisis was said to have spilled over to Swedish banks and mortgage institutions that, while they did not have large holdings of the complex instruments, were affected by turbulence in the markets that normally supply them with their liquidity (p. 21). The bill proposed the following (s. 1):

> ”The bill proposes a new law that would enable the Government or an agency appointed by the Government (the support agency), *when the situation so demands, to provide various types of credit institutions with support on short notice*. Support may be provided for credit institutions domiciled in Sweden and

[44] Currently Chapter 8, Articles 8 and 18.

only for the purpose of counteracting a risk for serious disruption of the financial system in the country. The authorisation to decide on support measures is not limited to a particular amount. Support is to be provided in the manner that is most suitable, such as in the form of guarantees or capital contributions. The basic principle is that Government guarantees for the purpose of facilitating financing are to be issued to multiple institutions, whereas capital contributions are to be issued to individual institutions. The support that is provided is to be linked with conditions for the purpose of ensuring that a healthy incentive structure is maintained to preserve the accountability of the credit institution, that the central government's long-term costs for the support are minimised, that any losses will accrue first and foremost to the institution and its shareholders, and that the central government will generally receive payment or other compensation for its risk-taking." *(italics mine)*

Furthermore, a collaborative effort was under way in the EU. The ministers of finance who attended the meeting of the Economic and Financial Affairs (Ecofin) Council in October 2008 agreed to certain fundamental principles for Member States to follow in order to manage the crisis. Measures were needed to "strengthen confidence and stability in financial systems and ensure that the credit supply was maintained in order to protect the assets of depositors." A joint declaration prescribed "coordinated measures" to provide financial institutions with additional liquidity (through central bank actions) and "facilitate financing for solvent banks with liquidity problems" (p. 23 f.).

The Government's bill was quick to point out that the Swedish actors were solvent and that there was no need at that point to take support measures for the management of solvency problems at a particular bank. But the Government found a "need to facilitate the financing of credit institutions given that even the Swedish institutions have been hurt by the poorly functioning securities markets". In the event that a "very serious situation" were to arise, the Government felt it was important that measures "can be taken quickly to stabilise the financial system and restore stability and confidence" (p. 25). Finally, the objective was that the system be essentially self-supporting through the establishment of the *Stabilisation Fund* (p. 32):

"To finance costs that cannot be covered by individual guarantee fees or other payments, a stabilisation fund is to be established to which guarantee fees and the central government's share of future gains and increases in value on its capital contribution are to be deposited. In the assessment of the Government, a stabilisation fee should be introduced (see Section 6) to supply the fund with requisite assets once the state of the market so permits."

In view of the above statements in the bill, the *following sections of the Support Act* may be cited. Without anticipating my own presentation, I can nevertheless note that there appears to be congruence between the stated purposes of the Support Act and its design. *Chapter 1, Section 2* states the following about ”Introductory Provisions”:

> *”If needed to counteract a risk for serious disruption of the financial system in Sweden, central government support may be provided* to credit institutions and to businesses domiciled in Sweden that have been set up by such an institution as part of a reconstruction procedure. Such support can be provided by means of guarantees, capital contributions or in another manner.
>
> Support may not include commitments that are manifestly incompatible with sound lending practice.”

Section 3 indicates that a decision to provide support under the Support Act is to be made primarily by the Government (1) and, with reference to *Section 4*, that support is to be provided ”after an agreement concerning the support has been entered into between the central government and the recipient or its shareholders,” but with the addition in Par*agraph 2*: ”If agreements are not possible or suitable in individual cases, the Government may nevertheless decide to provide support.”

It should further be noted that in *Chapter 2* – about ”Terms of the central government support measures” – the Riksdag makes it clear in *Section 1* that support *”only “* can be provided for “ongoing activities of a credit institution that are viable” (1) or for “orderly reconstruction or liquidation of credit institutions” that are deemed to be unprofitable in the long term (2). *Paragraph 2* adds here as well: If “extraordinary reasons arise,” support is also to be provided “in cases other than those referred to in the first paragraph.” *Section 2* states that the support “is to be designed to the extent possible in a businesslike manner that prevents improper distortion of competition.”

