

## **OPINION OF THE EUROPEAN MONETARY INSTITUTE**

on a consultation from the Swedish Ministry of Finance under Article 109f (6) of the Treaty establishing the European Community (the “Treaty”) and Article 5.3 of the Statute of the EMI as elaborated in the Council Decision of 22nd November 1993 (93/717/EC) on a draft proposal for legislation (Law 1995/96:172) repealing the Law on State support for banks and other credit institutions (Law 1993:765).

### **CON/96/03**

1. The above consultation was initiated on 14th March 1996 by the Swedish Ministry of Finance which requested an opinion by mid April 1996. For this purpose, it submitted the text of the above draft legislation together with an explanatory memorandum (DS 1995:67) to the EMI.
2. The EMI’s competence to deliver an opinion is based on Article 1, section 1, fifth indent, of the Council Decision of 22nd November 1993 (93/717/EC), as the draft legislation concerns the termination of State support facilities for the Swedish banking industry and may, thus, affect the stability of financial institutions and markets.
3. In 1992 Sweden adopted emergency measures to, inter alia, ensure that banks and certain other credit institutions could meet their commitments on a timely basis. This was introduced as a result of a banking crisis which developed after a downturn in the real estate market, the consequences of which became so grave that they threatened the stability of the financial markets as a whole. These measures, laid down in Riksdag Decision 1993:765, entailed the possibility of State guarantees, loans, capital contributions and other instruments to safeguard the interests of creditors of financial institutions as well as to protect the functioning and integrity of the financial markets. They were intended to be of a temporary nature and to last as long as the banking crisis would warrant their continued existence. After monitoring developments in the financial markets in general and the situation with regard to individual institutions in particular, Swedish financial authorities have come to the conclusion that the above emergency measures have fulfilled their function and may now be terminated. The Swedish financial authorities concluded that the banking system has undergone a radical financial and economic rehabilitation over the past two to three years. In particular, bad loans have diminished, the capital adequacy of financial institutions has strengthened and there is an increased potential in profit growth as well as improved financing conditions. In addition to these macro-economic considerations which plead for an abolition of the above emergency

measures, review of the financial situation with regard to individual institutions also shows that continued existence of the above emergency measures is not warranted. It is therefore proposed, through the above draft legislation, to repeal Riksdag Decision 1993:765 containing the emergency measures, per 1st July 1996.

4. The EMI is not in a position to assess in detail whether the effects of the banking crisis in Sweden at the beginning of this decade have now diminished to such an extent that the measures established through Riksdag Decision 1993:765 are no longer justified. This applies a fortiori to the financial soundness of individual credit institutions. The EMI does, at the same time, not have any reason to question the considerations of Sweden's financial authorities with regard to the abolition of the emergency measures. In addition, an undue continuation of such measures may give rise to competition distortions. Moral hazard problems may in this case also arise as financial institutions whose positions are covered by State guarantees may be inclined to take more risks than those whose business is not. Hence, the abolition of the above emergency measures marks the financial system's return to the undistorted working of an open market economy with free competition favouring an efficient allocation of resources. The EMI, therefore, welcomes the fact that the Swedish financial authorities have, over the past few years, closely monitored whether developments warranted continued existence of the emergency measures and now, on the basis of their observations, proposed termination thereof. Finally, the EMI notes with interest the undertaking by Sweden's financial authorities to continue work on reshaping the organisation and functioning of prudential supervision and, in particular, to focus on internal risk management and control practices.
5. The EMI agrees that this opinion may be made public by the competent Swedish authorities at their discretion.

12th April 1996