

Svante Öberg: My views on the Riksbank and financial stability

Speech by Mr Svante Öberg, First Deputy Governor of the Sveriges Riksbank, at a meeting with the Swedish Bankers' Association, Stockholm, 7 June 2011.

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My term of office as Deputy Governor of the Riksbank is drawing to a close and I have announced that I will not be available for a new period of office. After almost six years on the Executive Board of the Riksbank, it feels natural for me to now reflect on the experiences we have had and what these may mean for the future. Earlier in the spring, I presented my view of the Riksbank and monetary policy. And now it is the turn of our other important main task, namely financial stability.

In particular, there are three issues I would like to argue for:

- The Riksbank and Finansinspektionen (the Swedish Financial Supervisory Authority) should be merged
- The Governor's role should be strengthened
- The Riksbank should have a sufficient foreign currency reserve.

I will begin my speech by looking back on the years prior to the most recent financial crisis, the risks we saw – and the ones we didn't see. I will continue by describing the financial crisis and the measures we adopted during the crisis. I will then address the future and the work that is underway as regards reforming the framework of the financial sector. Finally, I will take up the three issues I have just mentioned and explain the reasons for my views on these issues. For the sake of clarity, let me also add that the opinions I will be expressing in this speech are my own. They are not necessarily shared by my colleagues in the Executive Board of the Riksbank.

The years prior to the financial crisis

When I first arrived at the Riksbank, I did not suspect that we were about to experience one of the worst international financial crises of our times. I had been through two previous crises. The first of these was the deep recession at the end of the 1970s and start of the 1980s, when, through a series of devaluations, Sweden attempted to restore the competitiveness it had lost due to the severe price and wage inflation of the 1970s. The second was the crisis we experienced at the start of the 1990s. This was a fairly typical financial crisis, starting with the deregulation of the credit market and leading to a banking crisis, a deep recession and large public finance deficits.

The Riksbank had built up its analytical capacity

Its experiences in the Swedish banking crisis at the start of the 1990s had led the Riksbank to build up its analytical capacity before my time at the bank started. In 1997, the Riksbank started to publish a Financial Stability Report twice per year. This describes our assessment of the stability of the financial system, as well as various risks and threats to this stability. From an international perspective, the Riksbank's work on stability analysis has been at the cutting edge.¹ We were the first central bank in the world to publish a stability report, and we

¹ See, for example, Allen et al. (2004), who have carried out an independent assessment of the Riksbank's stability work.

were also among the first to carry out stress tests describing the banks' resilience to various types of shock.²

Assessing the banks' credit risk, which is to say the risk that the banks would not recover the money they had lent, was an important part of this analysis work. It was just this kind of risk that had led to such large losses for the banks in the banking crisis at the start of the 1990s. Consequently, the risks we emphasised in the stability reports were primarily associated with credit risk.

We warned of the risks but missed the one that would give us problems

In the years leading up to the financial crisis, we made overall assessments along the lines of "financial stability in Sweden is satisfactory" (Financial Stability Report, June 2008). The four Swedish major banks (Handelsbanken, Nordea, SEB and Swedbank) were profitable and had enough capital to withstand possible shocks. However, we also pointed out risks, sharpening our tone when the risks became more apparent, just before the crisis.

One risk we emphasised at that point was that of overheating in the Baltic countries. Two of the Swedish banks had large and growing operations in these countries, meaning that a sudden slowdown in the economies of these countries could have led to significant loan losses for the Swedish banks. In particular, we analysed the banks' resilience towards a sudden economic downturn in the Baltic countries. The stress tests we conducted indicated that the banks had enough capital to cope with such a development.

Another risk we emphasised before the crisis was the rapid rates of increase in household indebtedness and in housing prices. One repeated statement was that we did not regard this as being an urgent problem, but that the development was not sustainable in the longer term. At this point, we could observe that housing prices and household indebtedness had increased by about 150 per cent over a ten-year period. At the same time, households' disposable incomes had only increased by about 50 per cent. There may indeed be reasons for household debt to increase significantly faster than income for a period, but, over the longer term, this is not sustainable.

A third risk we emphasised was that the price of risk was very low in a historical perspective. The low risk premiums could indicate that the investors had not received sufficient compensation for the risk they undertook in the purchase of various types of assets. Sudden price adjustments could result in many investors simultaneously wishing to rebalance their portfolios, for example by divesting higher-risk assets in favour of lower-risk ones. In turn, this could create additional turbulence.

On the other hand, one risk that we did not foresee was the funding problems that the banks would face during the crisis. We had certainly emphasised that the Swedish banks' unusually large dependence on market funding was making the banking system vulnerable. But it came as a surprise to find that the financial markets would be affected to such an extent that the banks would have to borrow extensively from the Riksbank to manage their funding needs.

