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SWEDEN

FINANCIAL SECTOR ASSESSMENT PROGRAM

October 2017

TECHNICAL NOTE—BANKING REGULATION AND SUPERVISION

This Technical Note on Banking Regulation and Supervision for Sweden was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in November 2016.

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BANKING REGULATION AND SUPERVISION

Prepared by
Monetary and Capital Markets Department

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program in Sweden in April 2016 led by Martin Čihák.
It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at
http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

AC	Additional Criterion
AML	Anti-Money Laundering
APRA	Australian Prudential and Regulatory Authority
AQR	Asset Quality Review
BFBA	The Banking and Financing Business Act (SFS2004 :297)
BRRD	Bank Recovery and Resolution Directive
CALE	Capital Adequacy and Large Exposures Act
CAR	Capital Adequacy Ratio
CDD	Customer Due Diligence
CP	Core Principle
CRD	Capital Requirement Directive
CRR	Capital Requirement Regulation
D-SIB	Domestic Systemically Important Bank
EBA	European Banking Authority
EC	Essential Criterion
ECB	European Central Bank
EU	European Union
FATF	Financial Action Task Force
FFFS	Finansinspektionen's Regulatory Code
FI	Finansinspektionen (The Swedish Financial Supervisory Authority)
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSC	Financial Stability Council
FTE	Full Time Equivalent
GDP	Gross Domestic Product
G-SIB	Global Systemically Important Bank
HQLA	High Quality Liquid Assets
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IRB	Internal Rating Based Approach
LCR	Liquidity Coverage Ratio
MoF	Ministry of Finance
MoU	Memorandum of Understanding
OSFI	Office of the Superintendent of Financial Institutions
RCAP	Regulatory Consistency Assessment Program
SIB	Systemically Important Bank
SIE	Supervision Intensity and Effectiveness
SEK	Swedish Kroner
NDO	Riksgalden (Swedish National Debt Office)
SREP	Supervisory Review and Evaluation Process

EXECUTIVE SUMMARY

The size of Sweden's banking system is equivalent to multiples of annual gross domestic product (GDP), and dominates the Swedish financial system. It is heavily concentrated, with four universal banks holding over 85 percent of all banking system assets. While these four large banks are all headquartered in Sweden, they have extensive cross-border operations in the other Nordic countries and the Baltics, making them critical to the entire region. One bank has been designated by the Financial Stability Board as one of the 30 global systemically important banks (G-SIBs).

Finansinspektionen (FI), an integrated regulatory agency, supervises Swedish credit institutions, including the four large banks. The mission believes that while the priorities and supervisory approach of the banking supervision function are appropriate given available resources, the mission also believes that the banking supervision function is materially under-resourced. The issue of under-resourcing is similar to findings in the 2002 and 2011 FSAPs. While the government expanded the annual budget of FI in recent years, these increases have not been sufficient to close the gap between FI resources and those of comparable supervisors in other advanced countries.

An ongoing concern is that FI's resources, even taking into account any planned increases, are inadequate to achieve an acceptable frequency of supervisory inspections of Swedish banks' operations, both domestic and cross-border. Staff are stretched and forced to postpone important supervisory actions. Too few people are dedicated to supervising banks; there are delays in completing important analytical work.

The FI's budget is part of the government's annual budget process and lacks certainty from year to year. Given the size and importance of the Swedish banking system and the risks posed to the Swedish economy from an under-resourced FI, the mission recommends a revision to the current way FI is funded with the objective of producing a more predictable long-term budget that better responds to the needs of FI.

The resource constraints are compounded by a very high turnover of bank supervisors and the paucity of staff with banking supervision experience. About a half of FI staff has under two years' experience as bank supervisors. While many staff have previous experience in banking and finance, it would be a challenge for anyone with minimal supervisory training and a lack of familiarity with FI's supervisory procedures to immediately begin effectively supervising banks.

FI has made considerable progress developing supervisory approaches and techniques, particularly structured risk assessments for the four large banking groups. The roll-out of a similar but less intensive process across FI's smaller supervised institutions is most advanced for the next six largest banks, but remains a work in progress.

Although FI has a regular program of meetings with key function holders of the ten largest banking groups, there is scope to increase supervisory interaction with bank boards and managing directors. The relevant Group Supervisor should, as general rule, participate in the periodic meetings between FI's Managing Director and bank chief executives and should meet periodically with bank boards and board committees.

Concerns raised in the 2011 FSAP regarding the insufficient granularity and frequency of reporting by supervised institutions has been addressed, starting in the Q3 2014. FI has implemented a new system for management of banking and insurance supervisory data. Staff expressed satisfaction with the system's functionality and flexibility to produce custom reports. The work to put in place a standardized set of internal screening and analytical reports, however, is still ongoing.

The 2011 FSAP recommended pursuit of options to ensure supervisory action was not delayed through judicial appeal, and greater certainty that actions would not be reversed, while at the same time respecting Swedish legal traditions. One concrete measure taken was a legal amendment to permit the liquidation of a bank to begin immediately upon the revocation of its license. This same policy should be extended to cover non-bank credit institutions that are also authorized to take deposits from the public.

The Swedish official financial community (FI, Riksbank, MOF, and SDNO) come together periodically in the Financial Stability Council (FSC). Over time, the FSC, along with preparatory work done by the staff of each agency ahead of each formal meeting, should improve the level of collaboration and coordination among the agencies. There are opportunities for more frequent sharing of data among the agencies, both to assist in monitoring financial institutions and to ensure that in the event of financial turmoil, all relevant parties are kept fully informed. Agreement on priorities assigned to key regulatory initiatives including those requiring changes to laws and ordinances, as well as collaborative approaches to reaching agreement on key regulatory measures, might help the banking industry better plan its capital and liquidity programs.

Table 1. Sweden: Main Recommendations		
Recommendations	**Responsible Authorities**	**Priority**
FI's should develop a five-year plan to increase its resources and capacity to reflect the size and importance of the financial sector in Sweden. The relevant comparator is supervisory agencies in other countries with significant financial sectors, not the size or the growth rate of other Swedish authorities (paras 24, 35)	FI	Near-term
FI should increase its resources through higher levies on the industry in accordance with its five-year plan (paras 56, 57)	MoF, Government	Near-term
FI should consider bringing bank supervisors in on secondment from other large supervisory agencies to act as mentors in support of its planned increase in resources (para 48)	FI	Near-term
As increased resources permit, the Group Supervisor should be supplemented dedicated core teams for Category 1 and 2 banks (paras 38-41)	FI	Medium-term
FI should develop a retention strategy to reduce turnover and retain a cadre of experienced supervisors (para 55)	FI	Near-term
FI needs to complete the roll-out of its Supervision Strategy • Complete internal guidelines, standard analytical and screening reports for Category 2, 3 and 4 institutions • Complete the risk-dashboard project (para 42)	FI	Near-term
FI should increase its frequency of supervisory interactions with bank boards of directors, committees of the board, and managing directors (para 71)	FI	Immediate and ongoing
Deposit-taking should be limited to those institutions licensed and supervised by FI (para 84)	MoF	Medium-term
The MoF and Government should give a high priority to amending laws or ordinances when required to give FI the specific legal mandate to issue binding regulations on safety and soundness issues (paras 58, 85,86)	MoF	Immediate and ongoing
Investigate the possibilities for limiting the circumstances in which supervisory actions could be stayed, and limit remedies to an award of monetary damages rather than unwinding an action if an authority is found to have acted in contravention of the law (para 89)	FI, MoF	Medium-term
Extend the provision that liquidation will begin immediately upon the revocation of a banking license to the revocation of a credit market company license to minimize the exposure of the Deposit Guarantee Scheme (para 89)	FI, MoF, NDO	Medium-term
Introduce a special resolution regime for non-systemically important financial institutions (para 93)	FI, MoF, NDO	Medium-term

INTRODUCTION[1]

1. This technical note focuses on four interrelated sets of issues: (i) the independence, mandates and resources of the bank supervisory function in Finansinspektionen (FI); (ii) the breadth and depth of the supervisory review process; (iii) coordination and collaboration among the domestic authorities; and (iv) the adequacy and use of remedial and corrective powers of the supervisor.

2. The Swedish banking system is one of the largest in Europe relative to gross domestic product (GDP), holding assets that are more than 3.5 times Sweden's GDP. Sweden is home to four significant banking groups that are active throughout the Nordic region and Baltics, with about half of total banking system assets domiciled outside Sweden. FI, which is responsible for supervising this sector, therefore, is not only important in Sweden, but also across the Nordic and Baltic region. It chairs four supervisory colleges. Its responsibilities are bound to increase further after FI's approval for Nordea, a Swedish bank designated by the Financial Stability Board as a global systemically important bank (G-SIB), to convert its major operating subsidiaries in Denmark, Finland and Norway into branches of the Swedish parent. Approval is conditioned on approvals in the other jurisdictions.

3. The Financial Sector Assessment Program (FSAP) reviews in 2002 and 2011 both raised concerns over the resources, mandates, and independence of FI. At the time of the 2011 FSAP there were 52 staff in bank supervision.

4. The Government responded to these concerns. By 2016, the number of staff in FI assigned to banking supervision had been increased to 91 authorized positions, with plans to add additional staff over time. The Ordinance governing the operations of FI was amended to clarify specific objectives, assignments and responsibilities, and to strengthen FI's independence. The Banking and Financial Businesses Act (BFBA) was amended to remove the potential government role in licensing.

