EUROPEAN CENTRAL BANK

# OPINION OF THE EUROPEAN CENTRAL BANK

**of 20 June 2003**

**at the request of the Swedish Ministry of Finance on a proposed legislative reform of Swedish banking and finance law**

**(CON/2003/10)**

1. On 26 February 2003, the European Central Bank (ECB) received a request from the Swedish Ministry of Finance for an opinion on a proposed legislative reform of Swedish banking and finance law (*lagrådsremiss om reformerade regler för bank- och finansieringsrörelse*) (the 'legislative proposal').

2. The ECB's competence to deliver an opinion is based on the second indent of Article 105(4) of the Treaty establishing the European Community and the fifth and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1] as the legislative proposal relates to payment and settlement systems and to rules applicable to financial institutions with influence on the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council of the ECB has adopted this opinion.

## The reform of Swedish banking and finance law

3. The Swedish reform of banking and finance law was initiated following the crisis in the banking sector in the early 1990s through the appointment by the Swedish Government of a committee to investigate the need for changes in the regulations governing banks and credit market undertakings – the Banking Law Committee (*Banklagskommitteen*). In its main report,[2] this committee recommended a comprehensive modernisation of the legislation governing banks and credit market undertakings. These recommendations were later addressed in a ministerial memorandum,[3] which formed the basis for the legislative proposal. According to the legislative proposal, the risk of serious disruption to the payment system and the credit supply – which would entail extensive

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1 OJ L 189, 3.7.1998, p. 42.

2 Regulation and Supervision of Banks and Credit Market Undertakings (*Reglering och tillsyn av banker och kreditmarknadsföretag,* SOU 1998:160).

3 Reformed Regulations for Banking and Financing businesses (*Reformerade bank- och finansieringsrörelseregler*, Ds 2002:5).

socioeconomic costs – makes regulation of banks and other credit institutions necessary. The intention is to achieve a stable financial system, in terms of resistance to both problems in individual institutions and macroeconomic disturbances, which provides good conditions for competition and a high degree of efficiency. The legislative proposal refers to the three main functions of the financial system: (i) the redistribution of savings to the benefit of existing needs regarding consumption and investment; (ii) the redistribution and reduction of risks; and (iii) the efficient fulfillment of the function of intermediary with regard to payments. It states that a well-functioning financial system should in particular ensure the reduction of the risk of disruption to the payment transmission function. One reason given for this focus is that systemic risk is a greater concern for the payment transmission function than for the other main objectives of the financial system. The market structure and developments with regard to financing activities, including the availability of capital through the securities market, mean that there is less risk of a crisis with respect to the supply of credit compared with the payment systems infrastructure, considering the latter's dependence on relatively few institutions. Although there is no legislative monopoly for banks to act as intermediaries with regard to payment systems, the existing monopoly for banks to take deposits has in practice resulted in a situation whereby banks have a dominant position as providers of payment services. Moreover, the trend towards consolidation in the banking industry has led to an increased dependence of the payment system function on ever fewer institutions and, consequently, systemic vulnerability has become greater. In order to safeguard the payment system, the legislative proposal attaches particular importance to payment intermediaries receiving short-term deposits and participating in payment systems open to a large number of senders and receivers of payments.

4. Against this background, the legislative proposal recommends a new definition of 'banking' (*bankrörelse*). This differs from the current definition, which refers to deposits on account where the balance is determined in nominal amounts and is available to the depositor at short notice. Instead, the legislative proposal suggests that the focus should be shifted towards an increased protection of the transmission of payments by entities that are both recipients of funds available to the depositor at short notice and providers of money transmission services via general payment systems. The proposed new definition is also different from the definition of 'credit institutions' in Community law, as further considered in paragraphs 11 - 14 below.

5. The legislative proposal states that neither the safeguarding of the payment system, nor consumer protection considerations, justify a restriction to banks of the right to accept deposits. On the contrary, it argues that an elimination of the banks' 'deposit-taking monopoly' would increase choice and competition. It therefore recommends that the exclusive right of banks to accept deposits is abolished. This suggestion is addressed in paragraphs 15 - 17 below.