Chapter 7, entitled *”The Stabilisation Fund and Stabilisation Fee,”* includes instructions for transferring payment under the Support Act to an interest-bearing account with the National Debt Office. Along with other assets that have been acquired pursuant to the Support Act, the assets deposited to the account constitute the *Stabilisation Fund* (Section 1). It follows from *Section 2* that credit institutions, etc., referred to in Chapter 1, Section 2 of the Support Act, i.e., those that may receive support pursuant to the above, are to pay an annual “stabilisation fee” in accordance with the reference base established by the Support Act (Sections 3-5). *Chapter 8* - the final chapter with “Concluding Provisions” – contains the *regulatory authorisation* mentioned above, i.e., *Section 4,* as follows: “The Government or an agency of its choice may issue directives

concerning support pursuant to this act.” The comments in the preparatory work are highly inadequate and cited below in their entirety (Government Bill 2008/09:61).

”The Government or an agency of its choice should be authorised to issue directives concerning support pursuant to the act.” (p. 63)

”The section authorises the Government or an agency of its choice to issue directives concerning support pursuant to the act. For example, such directives may concern the commitments that can be covered by a guarantee, the terms pursuant to Chapter 2 or interagency cooperation.” (p. 82).

It should be noted that the preparatory work repeatedly stressed that central government support pursuant to the Support Act may be provided only if needed to counteract a “risk for serious disruption” of the financial system in the country (see Government Bill. 2008/09:61, including 33, 35 and 71, as well as the Council on Legislation, which warned of a broad interpretation, p. 96) and that Chapter 1, Section 2 of the Support Act was designed accordingly. It is also worth noting that the Association of Swedish Finance Houses, which was heard as a referral body, expressed concern that finance companies would be at a disadvantage in relation to the banks, which the Government denied (p. 36): ”With respect to the views of the Association of Swedish Finance Houses, the Government does not find grounds for altering the basic requirement that there must always be a risk for serious disruption of the financial system in order for the interventionist central government support measures for which the new legislation provides scope to be used.” The Standing Committee on Finance report in response to the bill also stressed the risk for “serious disruption” and the committee recommended passage of the bill (Report 2008/09:FiU16).

Please note:

- The support activities stipulated in the Support Act are *regulated* relatively closely: The Riksdag specifies conditions and forms for payment of support, albeit – as described above – with “openings” for the Government to make broader decisions in certain respects if agreements “are not possible” (Chapter 1, Section 4, Paragraph 2) or if “extraordinary reasons” – a legal term that is assigned a highly restrictive meaning here – justify departure from the conditions of the Support Act for payment of support (Chapter 2, Section 1, Paragraph 2). In addition, Chapter 8, Section 4 contains a vague authorisation for the Government to issue ordinances (see below).
- Both the Support Act and the preparatory work are clear about the purpose, i.e., that support requires a *“risk for serious disruption” of the financial system in the country.*

3.3 *An ordinance for participation in Nordea's new issue by using the Stabilisation Fund?*

On 9 February 2009, the day before Nordea announced its plans (see above), the Government decided to issue the Contributions Ordinance, Section 1 of which reads as follows:

> "This ordinance contains provisions on capital contributions to solvent institutions provided under the Government Support to Credit Institutions Act (2008:814) *so as to strengthen the credit supply in order to prevent a risk for serious disruption of the financial system in Sweden." (italics mine)*

It should be noted at this point that the addition "so as to strengthen the credit supply" is not found in the Support Act, which specifies – as indicated above – instead that central government support may be provided to credit institutions "if needed to counteract a risk for serious disruption of the financial system in Sweden" (Chapter 1, Section 2).

The questions that I am ultimately to assess can – in view of the above – be formulated as follows:

1) Did the Support Act provide scope for the Stabilisation Fund to be used as it was despite the wording of the Support Act?
2) Can the delegation authorisation of the Support Act (Chapter 8, Section 4) have provided the Government with the latitude that the Contributions Ordinance permits?
3) Can the Contributions Ordinance be regarded as constituting implementation provisions pursuant to Chapter 8, Article 13:1 of the Instrument?