5. Responsibilities and the arrangements for coordination among the domestic authorities have changed since the 2011 FSAP. FI has been given explicit macroprudential responsibilities and a Financial Stability Council (FSC) has been established to regularly bring together the heads of the authorities with responsibility for financial sector concerns — FI, the Riksbank, Riksgalden (the Swedish National Debt Office—NDO) and the Ministry of Finance (MOF). The Bank Resolution and Recovery Directive (BRRD) has placed additional demands on coordination and decision-making as part of the contingency planning for dealing with distress in a major bank.

6. FI devoted much of the increase in bank supervision staff to building a Risk Supervision section staffed with experts on credit risk, internal models, capital and

[1] This Technical Note was prepared by Michael Andrews and Jonathan Fiechter (IMF external experts).

accounting, and liquidity risk. A review of the supervisory activities substantiates that FI has established a track record of identifying supervisory concerns and taking remedial action.

7. Nonetheless, while the resources available to bank supervision in FI have increased since the 2011 FSAP, they have not kept pace with the increased demands on supervision. The 2012 revision of the Basel Core Principles for Effective Banking Supervision places increased emphasis on the supervisory review process; the European Banking Authority (EBA) guidelines and technical standards include many minimum expectations for supervisory review and entail a higher degree of intrusiveness; the Basel III capital and liquidity standards introduce new supervisory requirements as well as enhanced prudential standards; and greater supervisory intensity is now expected for G-SIBs as set forth in the Financial Stability Board's "Recommendation on Intensity and Effectiveness of SIFI Supervision". These new policies have increased the demands on bank supervisors globally.

8. To discharge its duties with its limited resources, FI has taken a risk-based approach to supervision. It has focused most of its resources on the 10 largest groups (the top four banking groups are designated as Category 1 and the next six largest are designated as Category 2). Given the limited resources, this focus on the larger banks is appropriate. These 10 large banks collectively hold approximately 95 percent of total banking assets and their supervision should be a priority.

9. Even with the dedication of the majority of supervisory resources to the larger institutions, however, there may be extended time periods between reviews of specific risk areas in these banks. And a consequence of the focus of resources on the larger banks is that FI lacks sufficient resources to effectively supervise the remaining smaller banks –10 Category 3 banks and 92 Category 4 institutions.

10. The balance of this note is organized as follows. The next section provides an overview of the institutional and market structure of the Swedish banking sector, which is followed by sections addressing each of the four sets of key issues. The appendix provides additional detail on changes in prudential standards and the practice of bank supervision since the 2011 FSAP.

MARKET AND INSTITUTIONAL STRUCTURE

A. Overview

11. The Swedish financial system is large, with assets equivalent to more than 5.5 times GDP. Swedish banks comprise more than two-thirds of the financial sector by assets. The banking sector is highly concentrated, with one global systemically important bank (G-SIB) and three other large domestic banks, with extensive reach across the Nordic-Baltic region, collectively accounting for over three-quarters of the domestic Swedish banking market.

12. The four large banking groups are not homogeneous. One bank, SEB focuses on corporate and small business clients, with a correspondingly smaller share of the residential mortgage and consumer loan markets. Swedbank provides products and services to 59 generally small savings banks in addition to its own broad financial services offerings. Both SEB and Swedbank have significant presence in the Baltic countries. Handelsbanken has more branches in the United Kingdom than in Denmark, Norway and Finland combined. Nordea, the largest Swedish banking group, is also the biggest bank in Finland, and has a significant market share in both retail and corporate banking in Denmark and Norway, making it the biggest bank in the Nordic region.[2]

13. While the four large banking groups offer a wide range of financial services, the commercial bank and their mortgage subsidiaries are the dominant entities in each case. Insurance companies comprise about 7 percent of the combined assets of the four large banking groups. While large Swedish insurers also have banks in their groups, the bank subsidiaries are small relative to the insurance business.

14. Capital markets are well developed, **with total government and corporate bonds outstanding equivalent to about 90 percent of GDP and stock market capitalization of about 140 percent of GDP**. Covered bonds[3] account for about 40 percent of the bond market, with government securities comprising an additional 25 percent. The balance is largely comprised of large highly rated corporates, and a small but growing portion of smaller and less highly rated issuers.

15. Large Swedish banks are highly dependent on market funding, primarily through covered bonds. Deposits comprise only about one-third of the aggregate funding for all deposit-taking institutions (banks and credit institutions). Rather than holding large deposit balances, Swedish households accumulate significant savings in pensions, insurance and mutual funds. Insurance companies and the state pension funds hold 42 and 13 percent respectively of outstanding Swedish bonds, reflecting their important role in intermediating savings for mortgage finance through covered bonds.

16. Foreign investors hold about one-quarter of outstanding Swedish bonds, equivalent to more than 20 percent of GDP. Swedish covered bonds are issued in SEK and foreign currencies, primarily dollars and euros. The underlying mortgages are SEK-denominated with the issuers swapping foreign currency proceeds for SEK.

17. FI is a unified supervisor with responsibility for oversight of almost 2,000 entities. Supervised entities include banks and other credit institutions, insurance companies, insurance brokers, mutual benefit societies, securities and fund management companies, stock exchanges, authorized marketplaces and clearing houses. FI is also the macroprudential authority and has a consumer protection mandate. Figure 1 shows FI's organizational structure.

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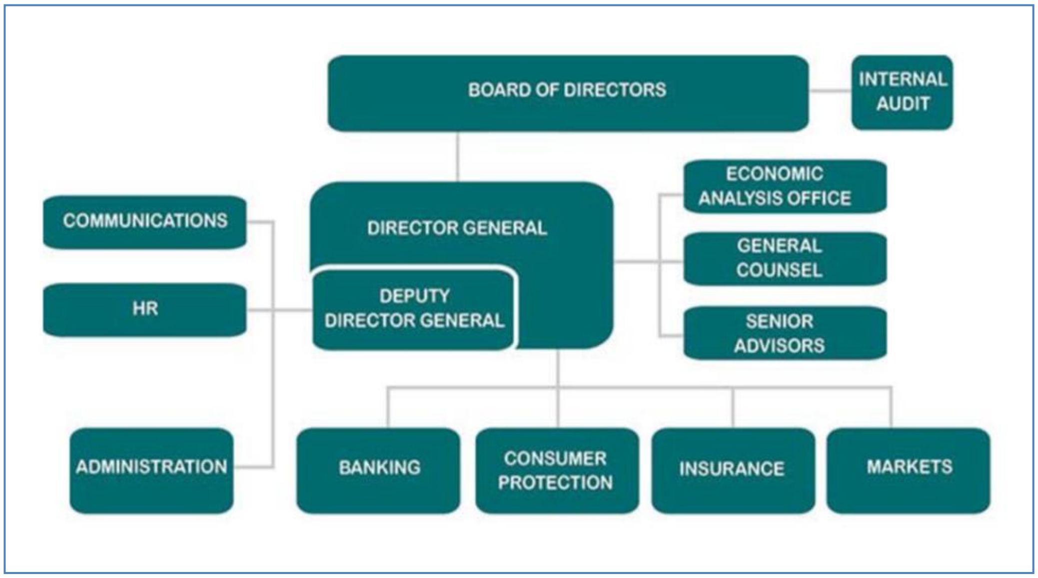
[2] http://www.nordea.com/en/about-nordea/who-we-are/our-position/ accessed April 23, 2016.

[3] Bonds issued by the mortgage subsidiaries of banks, or the banks themselves, secured by an underlying pool of mortgages.

18. Despite the large size of the Swedish banking market, the number of staff dedicated to banking supervision (Banking Operations) within FI total only 91 staff positions to supervise 124 institutions. An additional 22 staff within FI provide support (e.g., AML reporting and IT) to Banking Operations. Under FI's risk-based approach, supervisory intensity varies depending on the importance of the institution. FI's uses a similar approach in its supervision of insurance companies, dividing institutions into four categories and using a risk-based allocation of resources.

Figure 1. FI Organizational Structure



Source: FI.

B. Preconditions

19. Previous FSAPs for Sweden found that the preconditions for effective supervision are well established in the country. Sweden has benefitted from a history of sound macroeconomic policies and is currently enjoying one of the highest growth rates among developed economies. There is a well-established legal system with an independent judiciary. Transparency is a central tenant in public governance, with FI, like all government authorities, subject to The Public Access to Information and Secrecy Act. All information is subject to public disclosure unless there are specific grounds for keeping it confidential. International financial reporting standards (IFRS) have been adopted, and there is a full range of high-quality accountancy, audit, legal, and ancillary financial services available in Sweden, which serves as the regional hub for many international professional services organizations.

C. Safety Net

20. Arrangements for coordination among the authorities with financial stability responsibilities—the Riksbank, NDO, the MoF, and FI—have been revised since the

2011 FSAP.[4] FI has been given a specific macroprudential mandate in addition to its microprudential, market conduct and consumer protection responsibilities. The FSC, comprising senior representatives of the four authorities, has been formed and meets every six months. Consistent with the Swedish focus on transparency, the minutes of the FSC are made public. FI and the Riksbank each produce semi-annual Financial Stability Reports, which are available on their web sites.

