



EUROPEAN CENTRAL BANK

EUROSYSTEM

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ECB-PUBLIC

OPINION OF THE EUROPEAN CENTRAL BANK
of 18 May 2017
on the financial independence of Sveriges Riksbank
(CON/2017/17)

Introduction and legal basis

On 21 March 2017 the European Central Bank (ECB) received a request from the Swedish Ministry of Finance for an opinion on a draft legislative proposal concerning the financial independence and balance sheet of Sveriges Riksbank (hereinafter the 'draft legislative proposal').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third indent of Article 2(1) of Council Decision 98/415/EC¹, as the draft legislative proposal concerns Sveriges Riksbank. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft legislative proposal

- 1.1. The draft legislative proposal proposes to amend the Riksbank Act with the aim of regulating (a) the size of the Riksbank's equity capital; (b) the allocation of the Riksbank's profits and losses, including the distribution of dividends from the Riksbank to the Treasury; (c) the circumstances in which the Riksbank may request a recapitalisation following losses; and (d) the Riksbank's right to borrow from the Swedish National Debt Office for its foreign currency reserve².
- 1.2. *Existing provisions regarding the Riksbank's capital, accounting framework, allocation of profits and foreign reserves*
 - 1.2.1. Currently, the Riksbank Act provides that the Riksbank shall have capital in an amount of one billion kronor (SEK), a reserve fund of SEK 500 million and a contingency fund. Each year, the General Council of the Riksbank makes proposals to the Swedish Parliament and the National Audit Office on the allocation of the Riksbank's profit. The Riksbank's profit and loss account and balance sheet are approved by the Parliament, which also determines the allocation of the

¹ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

² See the draft referral to the Council on Legislation, The Riksbank's financial independence and balance sheet, p. 1.

Riksbank's profit³. The Riksbank is required to keep accounts in accordance with generally accepted accounting principles. In addition, the ECB's guidelines on the legal framework for accounting and financial reporting in the European System of Central Banks have to be applied⁴.

1.2.2. Currently the Riksbank Act provides that, in pursuance of its monetary policy, the Riksbank may, inter alia, purchase, sell and mediate foreign exchange. In pursuance of its foreign exchange policy, the Riksbank, inter alia: (a) is to hold assets in foreign currency, foreign claims and gold; (b) may purchase, sell and mediate foreign currency, foreign government securities, other liquid debt instruments in foreign currency and gold, as well as other rights and obligations linked to such assets; and (c) may obtain credit in foreign currency⁵. In exceptional circumstances, the Riksbank may, with the aim of supporting liquidity, grant credit (including in foreign currency) or provide guarantees on special terms to banking institutions and Swedish companies subject to the supervision of the Financial Supervisory Authority⁶.

1.2.3. Under the Budget Act, the National Debt Office, by decision of the Government, may raise loans for the central government to satisfy the Riksbank's need for foreign currency reserves⁷. Under the Riksbank Act, in pursuance of its exchange rate policy, the Riksbank may issue its own debt instruments denominated in foreign currency for these purposes⁸. As clarified in the referral accompanying the draft legislative proposal, such borrowing is carried out in practice by the National Debt Office raising foreign currency loans, then the Riksbank issuing a customised bond to the National Debt Office that reflects the loans raised by that Office⁹.

1.3. *Draft legislative proposal's provisions regarding the Riksbank's equity capital*

1.3.1. The draft legislative proposal provides that the Riksbank's equity shall not exceed SEK 60 billion (referred to as the 'targeted equity')¹⁰. For this purpose equity consists of primary capital, a reserve fund and retained profits. The Riksbank's restricted equity consists of its primary capital and the reserve fund. Initially, the primary capital shall amount to SEK 40 billion, and the reserve fund shall amount to zero¹¹. The draft legislative proposal further stipulates that an amount equal to two thirds of the targeted equity shall be referred to as the guaranteed level of the restricted equity¹². Although the phrase 'guaranteed level' is used in the draft legislative proposal, the draft legislative

³ Guidelines have been drawn up by the General Council of the Riksbank on how its profit is to be allocated. According to these guidelines, the Riksbank should pay 80 % of its profit to the State, after adjustment for exchange rate and gold valuation effects and based on a five-year average, with the remaining 20 % used to increase its own capital. See the Riksbank's submission to the Parliament, Proposal for the allocation of the Riksbank's profits for the financial year 2016, p.4, and the General Council's Annual Report 2016, available at www.riksbank.se. However, as these guidelines are not legally binding, there is no statutory provision limiting the amount of profit that may be paid out.

⁴ The Riksbank Act 1998, Chapter 10, Articles 1, 3 and 4.

⁵ The Riksbank Act, Chapter 7, Articles 2, 3 and 4.

⁶ The Riksbank Act, Chapter 6, Article 8.

⁷ The Budget Act, 2011, Chapter 5, Section 1, first paragraph. See comment to footnote 4.

