

## **Sweden must 'continue monitoring the situation' on the housing market and 'be prepared to tighten' the cap.□**

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### **IMF: EXECUTIVE SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS**

The Swedish economy has rebounded strongly. The impact of the financial crisis on Sweden's economy and financial sector was substantial, resulting in a sharp output contraction, currency depreciation, and major banks faced liquidity strains, which, coupled with concerns about asset quality in banks' operations in the Baltics, have lead to sharp decline in banks' share prices. The authorities' response was forceful, introducing a wide range of extraordinary measures that helped to contain the impact of the crisis, and restore market stability and confidence. Economic indicators improved markedly in 2010, and banks' capital position and profitability strengthened, allowing the exit from crisis-response measures to begin in April 2010.

Financial stability analysis indicates that banks are resilient to credit risk, but could face difficulties with respect to liquidity risks. The stress testing results show that banks should be able to maintain adequate capital in the face of severe credit risk shocks, owing to high profits and capital buffers, and relatively high-quality loan portfolios. Liquidity stress tests suggest vulnerabilities due to the banks heavy reliance on short-term wholesale funding.

The authorities' intention to accelerate the implementation pace of Basel III capital requirement, impose higher than minimum capital requirements on the largest and systemically important banks, and tighten liquidity regulations are welcome steps, given the nature of banks' exposures and prevailing risks.

**Against the backdrop of continuing house price increases** and the high and rising household indebtedness, the recently introduced regulatory cap on the loan-to-value ratio of 85 percent is a good start. The authorities should continue monitoring the situation and be prepared to tighten this cap if house prices continue to increase at the same pace.

Liquidity risks that emerged during the crisis were managed well, but some weaknesses were exposed. The authorities should monitor liquidity much more closely by instituting higher quality liquidity reporting. In addition, the governance framework of international reserve management should be clarified and the Riksbanken's (RB's) collateral framework reviewed.

The current financial stability arrangements are comprehensive and key elements are in place to ensure effective macroprudential oversight. Considerations could be given to augmenting the existing framework by establishing a high level Systemic Financial Stability Council (SFSC) to coordinate financial stability policies and actions among the various relevant authorities with clear lines of responsibilities and accountability.

The assessments of standards and codes show that compliance is generally high, although important concerns need to be addressed. In particular, issues related to Finansinspektionen's (FI's) operational independence, and the sufficiency of its resources are overarching concerns, and could potentially impair FI's ability to discharge its supervisory and oversight functions adequately and effectively. FI and RB should clarify further their respective regulatory responsibilities for financial infrastructures and enforce adequate risk management procedures for the central counterparty (CCP).

Sweden has put in place a good framework for cross-border supervision. The framework is developing within the context of the European Union (EU)-wide arrangements but has emerged as a good model for other countries. Supervisory colleges for major Swedish banks, and the Nordic-Baltic Memorandum of Understanding (MOU) and other arrangements, create a sound foundation for cross-border crisis management and burden sharing. However, further work might be needed on modalities for addressing potential cross-border liquidity and improving information sharing.

Although recent bank failures have been handled in a relatively effective manner, the crisis revealed shortcomings in the toolkit for dealing with failing banks. While legislation for dealing with systemic crises has been introduced, a robust and flexible framework to intervene and resolve all financial institutions is needed, including introducing a special bank resolution regime

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and reforming the deposit insurance legal framework.

The authorities have committed to swiftly address the concerns that were raised by the FSAP. In particular, the authorities will proceed immediately to strengthening FI's resources and independence, and will begin a review of the legal frameworks for bank resolution and securities markets. A task force has been established to coordinate and oversee the implementation of envisaged reforms.

*Source: IMF*