The financial crisis

The financial crisis hit Europe with full force in September 2008, when the US investment bank Lehman Brothers filed for bankruptcy. The background to the crisis is well-known, so I

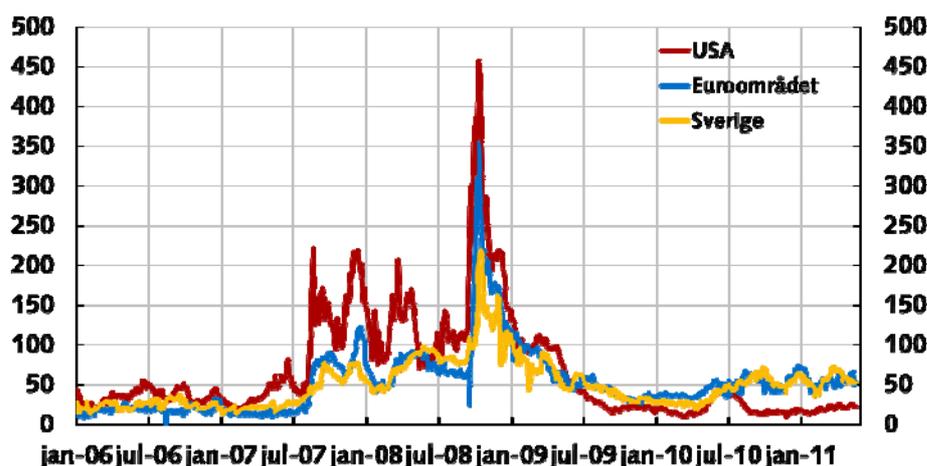
² The Riksbank has carried out stress tests since the start of the last decade. In 2006, we published for the first time stress tests in which we tested credit risk among the Swedish banks and reported the results by bank. As far as I know, at that time, we were alone among the world's central banks in openly reporting the results of stress tests by bank. The United States carried out stress tests of this kind in 2009, when the crisis was already a fact, and the European Union followed suit in 2010.

will not go into it here. The collapse of Lehman Brothers led to the financial markets ceasing to function normally. Certain markets did not function at all. The banks became unwilling to lend to one another, which, among other effects, manifested itself in the steep increase of the interest rates that the banks had to pay when they borrowed from one another. (Figure 1)

Figure 1

Ted spread

Difference between interbank rate and treasury bill,
3 month maturity, basis points

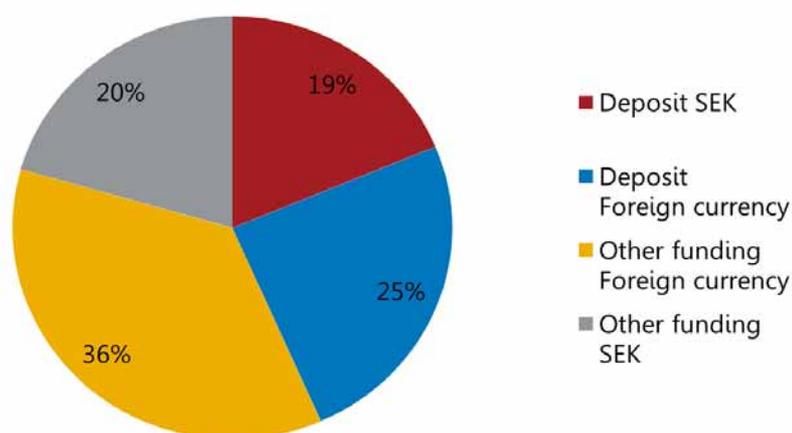


Sources: Ecowin and Bloomberg.

The Swedish banks were quickly drawn into the crisis in the autumn of 2008. They certainly did not have any great exposures towards the markets and institutions that were worst impacted. But they were still affected by the global shortage of confidence. The Swedish financial markets also functioned much less efficiently than normal. Two factors exacerbated the problems for the Swedish banks: the large degree of market funding and the high exposure towards the Baltic countries.

More than half of the banks' funding consists of borrowing on the financial markets and less than half consists of deposits from the public. Furthermore, a substantial share of the banks' funding is placed in foreign currency. In conjunction with the crisis, a shortage of dollars arose around the world and, when this shortage became acute, the Swedish banks were also affected. They then faced problems in obtaining funding, particularly with longer times to maturity. These problems rapidly became serious. (Figure 2)

Figure 2
The banks' funding December 2010
 Per cent



Source: The four major banks' reports and the Riksbank.