⁸ The Riksbank Act, Chapter 7, Article 3(2); the Budget Act, Chapter 5, Section 1, second paragraph.

⁹ See the draft referral, footnote 2, p. 17.

¹⁰ See the proposed new Article 1, Chapter 10 of the Riksbank Act.

¹¹ See proposed first to third paragraphs of new Article 2, Chapter 10 of the Riksbank Act.

¹² See proposed fourth paragraph of new Article 2, Chapter 10 of the Riksbank Act.

proposal does not, as such, legally guarantee the level of the Riksbank's restricted equity. The draft legislative proposal further provides that when calculating the targeted equity and the so-called guaranteed level, the amounts shall be recalculated in accordance with the annual percentage change in the Swedish consumer price index published by Statistics Sweden (the 'CPI adjustment'), except that if the change is less than zero (i.e. in the event of deflation), no recalculation need be done¹³.

1.3.2. As noted in the referral accompanying the draft legislative proposal, the Riksbank needs to have access to more loss-absorbing equity to manage losses that may arise as a result of a number of risks faced by the Riksbank. The Riksbank's recent purchase of government bonds with the aim of influencing long-term and short-term interest rates has created new risks for the Riksbank's equity, as significant holdings of government bonds are associated with risks due to lower asset values for the holdings when there is a trend towards rising interest rates. In addition, the banking sector in Sweden has continued to increase in size, and experiences from the financial crisis suggest that the Riksbank should have loss absorbing equity. The Riksbank's seigniorage should not be considered when determining the Riksbank's need for equity, due to changes to the general level of interest rates, together with the expectation that the banknote usage in Sweden will decrease over time¹⁴.

1.4. *Draft legislative proposal's provisions regarding the allocation of the Riksbank's profits and losses*

1.4.1 The draft legislative proposal provides that, if the Riksbank's annual accounts show a profit, provisions must be made to the reserve fund. However, such provisions may not exceed an amount corresponding to the change in the guaranteed level of the restricted equity, as adjusted pursuant to the CPI adjustment. Any excess funds will be transferred to retained profits. If after such transfers to the reserve fund and retained profits the Riksbank's equity exceeds the targeted equity (SEK 60 billion subject to the CPI adjustment, if applicable), the excess profit shall be transferred to the Treasury¹⁵.

1.4.2 The draft legislative proposal also provides that if the Riksbank's annual accounts show a loss, this loss will in the first instance be covered by retained profits, then by the reserve fund and, as a last resort, by the primary capital. If, after covering for losses, retained profits are greater than zero, an amount may be transferred from retained profits to the reserve fund that corresponds to no more than the change in the guaranteed level [for] the restricted equity pursuant to the CPI adjustment¹⁶. If the primary capital has been used to cover losses, the profits of coming years shall in the first instance be used to restore the primary capital to the level it stood at prior to the loss arising. Excess funds may be transferred to the reserve fund until the Riksbank's restricted equity amounts to the guaranteed level set out above (SEK 40 billion subject to the CPI adjustment, if applicable)¹⁷.

13 See proposed new Article 8, Chapter 10 of the Riksbank Act.

14 See the draft referral, footnote 2, pp. 20-24.

15 See proposed new Articles 3 and 4, Chapter 10 of the Riksbank Act.

16 See proposed new Article 5, Chapter 10 of the Riksbank Act.

17 See proposed new Article 6, Chapter 10 of the Riksbank Act.

1.4.3 As currently set out in the Riksbank Act, the General Council of the Riksbank makes proposals to the Parliament and the National Audit Office on the allocation of the Riksbank's profit¹⁸. The draft legislative proposal stipulates that, when applicable, and at least every five years, the General Council of the Riksbank shall make proposals to the Parliament and the National Audit Office on transferring the funds in the reserve fund to the primary capital¹⁹. As currently set out in the Riksbank Act, the Riksbank's profit and loss account and balance sheet are approved by the Parliament, which also determines the allocation of the Riksbank's profit²⁰. The draft legislative proposal provides that the Parliament shall further determine transfers of funds in the Riksbank's equity to cover losses, as set out above, as well as the restoration of the restricted equity, as set out below²¹.

1.5. *Draft legislative proposal's provisions regarding recapitalisation of the Riksbank*

1.5.1. The draft legislative proposal provides that if, following deduction of funds from the revaluation accounts, losses result in the level of the Riksbank's restricted equity being less than half of the guaranteed level set out above (i.e. less than SEK 20 billion subject to the CPI adjustment, if applicable), the Riksbank may submit a request for the level of the restricted equity to be restored. A request for restoration may concern at most the sum necessary to ensure that the restricted equity amounts to the guaranteed level set out above (SEK 40 billion subject to the CPI adjustment, if applicable). The determination on the request for restoration is made by the Parliament²².