21. The safety net has evolved significantly since the 2011 FSAP, in line with European Union developments. The Bank Recovery and Resolution Directive (BRRD) has been transposed into Swedish law through The Resolution Act and Resolution Ordinance, passed in December 2015 and coming into effect in 2016. The NDO, which administers the Deposit Guarantee Scheme, is also the designated resolution authority. As the supervisor, FI has the responsibility for determining if an institution is failing or likely to fail. The Riksbank serves as the lender of last resort. The NDO is still hiring staff to meet its resolution responsibilities. The detailed policies and procedures essential for effective implementation of the Resolution Act and Ordinance, including contingency plans to be able to promptly take control of an institution in distress and impose a resolution, provision of funding in resolution if required, and arrangements for coordination among the members of the FSC, are still being developed.

INDEPENDENCE, RESOURCES AND MANDATES

22. FI is responsible for supervising some of the largest banks in the Nordic region. These banks have extensive cross-border operations. To carry out this supervisory responsibility effectively, it is essential that FI meet the global standards[5] of being operationally independent, having a clear and unambiguous mandate to promote the safety and soundness of banks and the banking system, and having adequate resources for the conduct of effective supervision and oversight.

A. Independence

23. Operational independence is a major component of global standards and is intended to prevent any government or industry interference in the ability of a bank supervisor to carry out its responsibilities. Since the 2011 FSAP, which raised operational independence as an issue, FI reports that its independence has been strengthened and it is better able to allocate resources and set its own priorities within the overall budget ceiling set by the Government. The ability of the government to influence decisions related to the authorization of bank and insurance activities has been removed along with any government involvement in interventions, sanctions, mergers, and revocations.

[4] The safety net and related issues are addressed in more detail in the Technical Note on Crisis Preparedness.

[5] *Core Principles for Effective Banking Supervision*, Basel Committee on Banking Supervision, September 2012.

24. Despite the improvements in operational independence, including an indicative multi-year budget commitment, FI's actual resource envelope is still determined by the government on an annual basis. In addition, as identified in the previous FSAP, FI lacks, and has yet to be provided, the explicit power to issue binding guidance in several areas of credit risk management. The absence of the level of independence contemplated in the Basel Core Principles presents challenges in the multi-year planning essential to build supervisory capacity over the long term. Due to a failure to revise FI ordinance, prudential gaps with respect to four Core Principles (identified in the previous FSAP) have not been addressed.

B. Resources

25. A related element of independence is ensuring that a supervisory agency has adequate resources and is financed in a manner that does not undermine its autonomy and its ability to conduct its operations. This is particularly important, when a banking system is highly concentrated in a few dominant banks.

26. The issue of under-resourcing was highlighted in the 2002 FSAP, which concluded that the FI's staffing resources were "insufficient in relation to the tasks involving the implementation of the new capital accord and the supervision of large conglomerates." Again in the 2011 FSAP, a main finding was that FI's "resources need to be strengthened" and that FI's "overall capacity to supervise banks, including any meaningful program of on-site inspection, is impacted by a staffing shortage."

27. While resources have expanded in recent years (Table 1), demands on supervision from European Union (EU) directives, the Basel Committee, EBA, and other international bodies, and higher expectations on supervisors particularly with respect to G-SIBs and D-SIBS have meant that supervisory resources have not kept pace with demands. These additional demands have made it more challenging for FI to address some of the underlying issues identified in previous FSAPs. The pressure on FI's resources will increase even more as Nordea moves forward in 2017 with the branchification of its bank subsidiaries in Denmark, Finland, and Norway. A high turnover rate in FI has also puts a strain on supervisory resources, as experienced supervisors are put in a position of having to devote additional time to mentoring and reviewing the work of new staff.

Table 2. Sweden: Resources Available for Bank Supervision

	2010	2016
Large bank supervision	8	22
Other bank supervision	10	10
Specialists (credit risk, capital, market and liquidity risk, etc)	32	59
Subtotal	50	91
Functional support (AML, central legal, reporting, etc)	20	22
TOTAL	70	113

Source: FI.

28. When the resources assigned to banking supervision at FI are compared with other bank supervisors on the basis of the number and complexity of supervised banks and the size of the Swedish banking system, the level of under-resourcing at FI is clear. An analysis by FI of its resources assigned to the banking sector compared to other supervisors concluded that FI has a resource gap of approximately 45 percent.[6]

29. A comparison of two countries with somewhat comparable banking and regulatory structures, Australia and Canada, illustrates this point. While Canada and Australia are between two and four times larger than Sweden in terms of population and GDP, their commercial banking structures are similar to that of Sweden. Like Sweden, a small number of large commercial banks dominate the financial system in both countries. In Australia, the top five banks hold 84 percent of total banking assets; in Canada, the six largest banks hold 90 percent of bank assets. Similar to the large Swedish banks, the Canadian and Australian banks are also universal banks, have strong earnings and capital, and generally have a retail focus. A difference is that unlike Sweden, no Canadian or Australian banks have been designated a G-SIB by the FSB.

30. Both countries have prudential supervisory agencies (Canada's Office of the Superintendent of Financial Institutions—OSFI, and the Australian Prudential Regulatory Authority—APRA) that are separate from and outside of the central bank. Both are under Finance/Treasury, but to a large degree, have operational independence. As in Sweden, fees imposed on the regulated institutions fund the agencies' operations. Yet despite the similarities in banking systems, the Canadian and Australian supervisors both devote far more resources to prudential supervision—Australia has 565 FTEs and OSFI has 704 FTEs (Table 2). While the data in Table 2 for OSFI and APRA is less current that the FI data, it is still indicative of FI's under-resourcing.

31. Importantly, both APRA and OSFI are focused on prudential supervision and have much narrower mandates than FI. When one includes the other Australian and Canadian financial regulatory agencies, which are responsible for consumer protection and market conduct, the under-resourcing of FI becomes even more striking. For instance, in Australia, market conduct is carried out by a separate agency, the Australian Securities and Investments Commission (ASIC), which in 2015 had a staff of 1,609.

32. In part, the disparity of resources for prudential supervision between Sweden and Australia and Canada is due to the size of the respective financial sectors.[7] The Australian and Canadian banking sectors are in nominal terms about twice the size of Sweden's banking sector. On the other hand, their cross-border operations are more limited than Swedish banks. Comparisons of the allocation of supervisory resources devoted to banking is challenging because both APRA and OSFI, like FI, have prudential oversight responsibilities for insurance and pensions.

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[6] Finansinspektionen's future resource requirement 2017-2019, FI Ref. 16-1909 February 9, 2016

[7] Canadian bank data available at http://ws2.osfi-bsif.gc.ca/WebApps/Temp/af3f8912-94be-406b-ae88-fb2be88477baFinancialData.aspx, Australian bank data available at http://www.apra.gov.au/adi/Publications/Pages/adi-quarterly-performance-statistics.aspx

Measured by total assets, deposit-taking institutions comprise about 70 percent of APRA's portfolio, and three-quarter's of OSFI's. Banks account for a similar share of the entities in FI's portfolio subject to prudential supervision—banks, other credit institutions, insurance companies and pensions. Of the estimated 311 FTEs devoted to prudential supervision by FI, about one-third is dedicated to banks and other deposit-taking institutions.

Table 3. Sweden: Comparison of Prudential Supervision Resources

	FI (2016)	APRA (2014)	OSFI (2015)
Total budget (SEK million)	580(est)	760	934
Staff (FTEs)	420	565	704
Prudential supervision*	311 (est)	565	704
Other	109 (est)	n/a	n/a
G-SIBs	1	0	0
D-SIBs	3	5	6
Market share of SIBs (% of banking assets)	90	79	90
Banking assets as % of GDP	350	280	250

Sources: FI budget documents and APRA and OSFI annual reports.

* FI staffing assigned to banking, insurance, consumer protection, and market operations.

33. **With respect to SIBs, APRA and OSFI have larger dedicated core supervisions teams than FI, and like FI, both involve significant specialist resources to support the core teams.** In this regard, fees levied on Canadian deposit-taking institutions have increased by 50 percent over the last five years to fund increased specialist resources to support the core supervision teams, reflecting the increased international focus on the breadth and depth of supervisory review.[8]

34. **A recent internal assessment of future resource needs by FI concluded that banking supervision would require funding of at least another SEK 60 million over the next three years.[9]** This number will increase by SEK 15 million if Nordea completes the conversion of its Nordic subsidiary banks to branches. Arrangements have not yet been finalized among the relevant authorities, but it seems unlikely that all of the foreign supervisors (which total some 35 staff) who presently supervise Nordea's foreign subsidiaries will continue to have the same level of involvement in the oversight of Nordea.

[8] OSFI Annual Report 2014-15, http://www.osfi-bsif.gc.ca/Eng/Docs/ar-ra/1415/eng/index-eng.html

[9] Finansinspektionen's future resource requirements 2017-2019, FI Ref. 16–1909 February 9, 2016.

35. On the basis of this mission's review of FI's bank supervisory program relative to the size and complexity of Swedish banks, it supports FI's current assessment that banking supervision needs more resources. Given that resources for banking supervision were an issue in the 2002 and 2011 FSAPs, the mission further believes that consideration should be given to changing the budgetary process for FI, so that FI and its supervisory staff can be assured over the longer-term that the agency will continue to have adequate resources. FI should develop a five-year plan to build supervisory capacity to the required level. While the need is urgent, closing the resource gap will have to take place over a period of years and likely cannot be achieved within FI's current three-year plan, particularly given the lack of budgetary certainty in the current annual Appropriation Letter process.