6. The legislative proposal states that the need to regulate the provision of credit is not as strong as the need to regulate the payment system function. It is, however, difficult to define exactly which forms of financing are most worthy of protection. The legislative proposal recommends a new

definition of the term 'financing activities' (*finansieringsrörelse*), based on the Community law definition of 'credit institutions'. The definition of financing activities refers to institutions that accept repayable funds from the public and provide credit. This aspect of the legislative proposal is discussed in paragraphs 18 - 19 below.

7. The legislative proposal also recommends a reformation of the rules for banks and credit market undertakings, including new regulations concerning solvency and liquidity, risk management and transparency. Banks and credit market undertakings need to conduct their business in a manner that does not put at risk their capacity to meet their obligations and they should therefore be obliged to identify, measure, govern and control any risks associated with their business. The business should also be conducted and organised in a manner that allows an overview of the institution's financial position and be generally sound. These proposed new rules, and the role of the Financial Supervisory Authority (*Finansinspektionen*) in this respect, are addressed in paragraphs 20 - 21 below.

8. The legislative proposal also addresses specifically the supervisory activities of the Financial Supervisory Authority and its ability to monitor and intervene vis-à-vis institutions and with regard to the financial sector. The proposed legislation would allow the Financial Supervisory Authority to impose a wider range of sanctions, as considered in paragraph 22 below.

9. The main part of the reform is contained in a proposed new Act on banking and financing activities (*förslag till lag om bank- och finansieringsrörelse*). In addition, the legislative proposal contains a suggestion for a new Act on deposit-taking (*förslag till lag om inlåningsverksamhet*). Moreover, it contains several additional amendments to other Swedish acts related to banking and finance, including the Sveriges Riksbank Act (*lagen (1988:1385) om Sveriges Riksbank*), the Act on consumer credit (*konsumentkreditlagen (1992:830)*), the Act on measures against money laundering (*lagen (1993:768) om åtgärder mot penningtvätt*), the Act on capital adequacy and large exposures for credit institutions and securities firms (*lagen (1994:2004) om kapitaltäckning och stora exponeringar för kreditinstitut och värdepappersbolag*), the Marketing Act (*marknadsföringslagen (1995:450)*), the Act on deposit guarantees (*lagen (1995:1571) om insättningsgaranti*), the Act on systems for the settlement of obligations in the financial market (*lagen (1999:1309) om system för avveckling av förpliktelser på finansmarknaden*) and the Act on the issuance of electronic money (*lagen (2002:149) om utgivning av elektroniska pengar*). Many of these latter amendments of related acts represent changes of a legislative technical nature (such as the amended references in the Riksbank Act) resulting from the proposed introduction of the new Act on banking and financing activity and the repeal of the current Swedish acts on banking (*bankrörelselagen (1987:617)*) and financing activity (*lagen (1992:1610) om finansieringsverksamhet*) and are not commented upon separately.

10. The legislative proposal concerns several existing EU directives. The proposed Acts on banking and financing activities and on deposit-taking are, *inter alia*, intended to reflect rules contained in such directives. For instance, the proposed new definition of banking has to be read against the

provisions of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions[4] (the Consolidated Banking Directive). Other relevant EU legal acts are Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes[5] (the Deposit Guarantee Scheme Directive), Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems[6] (the Settlement Finality Directive) and Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up and pursuit of and prudential supervision of the business of electronic money institutions[7] (the E-money Directive). Also Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering[8] (the Money Laundering Directive) is relevant considering the proposed extension to allow non-supervised entities to take deposits under the new regime.