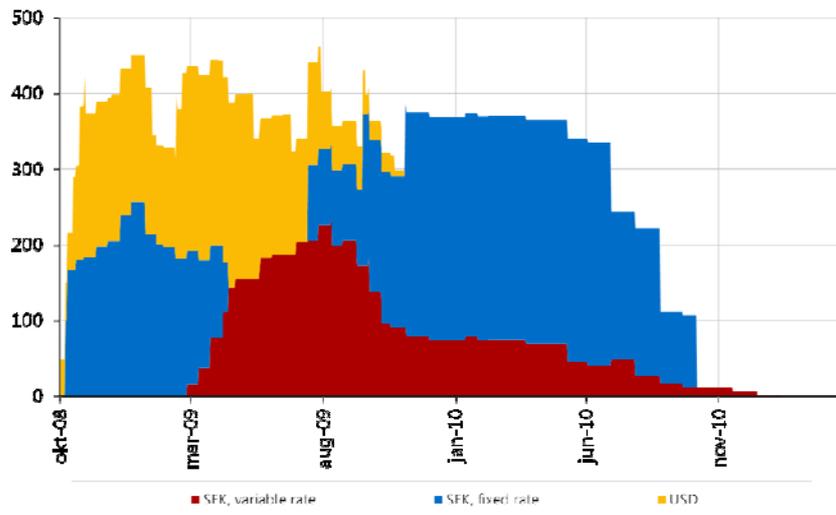
At the same time, the Swedish banks' exposures towards the Baltic countries became increasingly onerous. The global financial crisis became the factor to trigger an economic crisis in the Baltic countries. Investors saw the Baltic as a high-risk region where the devaluation of the currencies was also expected. Knowledge of these risks made international investors increasingly unwilling to lend money to Swedish banks. Even the Swedish banks that did not have any lending activities in the Baltic were affected by this, to a certain extent.

The Riksbank's measures dampened the negative effects

When the crisis had finally struck with full power, we acted rapidly and forcefully. Over three months, the Riksbank lent an amount corresponding to about SEK 500 billion to the banks. This meant that the Riksbank's balance sheet increased from about SEK 200 billion to about SEK 700 billion. We acted in our role as lender of last resort.³ All lending took place against collateral. So as to avoid restricting the banks' opportunities to borrow, we eased the regulations for collateral slightly. Among other changes, we accepted more types of security than previously. However, these new types of collateral were also of very high quality. To make it possible for several institutions to use certain of the Riksbank's lending facilities, we also decided to increase the number of counterparties. (Figure 3)

³ The term "lender of last resort" refers to the central bank's ability to inject money into the financial system.

Figure 3
The Riksbank's lending
 SEK, billions



Source: The Riksbank.

We also provided special liquidity assistance to two smaller banks. When the Icelandic bank Kaupthing was impacted by the problems in Iceland, the Riksbank provided its Swedish subsidiary with liquidity assistance. Carnegie Investment Bank also received liquidity assistance when it encountered problems with its funding shortly thereafter. It was against this background of unease on the financial markets and the insufficient legislation we had at that point for managing banks in distress that the Riksbank made the assessment that defaults by any of the banks could give rise to serious problems for the financial system. Under other circumstances, this assessment would probably have been different.

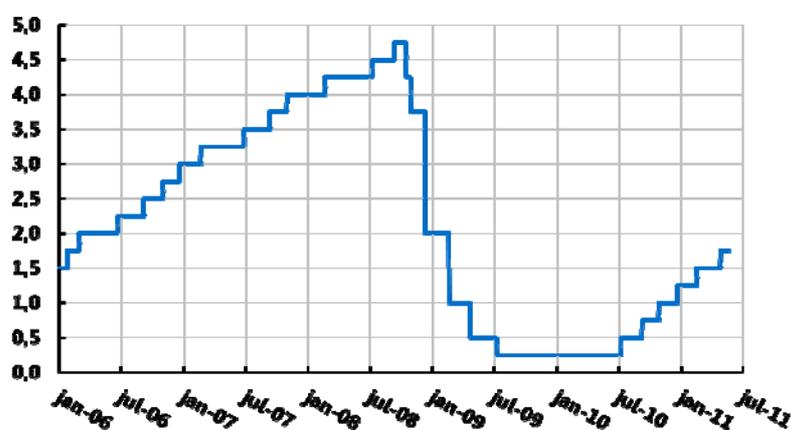
The Riksbank was also very active in the international cooperation to strengthen financial stability in our neighbouring countries. Together with the central banks of Denmark and Norway, we entered into a swap agreement with Iceland's central bank and, together with Denmark's central bank, we entered a swap agreement with Latvia's central bank while awaiting support from the International Monetary Fund (IMF). The Riksbank also entered into a swap agreement with Estonia's central bank. In addition, the Riksbank contributed towards strengthening the IMF's lending capacity. Sweden's commitments to the IMF increased heavily during the crisis and now amount to a maximum of over SEK 100 billion. In addition, the Riksbank entered into swap agreements with the central banks of the United States and the euro area to increase our access to dollars and euros. I will return to this later.