36. Sweden has been fortunate in that it has not had a major banking crisis since the early 1990s. But history has shown that no country or region is immune from crises. Given the critical importance of the Swedish banking sector to Sweden and the region, the concentration of assets in four large banks, the reliance of these banks on continued access to wholesale funding, and the inter-connection of these banks, having a well-resourced supervisory function should be a high priority for Sweden.

37. The mission recognizes the importance of having lean and efficient organizations. But practices have been observed at FI in the banking supervision function as direct consequence of tight resources, which appear to the mission to threaten the ability of FI to carry out its responsibilities. Too few people are dedicated to the larger banks, it has taken some time to complete important systems to support offsite analytical work, and FI cannot meet the EBA standard of completing a SREP at least every three years for the Category 4 institutions.

38. Within Large Bank Supervision are divisions responsible for Bank Analysis, Governance and Risk Operations, and Supervision of Large Banks. The latter division, assigned to the direct supervision of the four large banks has nine staff. This includes four Group Supervisors, two senior risk experts, an analyst, a legal scholar, and a Director of the division. Each Group Supervisor is assigned to an individual SIB and is supported by other specialist resources for specific activities. [10]

39. While this approach and structure is found in many supervisory agencies, the quantity of resources devoted by FI to each SIB are considerably less than is commonly the case. As noted earlier, a domestic systemically important bank, and certainly a G-SIB will typically be supervised by a combination of a core team, supplemented by a team of specialists (e.g., credit risk, capital markets, liquidity, AML, interest rate risk), depending on the focus of the supervisory activity. Combined, these teams may average around 45 FTEs. FI's approach is similar, but because of its resource constraints, it appoints only a single Group Supervisor rather than a team, supported by a

[10] The division has been strengthened by six additional staff positions in June 2016.

relatively small team in a matrix arrangement that incorporates risk specialists and other FI staff for planned supervisory activities.[11]

40. These four banks are complicated financial entities with extensive business lines and cross-border operations. Regardless of how good the individual supervisors are, reliance on a single Group Supervisor as the ongoing key contact means that much of the institutional knowledge and the relationship established with management of the assigned bank can be lost if the Group supervisor leaves FI or is rotated to another position. Senior management at several banks commented that the FI staff's turnover leads to a need to repeatedly "educate" new Group Supervisors about the bank's business, and suggested that FI could mitigate this burden by having a small team rather than a single key contact for major banks. This is one reason why supervisory agencies outside of Sweden typically assign a dedicated core supervisory team for large banks, providing continuity when members of the core team leave or are rotated off of the bank.

41. Similarly, the next six largest banks (Category 2 institutions) are split among three Group Supervisors, with each covering two institutions. While this provides a degree of back up, it would enhance both capacity and continuity to have small dedicated teams assigned to no more than two of these institutions. Some of these institutions are complex and the Swedish banking system would be well served by subjecting these banks to more intense supervision.

42. FI is in the process of creating standard templates to track key financial ratios for banks outside Category 1. These will identify emerging trends such as the rapid growth in particular parts of the balance sheet or income statement, and compare individual bank's performance and operations against a peer group. This risk-dashboard is an important part of off-site monitoring. Supervisors in many countries typically use this type of output to identify emerging risks and help set supervisory priorities. From the end of the summer 2016, it is available for Category 2 banks, and eventually for the Category 3 and 4 banks. The slow pace of implementing this important output is due to insufficient numbers of staff in the Bank Analysis division.

C. Shortage of Staff with Supervisory Experience

43. Despite having been created over 20 years ago, FI has only a small cadre of supervisors with long-term FI experience. FI has a practice of recruiting experienced staff members from the financial industry. While such staff understand the business of banking, they often lack bank supervisory experience. While 38 percent of the bank supervision staff at FI have five years or more experience as bank supervisors, about half of the staff have been at FI less than two years.

44. In most supervisory agencies, there is a core team of career supervisors. Staff are hired at a relatively young age, trained to become supervisors over a number of years, and remain with the agency for 10 or more years. Unfortunately, FI has not had sufficient resource flexibility to hire

[11] Four additional deputy group supervisor positions were authorized in June 2016.

cadres of young inexperienced staff, who may take several years to learn their job. Instead, FI has turned to experienced staff in the financial services industry and elsewhere in government. FI recruitment has focused on former internal auditors and compliance and risk officers.

45. Banking supervision is a skill that external hires need to learn. While there are obvious advantages to hiring staff that understand the business of banking and have been in internal control functions, there are cultural differences between the roles of supervisors and private sector bankers. More intense and intrusive supervision, with a focus on effective risk governance and promoting more effective boards, requires experienced staff who can exercise supervisory judgment. Even staff with backgrounds in the control and internal audit functions need training and experience to adapt to a banking supervision role.

46. FI's strategy of hiring staff from industry increases the importance of a clear mandate for the agency, reinforced by the tone at the top. To limit conflicts of interest, the FI has put in place a formal policy that new hires into FI have a cooling off period before they are permitted to work on projects directly related to their former employer. To further limit the perception of a revolving door, it is important for FI to have a clear mandate, reinforced by the tone at the top.

47. The varied experience of other more "traditional" supervisory agencies in the years leading up to the most recent crisis, makes it clear that no particular staffing model for supervision is consistently superior to other models. Hiring individuals out of the banking industry can be an effective way of building capacity quickly and brings the advantage of industry experience to the supervisory authority. But the experience of supervisory agencies that have supplemented their supervisory ranks with external hires from the banking sector indicates that the hiring process and attention to training is very important.

48. FI has a one-week orientation program for new staff and a series of training programs. These need to be tailored to the experience level of the external hires—training that might be suitable for a new hire out of university would not necessarily fit the needs or be appropriate for a mid-level banker. FI might consider bringing bank supervisors in on secondments from other large supervisory agencies to act as mentors to new staff. Another possible source of experienced supervisors is through FI leveraging the resources available from agencies that are part of the supervisory colleges.

D. High Turnover of Supervisory Staff

49. It is likely that the relatively short tenure for supervisors is an unavoidable consequence of increasing staffing levels over a short period of time. Bank supervisors who understand the new and more complex regulations and policies are also in high demand by the banking industry. Moreover, the flow of staff between public service and the private sector is common in Sweden.

50. A challenge to a policy of hiring staff out of the banking industry is that they may have greater job mobility and therefore, may be more difficult to retain. Similar to the experience of other supervisory agencies who have brought bankers on as supervisors, turnover at FI is high—approximately 15 percent annually. This high turnover poses at least three risks. First, the high turnover results in a loss of institutional knowledge. For complex institutions and regulations, there may be a steep learning curve on the part of the supervisor to understand the institution and senior personnel in the bank. The expected practice following the global financial crisis is for supervisors to have frequent communications with bank management to ensure that information flows between industry and supervisors occur on a continuous basis and there are no surprises. Achieving this flow of information requires a level of trust and familiarity. This makes it important to build in redundancies (e.g., have dedicated teams working on the large and complex institutions and on key rules), so that the agency is not put at risk by the departure of key personnel. Building in this redundancy requires an expansion of staff.

51. Second, banks may be reluctant to share proprietary information with their supervisors if there is a strong chance that those supervisors may leave FI to go to work for another bank that competes against the first bank. Several banks mentioned this was a concern (although one noted that this problem exists as bankers move between banks). A solution would be to build in a cooling off period (longer than the current two months for staff below the level of Executive Directors, who are subject to a six-month restriction); such cooling off periods should be subject to waiver by the Director General, for senior staff such as Group Supervisors who choose to move to the banking sector. Many jurisdictions have a one-year cooling off period before senior staff can go to work in the banking sector although given the dependence of FI on the banking sector for new hires, any such policy needs to be strategic and flexible to avoid unduly discouraging potential recruits from the financial sector from joining FI.

52. Third, a high turnover necessarily results in a high level of new hires. The introduction of new staff makes it very important that FI continue to update its supervisory guidance so that new staff has access to guidelines that provide a clear understanding of what is expected and that there is a consistent approach to supervision.

E. Multiple Mandates of FI

53. While the overall staffing of FI has increased over the past several years, FI's responsibilities outside of prudential supervision have also expanded as it has been assigned new mandates. This may have led to an unintentional dilution in the critical focus of FI management on banking and insurance supervision. While FI's staffing increased by 162 positions following the 2011 FSAP, a material portion of the new staff were devoted to new areas of responsibility for FI (e.g., macroprudential and market conduct supervision) presenting challenges in managing the limited FI resource envelope against potentially competing priorities.

54. FI operational units are organized under separate Executive Directors, which provide a degree of insulation and helps ensure that groups such as Banking or Insurance have a group of staff that are dedicated to their particular mandate. But the operational units themselves are relatively small and so are dependent on and to some extent, compete with each other in obtaining support from the shared functions such as administrative (e.g., IT), economic analysis and human resources. While the organization of FI appears to make a lot of sense given the multiple mandates, the risk is that as resources are allocated each year, trade-offs occur that might reduce the resources available to functions such as supervision.

F. Recommendations

55. To meet staffing needs over the near term, FI might consider making use of other Nordic supervisors (and possibly the ECB) to support FI's supervision of Swedish banks' cross-border operations. In the longer term, FI needs to continue to refine its HR strategy to build and retain a much larger core group of staff with supervisory experience. There may be opportunities to provide more support for senior supervision staff to reduce turnover and improve the terms and conditions of service to make FI a more attractive career option.