1.5.2. As noted in the abovementioned referral, when making the calculation as to when the restricted equity falls below half of the guaranteed level, the Riksbank must first deduct existing funds in the revaluation accounts. The Government concludes that the Riksbank should realise profits booked in the revaluation accounts, excepting changes in the value of the gold reserve, before restoration of the restricted equity can take place²³.

1.6. *Draft legislative proposal's provisions regarding the Riksbank's foreign currency borrowings from the National Debt Office*

1.6.1. The draft legislative proposal introduces a new chapter in the Riksbank Act governing borrowing from the National Debt Office for the Riksbank's foreign currency reserve pursuant to the Budget Act²⁴. The second paragraph of the new chapter stipulates that if the Riksbank has used some of its foreign currency reserve for liquidity support borrowing may take place through the National Debt Office to restore the foreign currency reserve. In addition, if exceptional grounds exist for doing so, the Riksbank may decide to strengthen its foreign currency reserve by borrowing in advance up to SEK 50 billion (as adjusted pursuant to the CPI adjustment) through the National

18 The Riksbank Act, Chapter 10, Article 3.

19 See proposed second paragraph of new Article 10, Chapter 10 of the Riksbank Act.

20 The Riksbank Act, Chapter 10, Article 4.

21 See proposed first paragraph of new Article 4, Chapter 10 of the Riksbank Act.

22 See proposed new Article 7, Chapter 10 of the Riksbank Act.

23 See draft referral to the Council on Legislation, footnote 2, p. 43.

24 See proposed new Chapter 10a of the Riksbank Act.

Debt Office²⁵. If exceptional grounds exist for doing so, and the Riksbank deems that the foreign currency reserve needs to be strengthened over and above this amount, this decision is taken by the Parliament following a request from the Riksbank.

- 1.6.2. The referral notes that the reason for the proposed arrangement is that advance strengthening of the foreign currency reserve should be limited to the event of a financial crisis or similar serious situations when there is a need to meet rapidly arising liquidity requirements (in general or in individual financial institutions). Circumstances of this type may be considered to form exceptional grounds for the advance strengthening of the foreign currency reserve to allow a rapid response to any such need that arises. This means that, in normal situations, the foreign currency reserve shall not increase in an uncontrolled manner²⁶.
- 1.6.3. The referral notes that at the end of 2016 the Riksbank's debt to the National Debt Office for the Riksbank's foreign currency reserve amounted to SEK 257 billion. The Government considers that existing advance loans that the Riksbank has already taken to strengthen the foreign currency reserve must be repaid when the draft legislative proposal enters into force. If the Riksbank intends to retain existing loans up to an amount of no more than SEK 50 billion, exceptional grounds for this borrowing must exist. However, in the Government's opinion, no such exceptional grounds exist at present. The repayment of the current foreign exchange loans should take place through the Riksbank transferring assets to the National Debt Office corresponding to the Riksbank's foreign exchange loans from the National Debt Office. Allocation of asset types to be transferred to the National Debt Office should take place following agreement between the Riksbank and the National Debt Office. Transferred assets should be managed within the framework of the National Debt Office's debt management²⁷.
- 1.7. *Entry into force of the draft legislative proposal*
- The draft legislative proposal would enter into force on 1 January 2018.

2. General observations

- 2.1. The ECB would like to emphasise that, although Member States with a derogation, including Sweden, do not yet participate in the third stage of economic and monetary union, they have a legal duty to adapt the statutes of their national central banks (NCBs) to ensure compatibility with the Treaty²⁸ and the Statute of the European System of Central Banks and of the European Central Bank (the 'Statute'). Any legislative reform in any such Member State should aim to gradually achieve consistency with Eurosystem standards²⁹.
- 2.2. The ECB recalls that it has repeatedly pointed out in its convergence reports that Sweden needs to adapt its legislation governing the Riksbank to comply with Treaty requirements related to, inter

²⁵ See proposed new Article 3, Chapter 10a of the Riksbank Act.

²⁶ See draft referral, footnote 2, pp. 30-31.

²⁷ See draft referral, footnote 2, pp. 18, 34-35, 39-40.

²⁸ See Article 131 of the Treaty.

²⁹ See paragraph 3.4 of ECB Opinion CON/2008/34.

alia, financial independence and the distribution of profits³⁰. The ECB recalls that both the ECB and its precursor, the European Monetary Institute, have issued several opinions in response to consultation requests from the Swedish Ministry of Finance and the Parliament which have considered matters relating to the financial independence of the Riksbank³¹.