With respect to *question 1*, my assessment is that a purely linguistic interpretation of the Support Act does not provide scope for the kind of departure from the content that has occurred. Not even a very broad interpretation of the Support Act would regard the departure as anything other than the addition of a *totally new element.* Nor can any justification – as far as I have been able to ascertain – be found in the preparatory work, which stresses that *any support shall be intended to counteract systemic risks*. The inclusion of "so as to strengthen the credit supply" is hardly consistent with that emphasis. Systemic risks refer to "the risk that the financial system will be exposed to such extensive disruption that its functionality is seriously compromised." Such a risk may also be defined as the "danger that a sudden and unexpected crisis at one or more financial firms will trigger a chain reaction that has serious consequences for all or central components of the financial system." (Government Bill 2008/09:61 p. 33).

The following may be noted with respect to *questions 2-3*. Constitutional support for the Contributions Ordinance is – as discussed above – somewhat unclear. The Contributions Ordinance does not specify whether it was issued as a result of the *authorisation provided in Chapter 8, Section 4 of the Support Act,* i.e., that the Government "may issue directives concerning support pursuant to this act," or whether the Government felt that it had *any constitutional justification* (see above with regard to the Government's statutory power under Chapter 8, Article 13 of the Instrument). While the type of authorisation that the Support Act stipulates provides the Government with fairly broad scope to issue ordinances, an ordinance may not alter the content of a law such that the prerequisites for its use are changed (see Section 3 above). In my assessment, however, such is the case with the Contributions Ordinance, which to that extent lacks support in the authorisation.

Nor does the Contributions Ordinance have, in my opinion, support in Chapter 8, Article 13:1 of the Instrument, i.e., as an *implementation provision*.[45] The Instrument is referring first and foremost to regulations of a *purely administrative nature,*, i.e., those that govern *how* a particular law is to be applied. While it follows from the preparatory work for the Instrument that implementation provisions may supplement a law in a material respect, restrictiveness is imposed. No new obligations, interventions, etc. are permitted under any circumstances. The law must be sufficiently detailed such that no essential addition is required in that connection. It is not particularly unusual for agencies, including the Government, to issue directives beyond what they have been authorised for and to designate them as "implementation provisions." On a number of occasions, the Supreme Administrative Court has assessed *whether a particular directive can actually be regarded as an implementation provision or, on the contrary, a directive without requisite constitutional support.*

See *RÅ 1988 ref. 146, in which* the National Tax Board's implementation provisions – comprising rules for exemption from default fines – contained terms and limitations *beyond* that which could be regarded as covered by the section of the law to which the directive referred. As a result, such terms and limitations could not be applied (see Chapter 11, Article 14 of the Instrument concerning judicial examination of a provision). In *RÅ 1996 ref. 5,* the Supreme Administrative Court ruled that the error in an implementation provision for a tax law could be "hidden" to the lower courts and that upper court could consider the error and declare the ordinance to be "clearly unconstitutional." A requirement that the various activities be conducted at different geographic locations entailed such an extension when the requirement had not been

[45] See Warnling-Nerep et al. a.a. s. 230 f., Bull & Sterzel a.a. s. 203 f. and Strömberg a.a. s. 131 ff.

specified in the text of the law; the error in the ordinance was therefore to be regarded as "obvious" by those who applied the law, who should consequently disregard the ordinance, apply the law and grant the company the reduction it had requested (see *RÅ 1998 not. 105,*, in which the Supreme Administrative Court pointed out that the issue of terms for a reduction had already been adjudicated through this previous precedent). Cases that address similar issues are *RÅ 2002 ref. 98,*, in which the Supreme Administrative Court explained in detail why the implementation provisions – this time from the National Insurance Board – lacked support in the Riksdag's authorisation and consequently could not be accepted, and *RÅ 2005 ref. 39*, with respect to directives of the National Labour Market Board. Finally, in RÅ 2010 ref. 88, the Supreme Administrative Court found that a directive of the Prison and Probation Service could not be regarded as exceeding the purview of an implementation provision and that there had therefore been no obstacle to applying the directive.

Chapter 8 of the Instrument is based on allocation of regulatory power according to which the Riksdag is the primary regulator. This is the perspective in which rulings – which may appear to be drastic – by the Supreme Administrative Court to nullify decisions issued through unconstitutional directives must be seen.