56. One element of the problem may be the tight resources and the unpredictability of annual budgets. While the asset base of the banking industry, which funds banking supervision through an annual fee is relatively predictable, the process of receiving approval for the budget from the Ministry of Finance through the annual Appropriations Letter may not deliver a predictable and adequate budget. Getting a big increase once every several years is far less effective and efficient than having a predictable and long-term budget that is tied to the underlying needs of the FI. A budget strategy more developed than the current three-year budget request is needed to provide more certainty to FI regarding its long-term funding and more closely links the FI's budget to its financing needs.

57. It is unclear whether there is sufficient flexibility under the present budget process to achieve this objective. As current arrangements have been found in two earlier FSAPs to provide insufficient independence and certainty of funding of FI, alternative arrangements should be considered. The most important factor for FI is that it supervises a financial system equivalent to more than five times GDP, so the basis for comparison of its size, budget and degree of budgetary certainty should be similar supervisory authorities in other countries rather than other Swedish government authorities.

58. The Swedish legal system requires specific references in laws or ordinances to enable an authority to issues binding regulations. As noted below in the discussion of cooperation and coordination, it is essential that gaps in the prudential framework for bank supervision, when identified, receive priority attention by the MoF and Government. This has happened with respect to the rapidly evolving EU prudential standards, however, there are important topics not covered by the EU directives that have to be addressed in national standards.

BREADTH AND DEPTH OF SUPERVISORY REVIEW

59. FI has made considerable progress with supervisory approaches and techniques, particularly structured risk assessments for the four large banking groups. The roll-out of a similar but less intensive process across FI's other three categories of supervised institutions remains a work in progress. An ongoing concern is that FI's resources, even taking into account the planned increases[12], are inadequate to achieve an acceptable frequency of inspections across the range of supervised credit institutions.

A. Supervision Strategy

60. The roll-out of FI's Supervision Strategy[13] is addressing one of the major findings of the 2011 FSAP—the lack of a formalized analytical framework to assess the risk profiles of supervised institutions. FI now undertakes an annual ranking of risks, beginning with a functional assessment within the various FI mandates—banking, insurance, markets, consumer protection and macro-prudential. Initial risk assessments within mandates are then rolled up to senior management and the Executive Director, who make decisions on the allocation of the FI resource envelope across the various mandates.

61. FI's Supervision Strategy is risk-based. It ranks firms based on their importance to the system, markets, and consumers, and the allocation of resources is made according to this risk-ranking. As a result, about 70 percent of bank supervision resources are devoted to the four largest banking groups—Nordea, Swedbank, Handelsbanken and SEB, which all have a significant presence in the Nordic-Baltic region and large domestic market shares. For these Category 1 groups there is a structured quarterly review program. FI is in the process of introducing a more structured semi-annual review similar to that in place for Category 1, for the next six largest banks, which comprise Category 2. The remaining approximately 100 banks and credit institutions—Categories 3 and 4—are subject to less frequent supervisory reviews. The 10 Category 3 banks are subject to SREPs every three years, while the 92 Category 4 banks may go much longer between such reviews—11 smaller institutions were subject to a SREP in 2015. This cycle of review for insured depository institutions is too long, even if these institutions are small and thus assessed as presenting no systemic threat.

B. Approach to Supervision

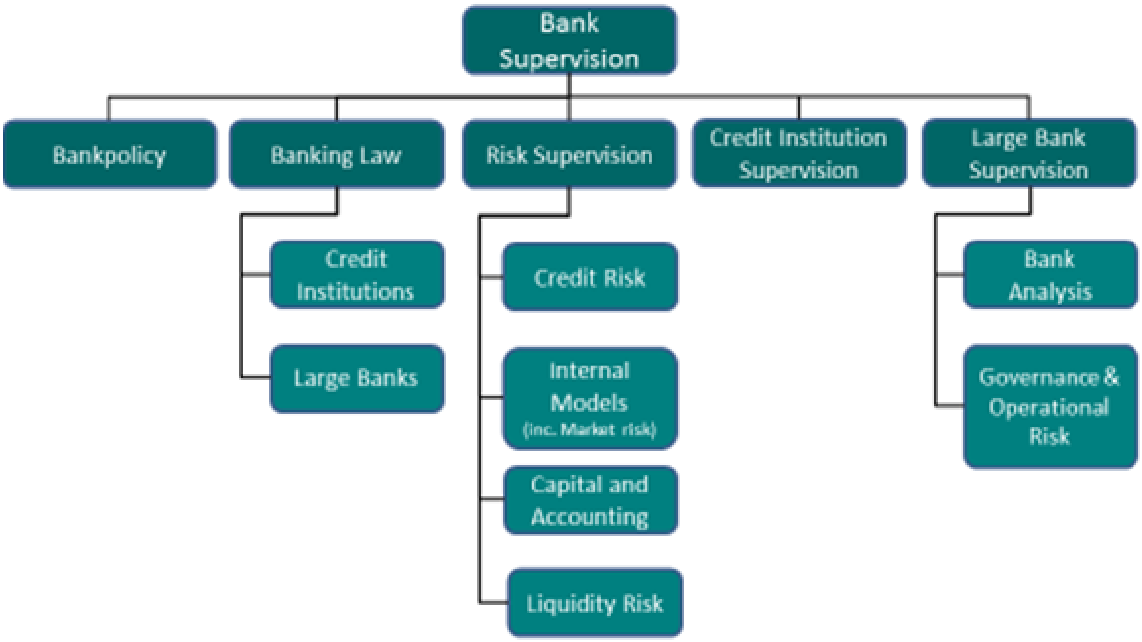
62. FI's approach is based on supervisory teams. For the 10 largest banks (Categories 1 and 2), this comprises the Group Supervisor, who acts as the main point of contact with the bank and has overall responsibility for development and implementation of the annual supervision plan, along with risk specialists and staff from legal (regulation), insurance, consumer protection and markets divisions as may be required by the specific elements of the plan. The Group Supervisor, who is

[12] As mentioned in footnotes 10 and 11.

[13] http://www.fi.se/upload/90_English/10_About/Whatwedo/tillsynsstrategi-eng.pdf

located in the Large Bank Supervision department for the four largest banks, and Credit Institutions Supervision department for the next six largest (Figure 2) is the constant element in the team, as well as allocated risk specialists and staff from the Bank Analysis division along with other FI staff who participate in inspections depending on the scope and objective.

Figure 2. Bank Supervision Organization



Source: FI.

63. The smaller banks (Categories 3 and 4) are managed on a portfolio basis, with an individual supervisor responsible for five or more institutions. As with the larger banks, risk experts and staff from other departments will be formed into a team for inspections. Aside from thematic or horizontal inspections covering all or a subset of all supervised institutions, on-site inspections are not routinely undertaken in the smaller institutions unless specific supervisory concerns have been identified.

64. FI does not make a sharp distinction between onsite and offsite processes. "Inspections," which frequently include a large offsite component, are usually targeted at specific issues or concerns identified in the risk assessment process. FI also does "thematic" or "horizontal" inspections of all or a specified subset of institutions, such as the annual thematic review of mortgage lending.

Box 1. Supervisory College Activities

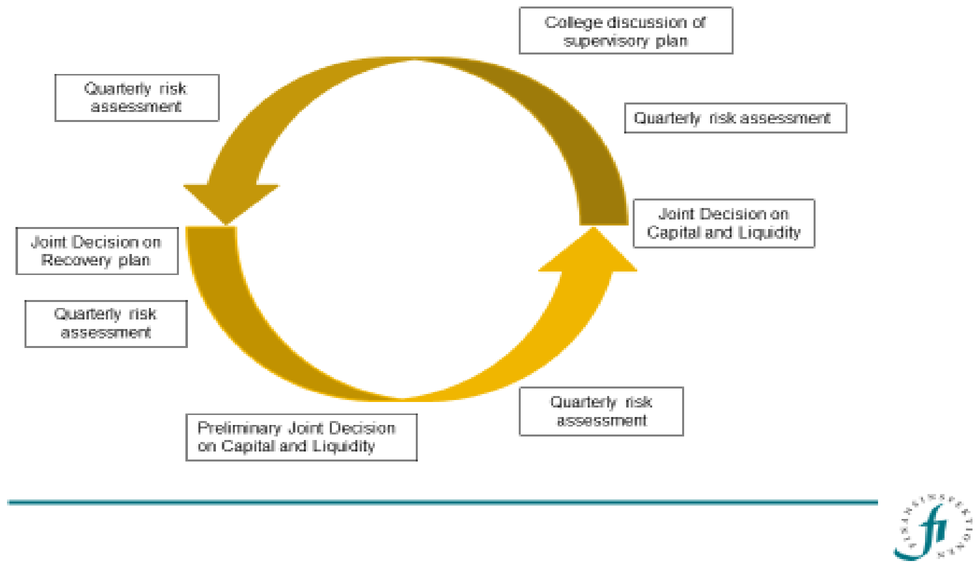
- Core College Meetings: March, June, September
- General College Meeting: December
- Quarterly Risk Meetings (Core College)
- ICAAP/ILAAP Presentation and Review (Core College Plus)
- Recovery Plan Presentation (General College)
- Joint Inspections (Core College)

65. The approach for the four large banks is driven by a supervisory cycle that has extensive input and participation by the relevant supervisory college (Box 1, Figure 3). An annual joint risk assessment provides the basis for developing the supervisory plan, which includes joint decisions on capital, liquidity and the recovery plan. FI's internal guidelines require minimum onsite activities for the Category 1 banks comprising: (i) two inspections performed by FI; (ii) one joint inspection including supervisory college members; and (iii) the annual Swedish thematic inspection on mortgage lending. In practice, for the past three years, an average of seven inspections have been completed annually for each of the four large banks.