- 2.3. The independence of an NCB, as required under Article 130 of the Treaty and Article 7 of the Statute, would be jeopardised if it could not autonomously avail itself of sufficient financial resources to fulfil its mandate (i.e. to perform the European System of Central Bank (ESCB)-related tasks required of it under the Treaty and the Statute). The principle of financial independence also implies that an NCB must have sufficient means to perform not only its ESCB-related tasks but also its own national tasks, e.g. financing its administration and own operations³². Therefore, a Member State may not put its NCB in a position where it has insufficient financial resources and inadequate net equity to carry out its tasks. For all these reasons, financial independence implies that an NCB should always be sufficiently capitalised. Financial independence requires that in performing its tasks an NCB can independently assess the risks involved and has the power to decide on any necessary precautions to take. An NCB is best placed to make these assessments and needs to have the necessary tools to evaluate the relevant circumstances and to make forecasts³³.
- 2.4. The ECB takes particular note that the Government has identified a number of financial risks faced by the Riksbank, including the relatively large size of the banking sector in Sweden, the Riksbank's significant holdings of low interest-bearing government bonds, and the anticipated decline in the Riksbank's seigniorage income due, inter alia, to decreased banknote usage in Sweden. Regarding the relatively large size of the Swedish banking sector, the Swedish banking system's total balance sheet amounted to SEK 17,250 billion in January 2017, which is four times Sweden's GDP³⁴. Sweden's large and growing cross-border banking sector has considerable commitments in foreign currencies³⁵. This entails significant risks to financial stability both in Sweden, as well as potentially for other countries in the Nordic-Baltic region, where Swedish banking groups have substantial market presence. In this respect it would be advisable, from a financial stability perspective, to carefully consider the Riksbank's day-to-day and exceptional spending needs given the Riksbank's tasks, including the Riksbank's tasks in exceptional circumstances, with the aim of supporting liquidity, to grant credit or provide guarantees on special terms to banking institutions and Swedish companies, subject to the supervision of the Swedish Financial Services Authority³⁶.

30 See, e.g., ECB, Convergence Report June 2016, pp. 194-95.

31 See ECB Opinions CON/2005/54, CON/2008/34 and CON/2013/53 and EMI Opinion CON/1997/26.

32 See, e.g., ECB, Convergence Report June 2016, p. 25.

33 See ECB, Convergence Report June 2016, p. 25; paragraph 2.2 of ECB Opinion CON/2009/53, paragraph 2.4.2 of ECB Opinion CON/2009/83, paragraph 3.3 of ECB Opinion CON/2014/24, paragraph 2.2 of ECB Opinion CON/2014/27 and paragraph 3.1.1 of ECB Opinion CON/2014/56.

34 See Sveriges Riksbank, Consultation response to the report on the Riksbank's financial independence and balance sheet, 27 April 2017, pp. 1-2; see also [Statistics Sweden's Financial Market Statistics, January 2017](#).

35 See Sveriges Riksbank, Consultation response to the report on the Riksbank's financial independence and balance sheet, 27 April 2017, p. 1.

36 See, e.g., ECB, Opinion CON/2012/69, paragraph 3.3; The Riksbank Act, Chapter 6, Article 8.

- 2.5. There are several provisions in the draft legislative proposal that would undermine the Riksbank's independence, including its financial independence and its ability to independently perform its basic monetary and foreign exchange policy functions, and the ECB's concerns in this regard are set out below in more detail. To ensure that the Riksbank has the requisite level of independence, it is critical that at all times it has sufficient capital and foreign exchange reserves to conduct its functions, and that it remains in a position to ensure the required existence of financial buffers, to preserve an appropriate level of own funds and reserves.

3. Specific observations

3.1 *Level of the Riksbank's equity capital*

3.1.1 Pursuant to the Riksbank Act³⁷, the Riksbank has its own funds that are kept separate from the Treasury. Furthermore, the Government's budget has no special appropriations item for the Riksbank. The cost of the Riksbank's operations are instead covered by its own revenues, e.g. from the return it receives from investing the capital allocated to it. Therefore, it is important that the Riksbank's equity is able to generate sufficient return to cover costs and accrued losses in the Riksbank's operations.

3.1.2 As mentioned above, in carrying out its tasks an NCB should assess the risks involved and have the power to independently decide on the necessary precautions to take. The draft legislative proposal provides for a statutory ceiling on the level of targeted equity which may be held by the Riksbank, resulting in it not having discretion to increase its targeted equity when required to cover its risk exposures. The draft legislative proposal therefore impacts adversely on the Riksbank's financial independence, in particular with respect to its ability to deal with future financial and economic developments³⁸.

Furthermore, there is no separate guarantee obligation with respect to the so-called guaranteed level [for] restricted equity, while the draft legislative proposal implies that the Riksbank can only apply for recapitalisation when the restricted equity has fallen below a certain level. As such, when these aspects are considered together, the draft legislative proposal contains an absolute ceiling on the level of the target equity but a more permeable lower limit which can drop quite considerably below the so-called guaranteed level before more substantial corrective action will occur. The ECB has concerns with respect to this arrangement from a financial independence perspective as it appears to be relatively permissive of a downward move in the level of equity capital while prohibiting an increase in the level of target equity or, at least, not providing a statutory mechanism under which it can be increased.

³⁷ The Riksbank Act, Chapter 10, Article 1.