In parallel with our liquidity assistance measures, we quickly reorganised our monetary policy. The repo rate was lowered from 4.75 per cent in September 2008 to 0.25 per cent by July 2009. Furthermore, our assessment in July 2009 was that the repo rate would need to be kept at this low level for slightly more than one year. To emphasise this and also to hold down the longer interest rates charged to households and companies, on three occasions the Riksbank offered one-year loans of up to SEK 100 billion at interest rates of 0.25 per cent. All in all, the Riksbank earned SEK 2.3 billion on the measures adopted during the crisis due to the interest rate differential between deposits and loans. Our primary intention was not to earn money through our measures, but, at the same time, it was important not to subsidise the banking system with public funds. (Figure 4)

Figure 4

The repo rate

Percentage points



Source: The Riksbank.

Other authorities also acted to safeguard stability

The Riksbank was not alone in adopting measures to safeguard the stability of the Swedish financial markets. Other Swedish authorities also intervened to counter the effects of the financial crisis. The Swedish National Debt Office issued treasury bills to meet the demand that had arisen for liquid assets. Finansinspektionen amended the regulations for financial companies (to make it easier for them to strengthen their capital bases) and for insurance companies (to reduce shocks to the bond markets). The government and the Riksdag decided to extend the deposit guarantee scheme and to introduce a comprehensive stability plan. Important elements in the stability plan were a guarantee programme for the funding of banks and mortgage institutions, a stability fund, and principles for the management of capital contributions to credit institutions. The Swedish National Debt Office was given a central role in this work as responsible authority for the new guarantee system, the stability fund, and any capital contributions.

The extraordinary measures were phased out

The Swedish economy made a strong recovery in 2010 and the banks no longer needed to borrow from the Riksbank to manage their funding needs. The Riksbank thus phased out its comprehensive lending to the banks during the summer and autumn of 2010. This phasing out was comparatively simple because, unlike many other central banks, we had not purchased any securities. When the loans expired, the banks repaid their loans, with the whole process taking place comparatively smoothly. The repo rate started to be raised in July 2010. It has now been raised at six monetary policy meetings in a row, to its current level of 1.75 per cent, and we expect that it will continue to be successively raised to a more normal level.

Two conclusions

Now, after the financial crisis, I think we can draw two conclusions on our actions in conjunction with the crisis.

Firstly, we did not see the crisis coming. As I mentioned previously, we wrote and talked about the Swedish banks' increasing risk-taking in the Baltic, the rapid rates of increase in

household indebtedness and in housing prices, and the low price of risk. We also wrote about the problems on the US mortgage market. But the crisis hit us from an unexpected direction. We hadn't expected that the banks would face such comprehensive problems in obtaining funding on the markets.

Secondly, the Riksbank reacted quickly and forcefully once the crisis hit Sweden. The comprehensive lending to the banks, combined with the rapid and forceful lowering of the repo rate, contributed to mitigating the impact of the crisis on the Swedish economy. One fortunate circumstance was that lending to the banks is what a central bank is always assumed to be able to do in its role as lender of last resort. The measures we needed to undertake were thus within the framework of our remit. What was unusual this time was that the Riksbank also needed to provide the banks with funding in dollars and to provide other central banks with euros. I will return to this later.

The future

The financial crisis led to a global realisation of the need to reform the regulations governing the financial sector. I will now give an overall description of some of the work currently underway to reform these regulations. I will start with the international work, continue with the Swedish regulations and then address our internal work at the Riksbank.

Wide-ranging international work on the prevention of new financial crises

At present, comprehensive international work is underway to adjust the framework of the financial sector. The aim is to strengthen resilience towards similar financial crises in the future. This work is being carried out by several different international bodies, for example the G20,⁴ the IMF, the FSB,⁵ the Basel Committee and the European Union. The first three of these are primarily focused on negotiation and agreements dealing with the direction of work, while the latter two are focused on the formulation of regulations and decisions concerning these. The Basel Committee has agreed to tighten the regulations for banks. The banks will be required to maintain more and better capital than under previous regulations. One important element of the new regulations is that the banks ought to build up capital in good times that they can use to deal with losses in bad times. The banks will also be forced to improve their liquidity through longer and more stable borrowing.

The European Union has established a new authority, the European Systemic Risk Board (ESRB) and three new supervisory authorities, the European Banking Authority (EBA), the European Insurance and Occupational Pensions authority (EIOPA) and the European Securities and Markets Authority (ESMA). The ESRB has the task of preventing crises in the financial system. Its work aims to identify risks to the stability of the financial system and, when necessary, to issue warnings or recommendations.⁶ One important element in the

⁴ The G20 (eng. Group of Twenty) is a group of nineteen major economies and the Europeiska unionen. Sverige is not included in the G20, but participates indirectly in the group's work through its membership of the EU.

⁵ Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system. FSB was established in 2009 and replaced the Financial Stability Forum. The board includes all countries in the G20, including the EU, and Hong Kong, Netherlands, Singapore, Spain, Switzerland and a number of international organizations and groups.