66. The structured quarterly review process for the large banks includes an initial quantitative review (Analysis 1) and a detailed review by FI risk experts in conjunction with the Group Supervisor (Analysis 2). This internal review process provides the foundation for quarterly meetings between FI and their key counterparts in the banks, with participation by core supervisory college members. FI intends to conduct a continuous risk assessment as required in the EBA guideline on SREPs.

67. FI has significantly increased the breadth and depth of its supervisory verification activities since 2011. At the same time, however, international expectations have changed. The 2012 revision of the Basel Core Principles for Effective Banking Supervision introduced additional emphasis on the supervisory review process. A new Core Principle (CP) 14, Corporate Governance, and the revised CP 15, Risk Management Process, have many criteria requiring the supervisor to determine the adequacy of banks' internal policies and procedures and the implementation of those policies and procedures. While some of this can be completed through offsite review of the banks' policies and procedures, verification that the policies are implemented and that processes are adequate in practice can only be assured through onsite work.

Figure 3. Supervisory Cycle



Source: FI.

68. FI's approach of targeted inspection activities is an effective way to use limited resources and verify the quality of implementation. Some exams, however, may not be very intense and several years can pass between reviews of areas such as market or operational risk. While complimentary about the quality of FI staff, one industry participant noted that when it underwent a joint inspection staffed by one of the supervisory college members, it received a more thorough and intense examination, which the institution found useful.

69. FI has increased its specialist risk capabilities and developed detailed review procedures, in many cases using EBA guidelines. However, demand for specialist resources by the responsible Group Supervisors generally exceeds the supply, resulting in rationing and a narrower scope of inspections.

70. FI has established a specialist credit risk function, which has made significant strides in addressing the 2011 finding that it was not in a position to robustly determine the quality of processes, policies, classifications and controls with respect to problem assets, provisions and reserves. The credit risk specialist function, staffed by former bankers with extensive credit risk expertise, was established in 2012 to expand FI's pre-existing credit-risk resources. Its initial activities were focused largely on completion of the EU-wide Asset Quality Review (AQR). The AQR was a useful exercise in identifying issues for follow-up in four institutions. Given the issues identified in 2011 and in the AQR process, and the demands of completing the annual mortgage thematic review, the mission believes that FI lacks sufficient resources to achieve an effective steady-state of routine credit risk reviews, on a risk-focused basis, across all of its supervised credit institutions.

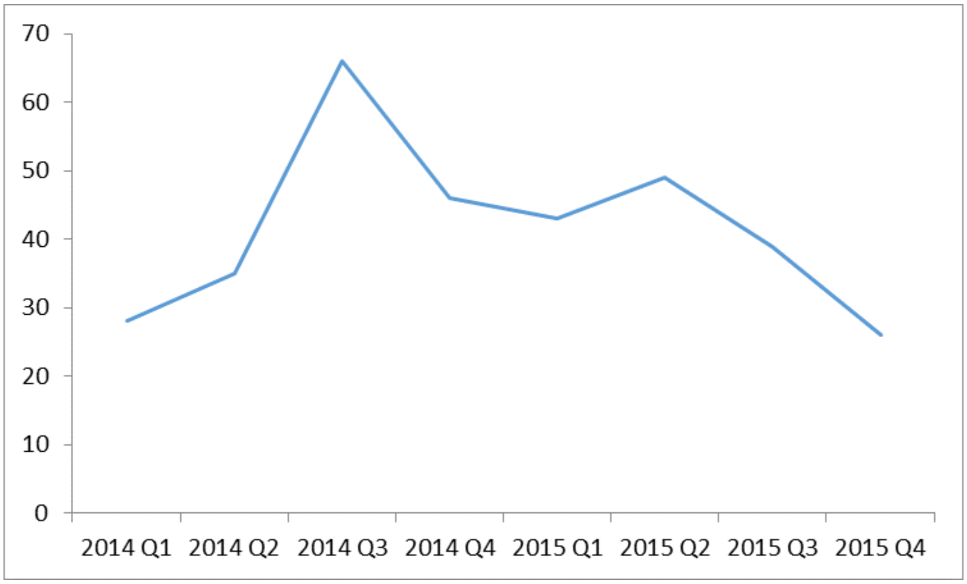
71. Although FI has a regular program of quarterly meetings with key function holders of the large banking groups, there is scope to increase supervisory interaction with bank boards and managing directors. The relevant Group Supervisor should, as general rule, participate in the periodic meetings between FI's Managing Director and bank chief executives. The Group Supervisor should also meet periodically with bank boards and board committees. For example, it would be constructive to share credit risk inspection findings directly with the board risk committee, in addition to the Board Chair. Similarly, there might have been value in meeting with board risk committees in the context of the thematic review on risk data aggregation to verify the role of the committee in providing appropriate board oversight and to ensure that boards are fully aware of FI's expectations.

C. Reporting and Analysis

72. Implementation of the EU-wide FINREP and COREP reporting requirements has addressed, from Q32014, the concerns raised in the 2011 FSAP regarding the insufficient granularity and frequency of reporting by supervised institutions. FI reports that the quality of reporting by institutions, after some initial problems when the new requirements were introduced, has improved, resulting a significant reduction in the number of follow-ups required due to misreporting (over 100 per quarter), observed in 2011 (Figure 4).

73. FI has implemented a new system for management of banking and insurance supervisory data. Staff expressed satisfaction with the functionality and flexibility of the system acquired from the vendor to produce custom reports. The work to put in place a standardized set of internal screening and analytical reports, however, is still ongoing. It is most advanced for the four large banking groups, with "Analysis 1" now being produced each quarter by the Bank Analysis Division. A similar report, which includes peer comparisons and trend analysis, is under development for the Category 2 (next six largest) banks. Production of these standard reports by the Bank Analysis Department will free the responsible supervisors from the largely clerical work of preparing the basic quarterly analysis, enabling more time to be spent on in-depth review and interaction with the supervised institution. An additional enhancement, a risk-dashboard that would include all supervised institutions, is also under development.

Figure 4. Number of Enquires by FI on Institutions' Supervisory Reporting



Source: FI.

COORDINATION AND COOPERATION

74. **The business of banking supervision and resolution has become more difficult over time in a number of countries.** Many financial institutions have become larger, more complex and international in scope. New and updated regulations and policy instruments have been introduced in an effort to make banks more resilient and to promote "domestic financial stability". Following the Global Financial Crisis, governments have introduced measures and instruments to reduce the likelihood that going forward they will be forced to bailout weak institutions. Countries belonging to the EU have had to adapt their banking and regulatory systems in response to a strengthening of international and European standards. For Sweden with its very large and concentrated banking system, the importance of a strong and stable financial system has been reinforced.

75. **A consequence of the new regulations and policies is that both commercial banks and national regulators have had to adapt to a rapidly changing environment.** New fora such as Supervisory Colleges and Crisis Management Groups, new policy instruments such as Recovery and Resolution Plans, new domestic and regional agencies such as National Resolution Authorities, the Single Supervisory Mechanism and Single Resolution Board, and revised prudential rules governing banks' capital, liquidity, etc., have stretched both bank and public agency staff resources.

76. **Despite the detailed nature of some of the rules and laws, the timing and nature of their implementation include a fair amount of national discretion.** For instance, there is a presumption that the more systemically important an institution is, the higher its capital requirement should be. The banking industry will need to adapt its operations and balance sheets to conform to these new policies and is relying on the public sector to provide timely and consistent

guidance on what is required. In some cases, FI will need to obtain changes to laws and new or revised ordinances, through the MoF.

77. Uncertainty over future policy decisions on capital and liquidity requirements puts a premium on the public sector, both domestically and in a cross-border context, working together in a collaborative and coordinated manner to deliver a consistent message to the banking sector. Failure to do so risks weakening support for the underlying policy decision. It also hinders the ability of the banking sector to engage in long-term planning. In times of stress, the perception of a lack of coordination may reduce the effectiveness of government actions and hampers financial stability and the confidence of markets in the public sector.

78. Two essential elements of good coordination and collaboration among public sector entities are to ensure that all relevant agencies have the opportunity to have input into the decisions while at the same time, agency mandates are clear so that ultimate accountability rests with one entity. Careful consideration of issues allows the public sector to make informed decisions that reflect a variety of factors while specific mandates make it clear which agency is the ultimate decision maker.

79. In meetings with Swedish financial institutions, the importance of having coordinated policy responses was emphasized. While banks had their own views regarding policy choices, equally important was having clear regulatory decisions that are applicable to all institutions. While major long-term policy issues may benefit from a public debate, and there may be valid reasons for differences of opinion, it is important that regulatory officials work together to maintain public confidence in the regulatory community. Reaching consensus on regulatory issues may also strengthen the bargaining position of the public sector in international negotiations.

80. The Swedish official financial community (FI, Riksbank, MOF, and SDNO) come together periodically on the FSC. Over time, the FSC, along with preliminary work done by the staff of each agency ahead of each formal meeting, should improve the level of collaboration and coordination among the agencies. Agreements on key regulatory strategies, which can be clearly communicated to the industry, would help it better plan its capital and liquidity programs.