³⁸ See paragraphs 4.3 and 4.4 of ECB Opinion CON/2008/34.

3.1.3 The ECB understands that the Riksbank's equity would not include its Riksbank's revaluation accounts³⁹. The revaluation accounts will not therefore be included when calculating the Riksbank's primary capital or targeted equity. From the perspective of legal certainty, it would be preferable to explicitly clarify this exclusion of the revaluation accounts from the definition of equity in the draft legislative proposal.

3.2 *Allocation of the Riksbank's profits and losses*

3.2.1 Detailed legal regulations on profit allocation are a positive development as they would bring not only transparency and predictability to the treatment of profits and the timing of payments to the Treasury, but would also legally bind the Government and the Parliament. However, it is noted that the Parliament's formal role in approving the Riksbank's profit and loss account and balance sheet and in determining the allocation of its profit is not envisaged to be repealed by the draft legislative proposal. On the contrary, the Parliament's formal role is planned to be expanded, so that the Parliament would also approve transfers of funds in the Riksbank's equity to cover losses⁴⁰. This is incompatible with the financial independence required of an NCB under the Treaty and the Statute.

3.2.2 Article 130 of the Treaty and Article 7 of the Statute explicitly prohibit that NCBs and members of their decision-making bodies seek or take instructions from, inter alia, any government of a Member State or any other body when carrying out the tasks and duties conferred on them by the Treaty and the Statute. In this context, it is important to shield the rules related to the distribution of profits from third-party interests⁴¹. As distribution of profits is one of the areas of financial independence where an NCB is most vulnerable to outside influence, decisions on the allocation of profits should be taken by the NCB's decision-making bodies and should not be subject to the discretion of third parties⁴². As stated by the ECB in its convergence reports and previous opinions⁴³ an NCB's statute may prescribe how its profits are to be allocated. In the absence of such provisions, decisions on the allocation of profits should be taken by the NCB's decision-making bodies on professional grounds, and should not be subject to the discretion of third parties unless there is an express safeguard clause stating that this is without prejudice to the financial independence necessary for carrying out the NCB's ESCB-related tasks as well as national tasks.

3.2.3 The ECB has repeatedly pointed out in its convergence reports⁴⁴ that the current arrangements regarding the Parliament's approval of the allocation of the Riksbank's profits are incompatible with the requirement of central bank independence under the Treaty and the Statute. While the draft

39 With effect from 2004, unrealised gains and losses are reported in special revaluation accounts, which consist of the difference between the cost of the acquisition value and the market value. If the unrealised losses exceed the unrealised gains at the end of the year, the difference is reported in the profit and loss account. This calculation is made security by security and currency by currency. See Sveriges Riksbank, Annual Report 2016, Balance sheet and profit and loss account, note 24.

40 In addition, the National Audit Office, in addition to the Parliament, will continue to receive proposals on an annual basis from the Riksbank regarding the allocation of the Riksbank's profits and the draft legislative proposal will mean that they will also receive proposals, at least every five years, with respect to the transfer of funds in the reserve fund to the primary capital.

41 See paragraph 3.6 of ECB Opinion CON/2007/14 and paragraph 3.2 of ECB Opinion CON/2009/53.

42 See ECB, Convergence Report June 2016, p. 27.

43 See ECB, Convergence Report June 2016, p. 27 and paragraph 4.2.2 of ECB Opinion CON/2013/53.

44 See ECB, Convergence Report June 2016, p. 195.

legislative proposal reduces the scope for discretion on the Parliament's part in respect of the Riksbank's profit allocation⁴⁵, the Parliament's right of approval of the allocation of the Riksbank's profits still impinges on the Riksbank's financial independence and is incompatible with Article 130 of the Treaty. As a consequence, the right of approving the Riksbank's annual accounts and determining the allocation of its profit should be transferred to the Riksbank.

3.2.4 In this respect, the ECB notes that the Riksbank's monetary policy framework and the Riksbank Act are currently subject to a separate review by a cross-party parliamentary committee. The ECB notes that the current procedure whereby the General Council of the Riksbank makes proposals to the Parliament on the allocation of the Riksbank's profit, and the Parliament determines the allocation of such profit, has been criticised by the European Commission for not being compliant with NCBs' independence as set out in the Treaty⁴⁶. The Commission further states that the concept of NCBs' independence implies that the Riksbank itself must approve the annual accounts and determine the allocation of the Riksbank's profit. As a consequence of the Commission's critical view, the directive to the committee asks the committee to consider a process whereby the General Council approves the annual accounts and determines the allocation of the Riksbank's profit⁴⁷.