⁶ The General Board of the ESRB consists of the central bank governors and the heads of the supervisory authorities in the European Union. The Riksbank participates actively in the ESRB's work. The Governor of the Riksbank, Stefan Ingves, has been appointed chairman in one of the two advisory bodies in the ESRB, the Advisory Technical Committee. This means that he is also included in the Steering Committee that prepares the General Board's meetings and monitors the ESRB's current work, and in the Advisory Scientific Committee, which is the other advisory body.

continued financial stability work is formed by stress tests of the banks. During the financial crisis, both the US and European authorities implemented and reported such stress tests. Their aims were to increase transparency concerning the banks' risks, to increase confidence in the sector, and to push the banks into increasing their capital bases. The next European stress test will be reported this June.

The Swedish regulations for the financial sector need to be strengthened

The Swedish regulations for the financial sector also need to be strengthened. Consequently, the Executive Board and General Council of the Riksbank have, in a communication to the Riksdag, urged the Riksdag to assign the government to carry out a thorough review of the regulations.⁷ The starting point for this is that we need a cohesive and effective regulatory framework that allows us to better prevent and manage crises in the future.

Firstly, the mandates and roles of the authorities involved are unclear. As the regulations are currently written, responsibility for financial stability is shared by the government, Finansinspektionen, the Riksbank and the Swedish National Debt Office. But it is not specified sufficiently clearly who is to do what or how the exchange of information and knowledge is to take place. Not least, the Riksbank's responsibility for financial stability should be clarified.

Secondly, we lack tools to prevent crises, a weakness that is partially connected with the unclear allocation of roles. Although Finansinspektionen has the task of promoting stability and efficiency in the financial system and has tools that can be used to influence the banks' behaviour, it does not have the explicit task of counteracting macroeconomic risks. At the Riksbank, we have interpreted the present laws relatively broadly to mean that we are to safeguard the stability of the financial system, while, at the same time, we lack effective tools to do this.

Thirdly, we need a new regulatory framework specifying how the central government is to handle banks in crisis. Today, banks that cannot pay their debts are declared bankrupt – just like any other company in the same situation. This is often a lengthy process and bank customers may have to wait several years to get their money back. Furthermore, it is not enough for each country to have its own solution. Banks are increasingly working across national borders.

The government and Riksdag must also decide whether Sweden should have the same regulations for the financial sector as other countries. Financial crises can lead to very high economic costs and there are a number of risks that are specific to Swedish financial stability, not the least of these being the Swedish banks' great dependence on obtaining funding on the international capital markets. At the same time, we know that the implementation phase of the new banking regulations will be lengthy. Consequently, there is reason for Sweden both to proceed more rapidly than planned and to introduce stricter regulations than required by Basel III.

The Riksbank's work with financial stability

Perhaps the most important lesson of the financial crisis is that we must take a broader approach to understanding and analysing systemic risks. Even if, before the crisis, we and other central banks pointed out individual factors as possible threats to financial stability, nobody really succeeded in predicting the situation that then arose. The traditional approach of analysing institutions, markets and infrastructure separately was not sufficient. During the

⁷ See the Riksbank's report to the Riksdag 2009/10 RB:4 "Report on certain areas that require investigation as a result of the financial crisis", www.riksbank.se. See also *Economic commentaries* no. 1, 2010, www.riksbank.se.

crisis, problems in individual institutions and markets rapidly spread and had far-reaching consequences for completely different markets in other parts of the world.

The financial crisis also revealed the strong link between the Riksbank's two main assignments – monetary policy and financial stability. Without stability in the financial system, it is difficult to conduct monetary policy, at the same time as price stability promotes financial stability. Normally, we use different types of measure for each of these two tasks. However, during the crisis, we needed to use both types of measure. The crisis also showed how important it is that the two departments handling financial stability and monetary policy work closely together. The prevention and management of systemic risks requires both macroeconomic competence and knowledge of the financial system.

Stress tests will continue to form a central part of our work. In the autumn of 2010, we carried out tests of the Swedish banks' liquidity for the first time. These showed that the Swedish banks were exposed to greater liquidity risks than the European banks against which we compared them. The greatest problem for the Swedish banks during the financial crisis was not loan losses, of course, but a shortage of liquidity. The crisis has also shown that the Riksbank's fundamental task as lender of last resort can no longer be limited to lending in kronor. Consequently, stress tests of liquidity need to be developed so that they also show what may happen if the banks are unable to obtain funding in foreign currency.

We also need to think through how the Riksbank could achieve greater impact for its analyses and assessments. So far, we have primarily relied on what we usually call moral suasion, which is to say making an impact through careful analyses and strong arguments. But, despite the risks concerning developments in the Baltic that we drew attention to before the crisis, too little was done to prevent the Swedish banks' rapid credit expansion in these countries. Last autumn, we took a step in the direction of becoming clearer in our communication by making direct recommendations in the Financial Stability Report to participants in the financial system. It remains to be seen whether this will lead to better results.