**The definition of banking**

11. The legislative proposal introduces a new definition of 'banking' so as to include both payment services through general payment systems and the receipt of funds available to the depositor with less than 30 days notice. Part of the rationale behind this new definition is the wish to focus on the activity which, according to the analysis in the legislative proposal, requires most attention from a systemic risk perspective, namely the functioning of payment systems open to a large number of senders and receivers of payments. This proposed new definition of banking is different compared to the definition of credit institution in the Consolidated Banking Directive. The Community definition of 'credit institution' is contained in Article 1 of the Consolidated Banking Directive and refers to an undertaking whose operations consist of accepting deposits or other repayable funds from the public and granting credits for its own account. As explained in the legislative proposal, also the existing Swedish definition of 'banking' differs from the definition of 'credit institution' in the Consolidated Banking Directive. In accordance with Chapter 1, Article 2 of the Swedish Banking Act currently in force (*bankrörelselagen (1987:617)*), 'banking' refers to operations that include deposits on account if the balance is determined in nominal amounts and available to the depositor on short notice. The provision of credit, which is a part of the definition of credit institutions in the Consolidated Banking Directive, is thus not a requirement for the conduct of banking under either the current or the proposed Swedish legislation. Those institutions which today do not meet the criteria for banks and which engage in lending are currently regulated instead by the Act on financing activities (*lagen (1992:1610) om finansieringsverksamhet*). As clarified in the legislative proposal, all Swedish undertakings that engage in the type of activities carried out by

4 OJ L 126, 20.3.2000, p. 1.
5 OJ L 135, 31.5.1994, p. 5.
6 OJ L 166, 11.6.1998, p. 45.
7 OJ L 275, 27.10.2000, p. 39.
8 OJ L 166, 28.6.1991, p. 77.

credit institutions, as defined in the Consolidated Banking Directive, are thus currently subject to a Swedish regulation that meets the latter's requirements. According to the legislative proposal, the repeal of the Banking Act and the Act on financing activities and the enactment of the proposed new Act on banking and financing activities, which will introduce the new definition of 'banking business', will not change this situation.

12. The effects of the proposed Swedish definition of 'banking' is in the following considered in the light of the use of the term 'credit institution' in Community legislation in general and in ECB legal acts. The ECB has considered the proposed new definition with particular regard to (a) the need for further integration of the financial markets on an EU-wide basis; and (b) the Eurosystem's monetary policy operations, the collection of monetary statistics, and the competence of the European System of Central Banks (ESCB) in the field of payment systems.

13. There is no legal requirement to use in national laws the same definition of credit institutions as in the Consolidated Banking Directive, and differences do exist between Member States. Such differences can, however, make the achievement of a truly single financial market more difficult. Extensive and innovative national reforms, as presented in great detail in the Swedish legislative proposal, may very well have implications for the functioning and future development of the financial market elsewhere in the EU. Hence, all Member States ought to have a common interest in the kind of important policies set out in the legislative proposal. The ECB is of the opinion that, to the extent possible, amendments to national financial legislation should promote the integration of EU financial markets. The ECB notes in this connection that future Community legislation can be expected to maintain the reference to credit institutions, as currently defined, which complicates the analysis of the resulting effects of having a divergent national definition. This issue has already been raised in previous consultations by other parties and is considered in the legislative proposal, where it is noted that some Swedish entities may comply with the proposed new definition of banking although they do not provide credit. The ECB would in this regard like to stress the importance of ensuring a level playing field across countries within the EU.

14. The legal acts of the ECB also make use of the term credit institutions, as defined in the Consolidated Banking Directive, and attach certain rights and obligations to an institution which has this status. The question as to which types of entities in a certain Member State are regarded as credit institutions is of particular importance to the ECB in the context of the Eurosystem's monetary policy operations and for the collection of monetary statistics. For countries that have adopted the euro, it is particularly important to establish the status of credit institutions in relation to the access to the standing facilities that are used as monetary policy instruments and to ensure equal treatment throughout the euro area. These institutions would also have to comply with the Eurosystem's requirements with regard to the minimum reserve system and the statistical reporting requirements of the ECB in the field of money and banking statistics. Moreover, the question of an institution's status as a credit institution is also important in relation to participation in EU payment systems. In this respect, the Consolidated Banking Directive and the Settlement Finality Directive