3.2.5 The ECB considers that profits may be distributed to the Treasury only after any accumulated losses from previous years have been covered and financial provisions deemed necessary to safeguard the real value of the NCB's capital and assets have been created. As regards financial provisions or buffers, NCBs must be free to independently create financial provisions to safeguard the real value of their capital and assets. Member States may also not hamper NCBs from building up their reserve capital to a level which is necessary for a member of the ESCB to fulfil its tasks⁴⁸. In this regard, the ECB understands that under the draft legislative proposal the Riksbank will continue to apply the ECB's guidelines on the legal framework for accounting and financial reporting within the ESCB, according to which an NCB may establish a provision for foreign

45 However, in this regard, there continue to be some difficulties with respect to the level of discretion provided to the Parliament, especially when certain provisions are read in conjunction with Article 11 of the draft legislative proposal, which provides that the Parliament has the power to approve the Riksbank's profit and loss account and balance sheet and determine (a) the allocation of the Riksbank's profit, (b) transfer in the Riksbank's equity following a loss or a subsequent profit and (c) restoration of the Riksbank's restricted equity. For instance, Article 3 of the draft legislative proposal does not contain an explicit requirement for a specific minimum amount of provision to be made to the reserve fund if the Riksbank's annual accounts show a profit; it only contains a maximum amount of provision which can be made. In addition, a clearer explanation of what constitutes 'excess funds' to be transferred to retained profits pursuant to Article 3 of the draft legislative proposal is needed to make clear that this constitutes the full remaining amount from the profit which has not been made as a provision to the reserve fund. When considered in light of these factors and the broad power provided to the Parliament in Article 11, the draft legislative proposal (Article 4) does not appear to contain an explicit and definitive limit on the amount that can be transferred to the Treasury.

46 See European Commission, Convergence Report June 2016, p. 115.

47 See Commission of inquiry – Review of the monetary policy framework and the Sveriges Riksbank Act, 2016), pp. 5-6.

48 See ECB, Convergence Report June 2016, p. 27; paragraph 3.3 of ECB Opinion CON/2009/26, paragraph 3.2 of ECB Opinion CON/2009/53 and paragraph 2.1 of ECB Opinion CON/2012/69.

exchange rate, interest rate, credit and gold price risks on its balance sheet and will decide on the size and use of the provision on the basis of a reasoned estimate of the NCB's risk exposure⁴⁹.

3.3 *Request for recapitalisation of the Riksbank*

- 3.3.1 The ECB has a number of specific concerns regarding the provisions of the draft legislative proposal concerning requests by the Riksbank for a recapitalisation following losses.
- 3.3.2 The ECB understands that under the existing provisions of the Riksbank Act⁵⁰ and the Swedish Parliament device⁵¹ the Riksbank already has the unrestricted right to make proposals to the Parliament or the Government with respect to the restoration of the Riksbank's capital. The draft legislative proposal implies that, henceforth, the Riksbank will only be entitled to submit a request to the Parliament for the level of its restricted equity to be restored up to a sum necessary to ensure the so-called guaranteed level if the Riksbank's restricted equity has fallen below a certain level (i.e. when the restricted equity is less than the initial level of SEK 20 billion, as adjusted by the CPI adjustment, if any). This would appear to restrict the Riksbank's existing general right to submit a request to the Parliament or the Government.
- 3.3.3 In addition, the draft legislative proposal stipulates that an amount equal to two thirds of the targeted equity will be referred to as the guaranteed level of the restricted equity⁵². As previously mentioned, although the phrase 'guaranteed level' is used therein, the draft legislative proposal does not, as such, legally guarantee the level of the Riksbank's restricted equity. The ECB would therefore expect the draft legislative proposal to stipulate how the State would implement this guarantee, so that the State would automatically recapitalise the Riksbank on its request and up to the amount of the guaranteed level.
- 3.3.4 Also, the proposed provision that the Riksbank would only be able to submit a request to restore its restricted equity when the level of the Riksbank's restricted equity is less than half of the guaranteed level implies that the Riksbank may be forced to continue operating with nearly a third of its targeted equity only. A crucial element of the Riksbank's financial independence is the Riksbank having sufficient funds at its disposal to be able to perform its tasks, including ESCB-related tasks and national tasks. As a consequence, either the Riksbank's existing general right to submit a request to the Parliament or the Government should be retained or, at a minimum, the level at which the Riksbank should have the possibility to request the Parliament to restore its restricted equity should be increased.
- 3.3.5 In addition, the Riksbank would only be able to submit this request following deduction of funds from the relevant revaluation accounts. The Government concludes that the Riksbank should realise profits booked in the revaluation accounts, excepting changes in the value of the gold

49 Article 8 of Guideline (EU) 2016/2249 of the European Central Bank of 3 November 2016 on the legal framework for accounting and financial reporting in the European System of Central Banks (ECB/2016/34) (OJ L 347, 20.12.2016, p. 37).