Three possible changes

After my nearly six years at the Riksbank, I think that there is reason for Sweden to think through three changes that may increase the possibilities of preventing and managing financial crises. Ahead of the investigations and deliberations regarding amendments to the Swedish regulations that have just started, I shall here present my opinions on these three points. At the same time, I would like to repeat that these are just my personal opinions and are not necessarily shared by my colleagues on the Executive Board. These three points are the ones I mentioned in my introduction:

- The Riksbank and Finansinspektionen should be merged
- The Governor's role should be strengthened
- The Riksbank should have a sufficient foreign currency reserve.

The Riksbank and Finansinspektionen should be merged

One of the issues we highlighted in our communication to the Riksdag was the allocation of roles between the bodies sharing responsibility for financial stability: the government,

Finansinspektionen, the Riksbank and the Swedish National Debt Office. Personally, I think there is good reason to merge the Riksbank and Finansinspektionen.⁸

Firstly, a merger of the Riksbank and Finansinspektionen would give us an authority capable of acting more forcefully to safeguard the stability of the financial system. Under the present system, the Riksbank can only issue recommendations, while Finansinspektionen can issue regulations and general guidelines. Through a merger, the recommendations that the Riksbank issues in its Financial Stability Reports, which have no binding effect, could instead be formulated as binding regulations.⁹

Secondly, and more importantly, there must be cyclical tools in the new regulations taking form, such as capital requirements varying over time. Both these and interest rate decisions influence the expansion of credit and thus growth and inflation. If these new tools are to be handled by Finansinspektionen, this would give us, in practice, two central banks, one subject to the government and the other independent of political bodies. A merger would allow us to avoid having two central banks which, under unfortunate circumstances, could be pulled in different directions.

Thirdly, there is the matter of macroeconomic expertise. As I mentioned earlier, both macroeconomic expertise and knowledge of the financial system are needed to manage systemic risks. Supervisory authorities are traditionally focused on monitoring individual institutions and do not normally have the former type of expertise to any great extent. It may also be difficult for a supervisory authority to build up and maintain a level of macroeconomic expertise sufficient to make a difference in financial crises that only occur every ten or twenty years. But such expertise always has to exist at the Riksbank.

Fourthly, there is the matter of resources. For many years, Finansinspektionen has had too few resources to carry out its tasks. This has been pointed out by the IMF most recently. A merger would probably mean that more resources would be allocated for Finansinspektionen's tasks. Merging the authorities would also allow us to avoid duplicating work and to achieve synergies such as a joint macroeconomic analysis and shared support functions and databases. It should also be noted that increased resources for this activity would not have to burden the taxpayers, as the financial sector would fund the activity via charges.

The role played by the state in financial stability is currently being strengthened in several areas of the world. In the United States, which frequently has a large number of authorities acting within one area, a council with overall responsibility for financial stability has been set up. In the United Kingdom, responsibility has been assumed by the Bank of England. The new EU authority, the ESRB, has been moved to the ECB. It has its own board and its own secretariat, but it will also have the ECB's resources at its disposal. In the next section, I will return to the possible structure of the managerial organisation of such a merged authority.

Naturally, there would also be objections to merging the Riksbank and Finansinspektionen. One of these is that a great deal of power would be gathered in the Riksbank. However, this should be weighed against the fact that Sweden would be gaining a powerful actor able to safeguard financial stability. Another objection is that the Riksbank's reputation may be marred by criticism of decisions in individual cases. I think that this could be avoided if these decisions are taken by a separate board of committee. No doubt there are also a great number of other issues that would need to be solved in a possible merger, for example the

⁸ In its most recent report, the Swedish Fiscal Policy Council proposed two alternative methods to strengthen macrofinancial supervision. The first of these is based on greater responsibility for the Riksbank, the second on a new authority, a financial stability council, or a committee for systemic risks.

⁹ In the most recent Financial Stability Report, we recommended the Swedish banks to retain or increase their capital ratios, to reduce their financing and liquidity risks, and to improve their public liquidity reporting.

possibility of appealing against decisions in certain cases. I think that, in an unbiased investigation, the advantages of a merger would be shown to outweigh the disadvantages.

The Governor's role should be strengthened

The Riksbank is governed by an Executive Board of six persons, with the Governor as chairman. This is an unusual form of management in Swedish public administration.¹⁰ It is mostly justified in terms of monetary policy. But it is not an appropriate way of leading an authority. Quite simply, I believe that the managerial structure has been the product of faulty logic, right from the start. With the benefit of my years at the Riksbank, I think that the role of Governor, as head of the Riksbank, should be strengthened to correspond with the role played by a normal agency head. Of course, there is a degree of variation among the managerial structures of the public authorities, but this is not an issue I intend to address today.