form a legislative framework that aims to ensure that only credit institutions subject to supervision by competent authorities participate in payment systems that are protected through the provisions on settlement finality implementing the latter directive. Hence, only undertakings that meet the definition of 'participant' under the Settlement Finality Directive (credit institutions) are entitled to participate in payment systems that have been designated under it, including the TARGET system operated by the central banks. Again, divergent national definitions complicates the application of the Eurosystem-wide (and, in relation to TARGET, the ESCB-wide) rules, even if the ECB can make efforts to take account of national differences when formulating its rules and, for its Guidelines, during the implementation stage.

**The abolition of the banks' monopoly on deposit-taking**

15. The legislative proposal also abolishes the banks' monopoly on deposit-taking. It is intended to enhance competition with regard to deposit-taking and introduce an element of choice for consumers through greater variety of alternatives for the deposit of their savings. This is achieved by, on the one hand, allowing entities other than banks to take deposit and, on the other hand, ensuring that households will continue to have access to forms of deposit-taking where the funds deposited are guaranteed under the Act on deposit guarantee (*lag (1995:1571) om insättningsgaranti*). Through the proposed abolishment of the banks' monopoly on deposit-taking, credit market undertakings will also be allowed to take deposits and the proposal extends the deposit guarantee to cover such deposits. In addition, the legislative proposal provides other companies not covered by the Act on deposit guarantee with the opportunity of taking deposits from the general public. This latter proposal will thus apply to non-financial institutions, which are not subject to prudential supervision by the Swedish Financial Supervisory Authority and deposits with such entities will not be covered by the deposit guarantee. Instead, the proposal introduces a set of special requirements for these entities and deposits through the enactment of the Act on deposit-taking activities (*lag om inlåningsverksamhet*). These requirements refer to the form of associations that may take non-guaranteed deposits, namely limited companies (*aktiebolag*) and economic associations (*ekonomiska föreningar*) with a minimum restricted own capital (SEK 10 million for limited companies and SEK 5 million for economic associations) and to the owners and auditors of such entities. They also prescribe a maximum amount on deposit per consumer of SEK 50,000 and specify the need to provide clear information concerning the status of the deposit as non-guaranteed. Other requirements refer to the presentation of the deposit-taking activity in the annual accounts and the possibilities for the Financial Supervisory Authority to intervene in cases of non-compliance. Finally, any undertakings involved in deposit-taking will also be subject to the Swedish legal rules and measures against money laundering.

16. In view of the special legal requirements and the role of the Financial Supervisory Authority, the proposed new (non-guaranteed) regime for deposit-taking should have no systemic risk implications. In this context, the ECB would like to emphasize, however, the importance of achieving the intended public awareness concerning the status of these additional entities as non-

supervised and of the deposits as not covered by the deposit guarantee scheme. The effectiveness of the application of the obligations to provide clear information contained in Section 7 of the Act on deposit-taking will be important in this regard. The information must be effectively communicated to the general public since it is important for depositors to be fully aware that the Financial Supervisory Authority does not in fact conduct prudential supervision over these entities (and that the monitoring of the entities' financial health therefore rests with the depositors themselves). This is especially relevant if these non-supervised entities encounter problems, since misconceptions concerning the supervision of these entities could otherwise potentially create negative spillover effects on the financial system.

17. The ECB would also like to mention that the proposed Act on deposit-taking should apply exclusively to 'deposits' that serve as savings deposits (store of value) and not to 'deposits' that serve as means of payment. Deposits collected by deposit-taking entities which are not supervised credit institutions should not function as electronically-stored means of payment since this could lead to a possible characterisation of the new form of deposit-taking as electronic money falling under the E-money Directive.