50 The Riksbank Act, Chapter 4, Article 1.

51 The Parliament device, 2014, Chapter 9, Article 17.

52 See proposed fourth paragraph of new Article 2, Chapter 10 of the Riksbank Act.

reserve, before restoration of restricted equity can take place⁵³. At a minimum, this implies that in calculating when the restricted equity falls below the SEK 20 billion level (as adjusted by the CPI adjustment, if any) at which the Riksbank may submit a request, the Riksbank must first deduct funds existing in the relevant revaluation accounts. Considering that at year-end 2016 the Riksbank's equity and relevant revaluation accounts amounted to over SEK 81 billion, this implies that the Riksbank would only be authorised to request a restoration in its restricted equity at a lower level compared to the existing level of the Riksbank's equity. Considering that funds existing in the relevant revaluation accounts are not included when calculating the Riksbank's equity, the ECB understands that the draft legislative proposal may imply that the Riksbank would have to be incurring and reporting negative net equity before it is authorised to request a recapitalisation. The ECB further understands that, as opposed to being a mere accounting or calculation exercise, this implies that the Riksbank would have to dispose of assets underlying the revaluation accounts before being in a position to request the restoration of its restricted equity. The ECB is concerned that there is a risk that any such obligation to realise revaluation gains recorded in the revaluation accounts could undermine the Riksbank's financial independence as the Riksbank might not be able to autonomously avail itself of sufficient financial resources to fulfil its mandate. An obligation to dispose of assets underpinning the revaluation accounts before making a request to the Parliament could also interfere with the Riksbank's independent decision-making process on what assets to hold, interfering with the Riksbank's mandate where these assets are held in pursuance of the Riksbank's monetary or foreign exchange policy.

3.3.6 Lastly, the draft legislative proposal does not provide for any obligation on the part of the State to provide capital after a request has been submitted by the Riksbank to have its restricted equity restored. Nor does the draft legislative proposal clarify within which particular time period the State should respond to the Riksbank's request.

3.3.7 In light of the foregoing, the ECB reiterates the importance of ensuring that the Riksbank's financial independence is safeguarded. The Riksbank should not be put in a position where it has insufficient financial resources and inadequate net equity to carry out its tasks.

3.4 *Riksbank's foreign currency reserve*

3.4.1 The holding and management of foreign reserves in pursuance of a central bank's monetary, exchange rate and liquidity policies is a basic function of a central bank, both within the ESCB⁵⁴ and internationally.

3.4.2 The ECB understands that under the Swedish Constitution⁵⁵ and the Riksbank Act⁵⁶ the Riksbank is responsible for monetary and foreign exchange policy and may conduct a variety of operations in foreign currencies in pursuance of its monetary and foreign exchange policies. The ECB

⁵³ See draft referral to the Council on Legislation, footnote 2, p. 43.

⁵⁴ See Articles 127(2) of the Treaty; Articles 18.1, first indent, 23, second indent, 30 and 31 of the Statute.

⁵⁵ The Swedish Constitution (2011:109), Chapter 9, Article 13.

⁵⁶ The Riksbank Act, Chapter 1, Article 2 as well as Chapters 6 and 7.

understands that the draft legislative proposal does not purport to limit in any way the independent powers enjoyed by the Riksbank in this respect.

- 3.4.3 As previously noted, central bank independence requirements under the Treaty and the Statute require that the Riksbank must be able to autonomously avail itself of sufficient financial resources to fulfil its monetary and foreign exchange policy mandates and finance its own operations. A Member State may not put its NCB in a position where it has insufficient financial resources to carry out its monetary and exchange rate policy tasks, as well as its national tasks. The Riksbank is best placed to independently assess what level of foreign reserves is necessary to enable it to perform its tasks.
- 3.4.4 The ECB understands that the Riksbank's foreign reserves were strengthened in recent years, partly because Sweden's commitments to the International Monetary Fund (IMF) have increased, but mainly to address potential systemic liquidity issues in foreign currency in the financial sector. The strong reliance of the Swedish banking sector on international wholesale funding at short maturities to finance its activities increases the vulnerability of the banking sector to liquidity crises. The majority of this foreign currency funding comes in the form of short-term certificates, unsecured bonds, covered bonds and deposits by non-Swedish monetary and financial institutions and has doubled since 2001 to 120 % of GDP in 2015⁵⁷. The Riksbank's foreign reserves therefore need to be sufficiently robust to provide liquidity support to banks when necessary. Taking into account banks' foreign currency liquidity needs as well as the time that may be required to replenish foreign reserves by borrowing or by accessing central bank swap lines, and the desirability to have a buffer for contingencies, the ECB considers, in line with recent model-based analysis from the IMF and the Riksbank, that it would not be appropriate to reduce Sweden's existing foreign reserves of 11 % of GDP⁵⁸. In light of the potential disruptive effects on the financial sector and on the national economy in the context of a liquidity crisis, a clear system and robust processes for decisions on the foreign reserves, which nevertheless allow flexibility with regard to the size of the amounts, is key to allow the Riksbank to efficiently provide liquidity support in crisis situations. The Riksbank needs to be in a position to access foreign reserves rapidly, without waiting for a crisis to materialise, at which point lengthy procedures may be necessary in order to mobilise the necessary foreign reserves⁵⁹. In this respect the ECB notes that the provision of euro liquidity pursuant to currency swap arrangements between the Riksbank and the ECB is not available on an unconditional basis.
- 3.4.5 The ECB understands that the draft legislative proposal does not purport to regulate the appropriate level of the Riksbank's foreign reserve assets generally, but rather the Riksbank's

⁵⁷ IMF Country Report 16/354, Sweden selected issues, November 2016.