Today, there is broad agreement that central banks should be independent of political bodies when it comes to monetary policy. Somewhat simplified, this is because it is more popular to lower the interest rate than to raise it, and there thus exists a risk that, over time, the interest rate will become too low and inflation too high if the government takes responsibility for monetary policy.

Furthermore, there is support in economic research for the argument that, in the long run, monetary policy decisions taken by several people are better than those taken by one person. It is also common in central banking for monetary policy to be determined by a monetary policy committee. My experience is also that the arrangement with six people taking decisions works well for monetary policy. There are effective routines for producing bases for monetary policy decisions and the reasons behind the different members' positions are clearly given in the minutes from the monetary policy meetings.

For these reasons, monetary policy decisions should continue to be taken by a monetary policy committee at the Riksbank which is independent of political bodies. For the same reasons, decisions on the application of the new tools for safeguarding macroeconomic stability should also be taken by this monetary policy committee. It is as yet unclear what these will be. They may include capital requirements, liquidity requirements, risk weightings, loans ceilings etc. that vary over time.

But this arrangement doesn't work well in other areas. When six people, all of whom have the individual responsibility of leading the Riksbank, are to decide on issues where opinions are divided, the preparatory processes can easily become prolonged. It can also lead to a complete inability to act. If one or more members strongly oppose a decision, this can lead to the issue not being taken up for decision at all.

Being six people can be particularly problematic when it comes to financial security. In these issues, we have striven to agree. Frequently, of course, we have had to take decisions to strengthen financial stability in a reality marked by a financial crisis. In such cases, it would not have been appropriate to show disunity over the best course of action. Reservations regarding such decisions could have the opposite effect to that desired. Instead of strengthening financial stability, we could weaken it. Despite this, our concrete measures functioned well during the financial crisis.

At the Riksbank, we have, in practice, successively moved away from the principle of all six members of the Executive Board needing to be involved in and decide on all issues. Just

¹⁰ I know of only two other authorities with several heads: the Swedish National Audit Office has three heads, of whom one is an administrative head, and the Parliamentary Ombudsmen have four heads, of whom one is an administrative head. Like the Riksbank, both of these authorities are under the Riksdag, which does not have any extensive experience of appointing and leading authorities.

over ten years ago, the five Deputy Governors were responsible for preparing matters within one or more departments. This was changed even before I came to the Riksbank, six years ago, when they were given preparatory responsibility for certain specific areas. Eventually a management group was formed. This consists of the Heads of Department, with the Head of the General Secretariat as chairman. It took over responsibility for certain strategic issues and responsibility for coordinating many of the daily operational issues which, previously, had largely fallen to the Executive Board to handle. Decision-making responsibility for daily operational issues has been delegated to the Heads of Department.

However, two members of the Executive Board remained responsible for tabling proposals for decision in issues of monetary policy and financial stability. This was also changed later, so that these two were no longer responsible for tabling proposals for decision, but only acted as spokespersons. When Irma Rosenberg left, the role of spokesperson for monetary policy disappeared, and when Lars Nyberg leaves at the end of this year, the role of spokesperson for financial stability will also probably disappear.

The Executive Board has also decided to assign the Governor to assume managerial responsibility for the Heads of Department and to monitor the Riksbank's activities within the scope of the fixed budget and operational plan. However, this will not solve the problem of the Governor not being head of the Riksbank in the same way as a Director General is head of an authority.

The Riksdag Committee on Finance has stated its intention to review the Sveriges Riksbank Act once other issues it has been assigned by the government to investigate have been cleared up. My suggestion is that the role of the Governor of the Riksbank also be reviewed and strengthened at the same time. There are many ways in which this could be done, and different countries have taken different approaches.

One possibility that I think might work well would be to have a Governor who is head of the authority and two Deputy Governors who, under the Governor, each take responsibility for their part of operations. This is how it was before the Executive Board was established. Furthermore, as I have already remarked, there should be a monetary policy committee, with or without external members, that takes monetary policy decisions. In addition, if the Riksbank and Finansinspektionen are merged, there should also be a similar committee or board to take decisions of the type currently taken by Finansinspektionen, with the exception of decisions dealing with macrofinancial stability, which should be taken by the monetary policy committee.¹¹

This would give us an arrangement similar to the model presently being launched by the Bank of England.¹² Finland also has a similar model, with the financial supervisory authority as a part of the Bank of Finland, but with its own board and head.

The Riksbank should have a sufficient foreign currency reserve

One issue that we in the Executive Board have not agreed upon is the issue of the size of the foreign currency reserve. Previously, under the present foreign exchange policy with a floating exchange rate, the foreign currency reserve has primarily been intended to support

¹¹ In addition, there should be a financial stability council for inter-agency cooperation and the exchange of information. As an alternative for strengthening macrofinancial stability, the Swedish Fiscal Policy Council has proposed such a council, and, in its recently concluded mission to Sweden, the IMF advocated a committee of this kind.