4. Summary and final assessment

In light of that which is presented above under Section 1 to the effect that Nordea was *not* experiencing a crisis, but was rather portrayed as one of the "strongest banks in Europe," use of the Stabilisation Fund by the Government based on the hastily written Ordinance appears difficult to justify. The conditions for paying support *pursuant to the Support Act* had hardly been met in any case. Nordea was not experiencing a crisis and would – from all appearances – have been able to carry out a new share issue even if the central government had not participated. It is difficult to avoid the impression that the Government was *acting as a Nordea shareholder* when it issued the Contributions Ordinance rather than – pursuant to the Support Act – intervening to *"counteract a risk for serious disruption of the financial system"* (Chapter 1, Section 2). In view of Chapter 2, Section 2 of the Support Act, whether the support that was granted to Nordea actually met the criteria that support "is to be designed to the extent possible in a businesslike manner that prevents improper distortion of competition" may in that case be called into question.

It goes without saying that what constitutes a "risk for serious disruption of the financial system" is a matter of judgement, but it is difficult to avoid the impression that the Government chose the easiest recourse for achieving its

objectives: an ordinance that could be hastily approved by five cabinet ministers without "troubling" the Riksdag pursuant to Chapter 9 of the Instrument – with an expenditure appropriation or borrowing requirement – or pursuant to Chapter 8 of the Instrument – with a request for authorisation that would actually provide support for the Contributions Ordinance. Strengthening the credit supply – as specified in the Contributions Ordinance – is certainly an essential task, but the Government – which operates under constitutional accountability to the Riksdag – may not act on its own to achieve that objective *if* it can be shown to contravene the Riksdag's unequivocal will in the law that is being applied.

Thus, my assessment is that the Support Act *does not provide scope for the Contributions Ordinance*, particularly if the *actual use* of the Contributions Ordinance is taken into consideration. The Government's bill (2008/09:61) was prepared in autumn 2008 for the explicit purpose of satisfying the central government's need to provide various types of support to counteract the risk that credit institutions would experience acute problems, which would constitute a risk for *serious disruption of the financial system in the country*. Concern arose, however, in early 2009 that the banks would cut back on lending for the purpose of strengthening their capital cover, which may be one explanation for including the criterion of *strengthening the credit supply* as a reason for the central government to support credit institutions, which went beyond the Government's mandate in my opinion (whatever attempt is made to justify the Contributions Ordinance from a constitutional point of view). It may be noted, however, that Bill 2008/09:61 (p. 71) used the expression "*secure* the credit supply" in reference to the 1993 law (1993:765). In my assessment, though, the word "strengthening" is not the same as "securing" the credit supply.

Moreover, the Contributions Ordinance was used solely to support Nordea, i.e., a bank in which the central government had large holdings, even though – from a purely materialistic point of view – the risk of a negative impact on the credit supply seems to have been considerably greater for both Swedbank and SEB (which were reportedly in a more vulnerable position – due to large loan losses in the Baltic countries – than Nordea was). It would appear that the central government – through the Government – simply wanted to participate in the new share issue but at the same time presumably wanted to avoid financing the capital contribution through the central government budget, which would have entailed complications with respect to Chapter 9 of the Instrument insofar as the Riksdag would have needed to grant some form of consent (which is time-consuming under all circumstances).

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The Stabilisation Fund is a new tool with which the central government can finance and manage the costs associated with future financial crises. By paying fees to the Fund, the financial sector – rather than taxpayers – is to assume responsibility for any support measures that such crises may require. The Swedish National Audit Office (NAO) examined whether the Fund was designed in an effective manner and whether its use in connection with Nordea's new share issue in February 2009 was consistent with the Riksdag's intentions.

The NAO found that the Fund, as it is currently structured, would have to issue new government bonds to finance any support measures that it provides. Whether such an investment policy is the most cost-effective long-term approach to managing a financial crisis remains unclear. The audit also shows that the Fund does not reduce central government debt, given that the central government's financial position is governed by the surplus target.

The NAO recommends that the planned size of the Fund be linked to a parameter that more accurately reflects ongoing risk factors in the financial system. Considering that the financial sector is to be responsible for the majority of the direct costs associated with the support measures it receives, the Government should explore whether the Fund can be debited in arrears for the value of its subscription rights to Nordea's new share issue.

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