81. Collaboration among agencies is particularly important in times of financial turmoil. Formal protocols for the exchange of relevant information among the Riksbank, FI, and NDO might facilitate such collaboration. In that regard, a formalized procedure for the Riksbank to inform FI of material information that may come to its attention through its market operations and settlement account activities would provide valuable early warnings of emerging problems to FI**.** While FI receives weekly data from the Riksbank, FI does not have automatic access to supervisory relevant information such as a bank actively seeking interbank or Riksbank credit to meet settlement obligations. FI also should be advised by the Riksbank if an institution encounters repeated technical issues in the payment system, as this has implications for the institution's operational risk management. While Riksbank staff indicated that such information would normally be shared through informal channels should the need arise, a more formal process is warranted. Similarly, there should be a formal process for the Riksbank and FI to advise the NDO if information gleaned through their operations is material to NDO's role as the resolution authority (this is envisaged in the Swedish implementation of the BRRD).

82. Some of the previously identified gaps in the prudential framework have been addressed through EU legislation and regulation, as well as regulations issued by FI. However, the long delay noted above with respect to credit risk regulations means that significant gaps remain with respect Basel Core Principles (CPs) 16, 17, 20 and 21 (Table2). Thus, while gaps affecting four other risk areas have been addressed, two largely by issuance of FI regulations, and two largely by EU standards, some gaps between the Swedish standards and international best practices remain unaddressed since 2011.

83. Despite the lack of progress with revised credit risk guidelines, there are some prudential requirements for most of the essential criteria of CPs 16, 17 and 20. FI's regulations on risk management, corporate governance and internal controls, and EU-wide standards including Capital Requirements Directive (CRD) IV, pick up many of the requirements. It is only in the area of country and transfer risk that there is no specific EU-wide or Swedish national standard.

Table 4. Sweden: Addressing Gaps in Swedish Prudential Standards

Risk Topic	Progress since 2011
Risk Management (CP 15))	FI Regulations and General Guidelines Regarding Governance, Risk Management and Control (FFFS 2014:1), CRD IV, EBA guidelines
Credit Risk (CP 17)	EU standards do not address all aspects of the principles. Updated Swedish national guidance not yet issued, awaiting revision of FI Ordinance to provide specific powers in this area.
Problem Assets, Provisions and Reserves (CP 18)	EU standards do not address all aspects of the principles. Updated Swedish national guidance not yet issued, awaiting revision of FI Ordinance to provide specific powers in this area.
Related Parties Transactions (CP20)	FI intends to provide more specific guidelines regarding exposures to related counterparties in the planned updated regulations on Credit Risk.
Country and Transfer Risk (CP 21)	FI intends to provide more specific guidelines regarding country and transfer risk in the planned updated regulations on Credit Risk.
Market Risk (CP 22)	Addressed through CRD IV and EBA guidance.
Liquidity Risk (CP 24)	Addressed through introduction of a national LCR requirement in 2012 for the largest banks, which is based on the Basel recommendations. Note that Sweden has not used the flexibility on phase-in due to the fact that a national requirement was implemented.
Operational Risk (CP 25)	FI Regulations and General Guidelines regarding the management of operational risks (FFFS 2014:4)

84. The 2011 FSAP recommendation that deposit taking be limited to those institutions licensed and supervised by FI has not been implemented. FI put forward to the MoF the report "Supervision and registration, April 7, 2011," which recommended that the concept of deposit companies should be abolished so that businesses conducted in accordance with the Deposits Business Act should be permitted only by companies authorized by FI. To date, no action has been taken to implement these recommendations.

85. FI needs the flexibility to be more proactive in issuing regulations to address identified weaknesses. FI may issue regulations only in the areas specifically vested by a law or ordinance. In the case of the issuance of credit risk standards noted above, introduction has been delayed by several years awaiting amendment of the law or ordinance to provide the specific power required.

86. Ideally, FI should have a broad ability to issue regulations related to *any* safety and soundness issue. If this cannot be accommodated within the Swedish legal framework, then the MoF and Government should increase the resources assigned to amending the laws or ordinances, so that gaps identified by FI can be more promptly addressed. Failure to move forward on credit risk standards in the five years since the last FSAP, leaving material gaps with respect to four CPs, is a significant weakness in the prudential framework.

REMEDIAL AND CORRECTIVE ACTION

87. The 2011 FSAP noted several specific remedial powers lacked by FI (no specific power to remove senior management or rescind the appointment of an auditor). There is no evidence to suggest that these have been significant shortcomings in practice; when necessary, FI has been able to work with supervised institutions to achieve these changes. These powers will be addressed by 2017 in EU-wide standards.

88. There have been five cases since 2011 where claims for damages have been brought against FI before the Office of the Chancellor of Justice. In all five cases the Chancellor has ruled against the claimants. The possibility remains that supervisory action and resolution decisions may be stayed or reversed in a court of law.

89. The 2011 FSAP recommended pursuit of options to ensure supervisory action was not delayed through judicial appeal, and greater certainty that actions would not be reversed, while at the same time respecting Swedish legal traditions. One concrete measure taken was a legal amendment to permit the liquidation of a bank to begin immediately upon the revocation of its license. However, this does not apply to non-bank credit institutions, which are also authorized to take deposits from the public. This provision should be extended to non-bank credit institutions for the same reason—to reduce the loss exposure of the Deposit Guarantee Scheme.

90. The uncertainty arising from the potential for a stay or reversal of FI decisions remains. This also extends to decisions of the NDO in the context of resolution. Both the NDO and the FI are of the view that the presumption that their actions are in the public interest lessen the likelihood of a stay. Only once, ten years ago, has an action by FI been stayed by the courts;

however, the potential to delay or overturn resolution and supervisory decisions may complicate dealing with troubled institutions. The authorities, particularly in the context of recovery and resolution planning, should investigate the possibilities for limiting the circumstances in which actions could be stayed, and to limit remedies to an award of monetary damages if an authority is found to have acted in contravention of the law.

91. Review of supervision activities suggests that FI has taken decisive actions when warranted but such actions may not have been as timely as desirable. In a bank where the AQR inspection revealed long-standing credit risk management weaknesses, the supervisory dialogue took over two years until the identified problem was fully addressed. The mission believes that the elapsed time of more than two years is indicative of a lack of resources.

92. The concern expressed in 2011 over the lack of a special resolution regime has been addressed for systemically important institutions through the implementation of the BRRD via the Resolution Act and Ordinance. Many details of the resolution of systemically important institutions, however, remain to be worked out by the NDO, particularly the practical arrangements for coordinating among the members of the FSC.

93. General laws on bankruptcy, liquidation and winding-up continue to apply to all non-systemically important institutions. While having a special regime for systemically important institutions meets with minimum requirements of the Key Attributes of Effective Resolution Regimes and the BRRD, it would be beneficial to have a special resolution regime for other financial institutions. The ability to quickly seize control and resolve a failing institution can minimize losses to the Deposit Guarantee Scheme and minimize the disruption to the institution’s clients, reducing costs and disruption. Being able to resolve an insured depository institution, regardless of size, promptly and efficiently is in the public interest, even when the institution is not systemically important.

Appendix I. Update on Prudential Standards and the Practice of Supervision

The 2011 FSAP noted a number of areas where additional supervisory guidance was required and/or planned, even for principles assessed as largely compliant, to ensure that the prudential framework for banks was well aligned with international standards. Rapidly evolving international standards have in some cases overtaken FI's plans, and in other cases require that new or revised standards that had not been considered at the time of the 2011 FSAP now have to be met.

Principle	Issue/Topic	Status
Legal Protection for Supervisors, CP 1.	FI and its staff lack specific protection against liability for actions and omissions in discharging their duties when acting in good faith.	No changes since 2011, however, the Authorities, considering the existing provisions and practical experience, conclude that the general provisions applicable to all government authorities provide FI staff with extensive legal protection against actions taken in good faith while discharging their duties.
Permissible Activities, CP4.	Although about 99 percent of total deposits are held by institutions subject to FI oversight, approximately 20 entities operating under the Deposits Business Act, and not subject to FI oversight, also accept deposits.	CRD IV Article 9 stipulates that "Member States shall prohibit persons or undertakings that are not credit institutions from carrying out the business of taking deposits or other repayable funds from the public" and "Such restriction shall not apply to the taking of deposits or other funds repayable by a Member State, or by a Member State's regional or local authorities, by public international bodies of which one or more Member States are members, or to cases expressly covered by national or Union law, provided that those activities are subject to regulations and controls intended to protect depositors and investors." Continued existence of Swedish deposit-taking institutions not subject to FI oversight appears to contravene CRD IV.
Licensing, CP 5.	The absence of specific power for FI to revoke a license obtained with false information was addressed through legal amendment. FI does not assess the individual senior management (EC7) for fitness and probity, except for the CEO and deputy CEO. While not mandatory under the EBA guidelines, which thus are not in line with the Core Principles, it is worthy of note that at the time of issuance in 2012, the EBA noted that most competent authorities did assess senior management as part of the authorization process, and also at the time of appointment of new Key Function Holders.	FI notes that the concept of "senior management" does not exist in Swedish law.
Transfer of Significant	Although assessed as Compliant in 2011, the standards in the	the MoF has proceeded on the 2011 recommendation. It may receive