¹² The new committee for financial stability at the Bank of England will take responsibility for decisions on macrostability, but not traditional supervisory issues, which will also be moved to the Bank of England. The new committee partly consists of the same people as the monetary policy committee.

the krona's exchange rate if necessary. However, it has not been used for this purpose since 2001, and, when it was used, the results were unfavourable.

The financial crisis made abundantly clear that the foreign currency reserve was also needed to provide the banks with liquidity in foreign currency in the event of a crisis. This is a matter of the central bank's fundamental function as lender of last resort. As I mentioned earlier, it can no longer be seen as only concerning liquidity in kronor. Of the four major banks' lending to the public of about SEK 7 000 billion, about SEK 2 500 billion was funded with securities issued in foreign currencies, of which about half had times to maturity of less than one year.

The Riksbank's gold and foreign currency reserve was not enough to meet the need for dollars that arose during the crisis. This amounted to about SEK 200 billion and was invested in various currencies and different types of asset. During the autumn of 2008, our lending in dollars peaked at about SEK 250 billion. In addition, we increased our international commitments to the IMF and concluded swap agreements with the central banks of Iceland, Latvia and Estonia so as to be able to give them loans in foreign currency if necessary. The Swedish banks also borrowed significant amounts in foreign currency from other central banks and made great use of the government borrowing guarantee.

To manage the situation, we were forced to rapidly establish a swap agreement with the US central bank (the Fed), which gave us the possibility of borrowing USD 30 billion. The Fed concluded similar agreements with several other central banks as it had an interest in ensuring that the European banking system did not collapse as a result of a shortage of dollars. We also concluded a swap agreement with the ECB, which gave us the possibility of borrowing EUR 10 billion.¹³ In addition, we also ensured that it would be possible to borrow from the Bank for International Settlements (BIS). The agreement with the Fed has now expired and it is not likely that we would be able to conclude a similar agreement in the event of a new crisis, among other reasons because the Fed has received criticism at home for its support to the European banking system.

The question of a suitable size for the foreign currency reserve led to some long discussions among the Executive Board. It was not easy to calculate how large the foreign currency reserve should be, and different Executive Board members had differing views on the matter. Finally, in the spring of 2009, we agreed to ask the Swedish National Debt Office to temporarily borrow a further SEK 100 billion in foreign currency, thereby reinforcing the foreign currency reserve to about SEK 300 billion. Including the agreements with the Fed and the ECB, the foreign currency reserve thus amounted to about SEK 600 billion in the autumn of 2009. Now it has decreased to about SEK 300 billion again and, according to an earlier decision, part of this is temporary.¹⁴

I was one of those who considered that the Riksbank's own foreign currency reserve should be greater than SEK 300 billion, and this is an opinion that I still hold. My reason is that the Swedish banking system is still highly dependent on market funding in foreign currency. If the fiscal problems in Greece lead to the writing off of the Greek national debt, this may lead to renewed difficulties for the Swedish banks in obtaining funding in foreign currency.

One alternative to retaining a good-sized currency reserve in the Riksbank would be for the banks to reduce their dependence on market funding in foreign currency. As I mentioned earlier, greater demands will be made on the banks' liquidity through the Basel regulations. But they say nothing about requirements for preparedness regarding liquidity in foreign currency, something which is particularly important for us in Sweden. Imposing charges on

¹³ The agreement with the ECB is conditional to approval from the ECB in every single case. It was used to borrow a smaller sum in conjunction with the Riksbank's swap agreement with Latvia.

¹⁴ In its recently concluded mission, the IMF concluded that the foreign currency reserve is sufficient to meet risks, but this assessment should be reviewed on an ongoing basis with reference to developments in the euro area.

the banks' market funding in foreign currency could possibly get the banks to reduce this, thereby reducing the need for a large foreign currency reserve and thus fund the costs to society of the foreign currency reserve.¹⁵ However, such charges do not exist at present and the effects of any charges are not clear.

Conclusion

About a week ago, we published our first Financial Stability Report for the year. In this, we report that the Swedish banks' resilience towards shocks has continued to improve over the last six months. However, in large parts of the world, the recovery from the financial crisis has proceeded slowly and the financial markets are still marked by great uncertainty. This uncertainty is primarily linked to the fiscal problems in Europe.

The issues I have addressed today are not issues that have much to do with the current situation. Instead, they are a few opinions on how the regulations for the financial sector should be changed to reduce the risk of new financial crises and to reduce the negative consequences for Sweden if such crises should again arise internationally. In particular, I have addressed ways in which the Riksbank could play a stronger role in this connection.

Thank you!

¹⁵ My colleague Lars Nyberg has proposed that charges be introduced.