**Financing activities**

18. The need to regulate financing activities is considered less important than the need to regulate the transfer of payments. With regard to the granting of credits, the legislative proposal takes as a starting point the Community definition of credit institutions (receiving deposits from the public and granting credits for its own account) and lays down a new definition of 'financing activities'. The proposed definition refers to institutions that (i) accept repayable funds from the public, directly or indirectly through a closely connected company; and (ii) provide credit, give guarantees in support of credit transactions or acquire debt obligations or rent out personal property for financing purposes. As a general rule, financing activity will only be allowed with authorisation from the Financial Supervisory Authority and will be subject to the latter's supervision, although certain exceptions are proposed. One change to the current regime is the proposal that only credit providers that take deposits from the general public will be covered by the definition and subject to the Financial Supervisory Authority. Other deposit-taking entities (not covered by the definition of financing activities), will be subject to the rules in the Act on measures against money laundering, which is welcomed by the ECB.

19. The ECB shares the view that it is deposit-taking entities participating in general payment systems that require most attention from a systemic risk perspective. Considering the proposed new rules on the extension of deposit-taking activity to encompass banks and credit market undertakings which participate in general payment systems, the ECB would like to emphasize that the supervisory resources should focus on the more systemically relevant institutions. The expansion of the tasks of the Financial Supervisory Authority will require that sufficient resources continue to be allocated to its core functions with regard to financial stability. It is also recalled that, as an additional safeguard, the Treaty allocates the oversight of payment systems to the central bank and the

continued close co-operation between the Supervisory Authority and the Riksbank will remain important.

**The rules for banks and credit market undertakings**

20. The legislative proposal contains common new rules for banks and credit market undertakings. The ECB notes, in particular, the proposed new rules concerning solvency, liquidity, risk management and transparency. The legislative proposal states its intention of defining a regime whereby credit institutions conduct their business in a manner that ensures, *inter alia*, that they can fulfil their obligations and control their risks.

21. The ECB welcomes the proposed new prudential rules for banks, considering, *inter alia,* the role of the Financial Supervisory Authority referred to in Chapters 13 – 17 of the proposed Act on banking and financing activities and its power to issue more detailed regulations within its competence. In addition, the ECB notes that, in the previous consultation on the legislative proposal, Sveriges Riksbank indicated that, although solvency is important, the control of liquidity risk should be further emphasized considering, *inter alia*, the 'moral hazard' stemming from the Riksbank's function as lender of last resort. On this specific issue, the ECB understands that the Swedish Government shares this point of view, as explained in the legislative proposal, and this is welcomed by the ECB.

**Supervision**

22. The legislative proposal allows the Financial Supervisory Authority to apply a wider range of sanctions related to the authorisation and supervision of credit institutions. It explains that the present system of sanctions has been criticised for not providing the Financial Supervisory Authority with sufficient possibilities to intervene appropriately. The possibility of revoking a bank's charter or a credit market undertaking's licence is never used in practice since it is, as a rule, considered as too far-reaching an intervention. The future system should enable the Financial Supervisory Authority to concentrate its supervisory initiatives on breaches of a more serious nature from the point of view of system stability. The Financial Supervisory Authority should have greater scope than at present to assess the measure that is appropriate in a particular situation and to be equipped with more means at its disposal for intervention. A new system of interventions and sanctions, which is more flexible than the present regime, is suggested in the legislative proposal. The Supervisory Authority can, *inter alia*, issue an order to take action within a specified period, a prohibition against the carrying out of a certain decision or a warning. If there is a serious breach, the credit institution's authorisation can be withdrawn. The Authority may decide not to intervene if a breach is minor or excusable, if the institution rectifies the problem, or if another authority has intervened and this is regarded as sufficient. The ECB welcomes the proposal to provide the Financial Supervisory Authority with a set of sanctions that are better adapted to the objectives of effective prudential supervision.

23. The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion. This opinion will be published on the ECB's website six months after the date of its adoption.

Done at Frankfurt am Main on 20 June 2003.

*The President of the ECB*

[signed]

Willem F. DUISENBERG