⁵⁸ The IMF analysis suggested that the appropriate reserve cover for banks' foreign exchange liquidity needs was about 8.5 % to 9.5 % of GDP. A buffer on top of such amounts was also needed for other potential use of reserves in a crisis, such as making interest payments on foreign exchange debts and meeting obligations to the IMF. Albeit using different assumptions, the Riksbank conducted a similar analysis and came to the conclusion that the banking system's need for refinancing from the Riksbank's currency reserve over a three-month period amounted to the equivalent of SEK 535 billion (12 % of GDP).

⁵⁹ See Sveriges Riksbank, Consultation response to the report on the Riksbank's financial independence and balance sheet, 27 April 2017, p. 8.

ability to borrow foreign currency from the National Debt Office. In this respect, the ECB notes that it is relatively unusual within the ESCB for an NCB to strengthen its foreign reserve assets by borrowing from its national debt office or Government. Insofar as such borrowings are financed by debt issuances in the international capital markets by the National Debt Office, on behalf of the State, the ECB fully understands the Government's desire to impose limitations on the Riksbank's ability to increase its foreign reserves through this particular means. As noted by the Government, the scope for raising loans in foreign currency is limited, and the need for advance borrowing by the Riksbank through the National Debt Office may be legitimately submitted to a broader assessment, in which the Government's entire borrowing requirement, the costs of borrowing and the budgetary policy framework, can be considered. The ECB shares the Government's view that the Riksbank's other possibilities for obtaining foreign exchange and other tools to safeguard liquidity and the supply of foreign currency should also be taken into consideration. On this basis, the ECB clearly understands that the draft legislative proposal is not intended in any way to constrain the Riksbank's ability to increase its foreign reserves by the other means at its disposal, whenever necessary in pursuance of the Riksbank's independently formulated monetary, foreign exchange and liquidity policies. This understanding is of importance to the ECB, since any other understanding would clearly encroach on the Riksbank's independence under the Treaty and Statute in the performance of its basic monetary, foreign exchange and liquidity policies. It would not seem realistic for the Riksbank to rely exclusively on the National Debt Office to meet the Riksbank's foreign currency needs in a financial crisis situation, taking account of the availability and cost of funding in such situations, as well as the time period within which the National Debt Office would be able to borrow the necessary amounts of foreign currency in the market.

- 3.4.6 The ECB notes that at the end of 2016 the Riksbank's debt to the National Debt Office for the Riksbank's foreign reserve assets was SEK 257 billion. This amounts to over half of the foreign reserve assets on the Riksbank's balance sheet at year-end 2016, and almost one third of the total assets on the Riksbank's balance sheet at year-end 2016 (SEK 845 billion). The Government considers that existing advance loans that the Riksbank has already taken to strengthen its foreign reserve assets must be repaid when the draft legislative proposal comes into force, and that this repayment should take place through the Riksbank transferring assets to the National Debt Office corresponding to the Riksbank's foreign exchange loans from the National Debt Office. Absent the explicit agreement of the Riksbank, such a significant asset transfer would represent a substantial interference in the institutional and financial independence of the Riksbank pursuant to the Treaty and Statute, as it would interfere with the Riksbank's ability to independently manage its foreign reserves and overall balance sheet in pursuance of its basic monetary, foreign exchange and liquidity policies. In principle, the terms of these borrowings have already been contractually agreed, and the ECB understands that a prepayment arrangement has not been agreed by the Riksbank and the National Debt Office. Any early repayment of the loans would therefore require the Riksbank's agreement. The Government's proposal to restrict the Riksbank's right to borrow through the National Debt Office for the strengthening of its foreign currency reserves should only operate on a prospective basis, and not retrospectively. If a transitional approach is agreed, with the aim of gradually phasing out the existing arrangement, the Riksbank would not be forced to

immediately repay its foreign current debt to the National Debt Office, but rather would be able to build up its foreign exchange reserves gradually in parallel, in accordance with the Riksbank Act, as its outstanding debt to the National Debt Office matures. Any forced immediate repayment of the debt to the National Debt Office would interfere with the Riksbank's ability to independently carry out its basic monetary policy, foreign exchange and liquidity tasks. The referral accompanying the draft legislative proposal should, therefore, reflect this important point.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 18 May 2017.

[signed]

The President of the ECB

Mario DRAGHI