Principle	Issue/Topic	Status
Ownership, CP 6.	revised 2012 version of the Core Principles have changed. The shortcoming that led to the recommendation for a legal amendment to establish a requirement for banks to notify FI upon become aware of any material information that may negatively affect the suitability of a qualifying shareholder was an additional criterion in 2011. It is now an essential criterion (EC 6).	higher priority now that the lacuna is an essential criterion.
Major Acquisitions, CP 7.	Concerns over the high threshold (25 percent) for notification of FI, and lack of procedures for review of a proposed transaction.	Introduction of a notification requirement at the 10 percent threshold, and an FI Guideline for review have addressed the deficiencies.
Supervisory Approach, CP 8.	The major shortcoming identified in 2011 was the lack of a structured risk assessment process.	FI has made significant progress through the ongoing implementation of its Supervision Strategy. There is an EU-wide issue with respect to EC 1 and 6, as in the EU framework the responsibility for resolvability assessments is assigned to resolution authorities rather than competent authorities as required by this Principle. However, the arrangements to be developed to implement the Resolution Act and Ordinance, which transcribe the BRRD into Swedish Law, offer the opportunity to meet the intent of the Principle of ensuring that potential obstacles to recovery and resolution are identified and addressed through the supervisory process. This will require close cooperation between the NDO and FI to ensure that FI is able to demonstrate that its supervisory approach has adequately assessed the resolvability of banks as required by the Core Principles, even though Swedish law assigns the responsibility for resolvability assessments to the NDO.
Supervisory Techniques, CP 9.	In the 2011 assessment weaknesses were cited in seven CPs (risk management, credit risk, problem assets, market risk, liquidity risk, operational risk and internal audit) on the basis that FI is unable to satisfy itself that firms are complying with minimum standards in these areas. The assessors determined that there were inadequate levels of on-site supervision and inspection.	The significant increase in FI resources has been directed in part to increasing FIs capacity for supervisory review and verification. New analytical processes for liquidity, operational risk, credit risk and market risk have put in place more robust processes for supervisory verification. The two EBA yearly assessment sheets for the Nordea and SEB Colleges were positive, particularly with respect to joint risk assessments, indicating that for the larger banks there has been improvement in supervisory verification. Quarterly reviews for the large banks are an important element of the supervisory process; however, the number of inspection activities, even for the large banks, means that several years may pass between onsite review of specific risk areas.

Principle	Issue/Topic	Status
Supervisory Reporting, CP 10.	Concerns previously expressed about the granularity of reporting and the number of reporting errors by banks	FINREP and COREP implementation has addressed the concerns about the content of supervisory reporting. The number of reporting errors by banks has diminished significantly.
Corrective and Sanctioning Powers, CP 11.	2012 assessment included several specific recommendations: • Ensure that sanctions can be applied to senior management (in addition to Managing Director) • Consider early intervention framework • Identify appropriate revisions in order to remove legal uncertainties that are created by the possibility that a revocation decision can be overturned • Review levels of fines that can be applied to supervised institutions, including the removal of the existing cap of SEK 50 000 000.	Power to sanction has not been extended to senior management (beyond the managing director). Early intervention framework strengthened by implementation of CRR and CRD. Legal amendment to have liquidation commence immediately in the case of revocation of as bank license. Level of fines increased through implementation of CRD.
Corporate Governance, CP 14.	This is a new principle in the 2012 revision, and thus was not assessed in 2011.	FFFS 2014:1 establishes high level requirements for the Board in Chapter 3. However, the wording does not clearly establish the overall responsibility of the Board as contemplated in Principle 14, and elaborated upon in the Basel Committee Guidance, *Corporate Governance Principles for Banks* July 2015, which clearly separates good board practices from the role of senior management, and requires that senior management be subject to effective Board oversight (see page 2, (1) Board practices and (2) Senior Management). FI advised that the concept of senior management does not exist in Swedish law and further takes the view that the duties of the Board as specified in Chapter 8 Section 4 of the Companies Act making the directors responsible for the organization of the company and the management of the company's affairs establish an adequate standard. Nevertheless, Chapter 4 of EFFS 2014:1, could be read to mean that overall responsibility for controlling and managing risks could lie with the managing director, which is not the intent of the Basel guidance. (see Section 3 and 4, *with emphasis added* below): Section 3. The board of directors shall regularly, at least once a year, evaluate and, if required, update the internal rules on which it has decided. *The managing director shall regularly, at least once a year, evaluate the internal rules on which he/she has decided and update them if needed.*

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		In addition, the board of directors *or managing director* shall regularly review and assess the efficiency of the undertaking's organizational structure, procedures, measures, methods, etc. decided by the undertaking to comply with laws and other statutes regulating the operations of the undertaking that are subject to authorization. The board of directors *or managing director* shall also take appropriate measures for addressing any deficiencies therein. Section 4. The board of directors *or managing director* shall regularly evaluate whether the undertaking effectively and appropriately controls and manages its risks.
Risk Management, CP 15.	Previous concern that FI placed too great a focus on procedures and documentation rather than meaningful corroboration of quality of implementation	FI has increased its specialist risk management capacity and introduced structured approaches for risk assessment. Concern remains that due to resource constraints there may be an insufficient level of onsite verification.
Capital Adequacy, CP 16.	New capital standards—Basel II.5 and III.	The compliance of EU legislation with the Basel capital framework was assessed by the Basel Committee in 2014 (Regulatory Consistency Assessment Program (RCAP)—Assessment of Basel III regulations—European Union, December 2014). The assessment found the implementation of the Basel framework in the EU Materially Non-Compliant. The EU RCAP Assessment shows some areas where the Swedish application of the CRR/CRD is conservative and does not make use of all of the available options. Sweden frontloaded CRD and the four largest banks have been subject to a 3 percent buffer for systemic risks from 2013 and 5 percent from 2015 in accordance with the November accord. The risk weight floor for Swedish retail mortgages was introduced at 15 percent in 2013 and raised to 25 percent in 2014. The risk weight floor is constructed as an add-on under pillar 2. No entities have been excluded from prudential consolidation under the provisions of Article 19 (2) (c) the CRR. The CRR (Article 33) provides an exception for deduction of own creditworthiness gains on certain covered bonds, this provision is not used in Sweden. The CRR (Article 49) allows an option for consolidation (non-deduction) of insurance subsidiaries under a conglomerates policy. This option does

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		not include the BCBS Basel III FAQ condition that the capital required under consolidation must be at least as high as under deduction nor does it include the disclosure requirements. FI has not exercised the waiver. The CRR permits a more generous transitional phase-in period for certain deductions than under Basel III. Transitional arrangements for the amount of deferred tax assets that rely on future profitability subject to transitional arrangements under the CRR Article 478(2), amount of equity holdings in insurance undertakings, etc. subject to transitional arrangements under the CRR Article 47, amount of unrealized losses on exposures to central governments classified as 'Available for Sale' under IAS 39. FI uses none of those transitional arrangements, which provides additional comfort regarding the definition of capital, risk coverage, and the method of calculation; however, the fundamental concerns raised by the RCAP remain.
Credit Risk, CP 17.	Standards have changed, with two new ECs. EC 4 requires a prudential standard with respect to monitoring the total indebtedness of counterparties. EC 6 requires that a bank's Board or senior management to approve credit risk exposures exceeding a certain amount or percentage of a bank's capital or especially risky or otherwise not in line with the mainstream of the bank's activities.	There is no specific requirement in the EU framework with respect to EC 4 or 6, and updated national guidance has not yet been issued. Amendment to the Ordinance is required to permit FI to issue credit risk regulations due to lack of regulatory powers.
Problem assets, provisions and reserves, CP 18.	FI lacks the specific power to require banks to reclassify and/or increase provisions.	Amendment to the Ordinance is required to permit FI to issue credit risk regulations due to lack of regulatory powers. Previous concerns over adequacy of reporting addressed through FINREP and COREP.
Transactions with Related Parties, CP 20.	Recommended in 2011 that FI draft more specific regulations to ensure that there is clarity of requirements that institutions must meet.	Amendment to the Ordinance is required to permit FI to issue credit risk regulations due to lack of regulatory powers. Updated credit risk regulations not yet issued.
Country and Transfer Risk, CP 21.	No EU-wide or national standards established for country and transfer risk.	Amendment to the Ordinance is required to permit FI to issue credit risk regulations due to lack of regulatory powers. Intended to address this lacuna in the new credit risk regulations.
Market Risk, CP 22.	Previous concern that prudential standards had not been updated since 2000.	Addressed at EU level through revisions to the CRD and new EBA guidance.
Interest Rate Risk in the Banking Book, CP 23.	Previous recommendation for more specific prudential guidance.	Addressed, albeit at a high level, through revision of the CRD and a national Pillar 2 add-on.
Liquidity Risk, CP 24.	Extensive changes in international standards since 2011.	FI introduced a LCR requirement on larger Swedish institutions in 2013. Liquidity reporting is already in place. Other elements of the Basel III liquidity framework will be implemented in line with EU

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		requirements.
Operational Risk, CP 25.	Previously identified lack of prudential standards.	The Regulations and General Guidelines regarding the management of operational risks (FFFS2014:4), which are in line with the Basel Committee guidance, has addressed the lacuna in the prudential standards.
Internal Control and Audit, CP 26.	Significant enhancements of international standards.	FI's Regulations and General Guidelines regarding governance, risk management and control at credit institutions (FFFS2014:1) incorporate enhanced Basel Committee Guidance.
Financial Reporting and External Audit, CP 27.	Previous recommendation that FI should have the power to reject or rescind the appointment of an external auditor.	FI has been able to achieve the objective in practice even without the explicit power. Anticipate that new EU law on auditors and corresponding new FI mandate will provide FI with the specific power.