

Approach to liquidity provision in bank resolution

Introduction

One of the lessons learnt from the global financial crisis of 2007-2008 is that allowing systemically important banks to fail is very costly. For this reason, the Swedish National Debt Office has been authorised to take control (but not ownership) of a failing systemically important bank and then to restructure or transfer the business in an orderly manner.¹ This procedure is called resolution. The purpose of resolution is to maintain the continuity of all or part of the failing bank's operations in order to minimise disruption to the bank's customers, the financial system and the wider economy.

A necessary condition for successful restructuring is that the bank in resolution is able to finance its operations. One basic principle of the resolution procedure is that it is the bank's owners and lenders – not the taxpayers – that shall continue to finance the bank. Resolution restores the bank's viability (solvency). However, during a transitional phase, a bank that has been put into resolution may find it difficult to obtain sufficient liquidity on its own and may therefore need temporary liquidity support.

Both the Swedish National Debt Office and the Riksbank may provide liquidity support. The respective liquidity support arrangements of the two authorities are described below, with a focus on resolution. In a crisis situation, it is of the utmost importance that market participants are aware of the liquidity support role of each authority in order to ensure the effective implementation of resolution and thereby safeguard financial stability.

The Swedish National Debt Office's capacity to provide liquidity support

During a resolution procedure, the Swedish National Debt Office takes control of the bank in crisis and applies one or more so-called resolution tools. With the help of the tools, the entire bank's operations can be sustained. The bank's owners lose their ownership and some creditors' claims on the bank are written

¹ These powers were granted to the Swedish National Debt Office when the EU crisis management directive was incorporated into Swedish law in 2016 and the Swedish National Debt Office was appointed Sweden's resolution authority.

down and converted into equities. Through such measures, the Swedish National Debt Office ensures that the bank is viable and fulfils the capital adequacy requirements. The resolution procedure is concluded when the Swedish National Debt Office relinquishes control of the bank.

The Swedish National Debt Office has a number of options to support the bank's liquidity situation during the resolution procedure. In connection with a resolution decision, the Swedish National Debt Office may issue guarantees for, or grant credit to, a bank in resolution or a bridge institution². Guarantees can be issued to enable the bank to borrow funds on the capital market. The Swedish National Debt Office can also issue guarantees for a loan granted by the Riksbank to a bank in resolution.

Guarantees and loans granted by the Swedish National Debt Office are financed by the resolution reserve. The resolution reserve is a reserve of funds that has been built up through fees paid by credit institutions in Sweden to the Swedish National Debt Office. This upholds the principle that resolution proceedings should not be financed by taxpayers.

The resolution reserve amounted to about SEK 61 billion at the end of 2024. If the funds in the reserve are insufficient, the Swedish National Debt Office is authorised to borrow funds in an amount of up to SEK 100 billion from the central government without a decision by the Riksdag, the Swedish parliament. The Swedish National Debt Office can also issue guarantees up to SEK 200 billion without a decision by the Riksdag. If utilisation of the resolution reserve is high, additional fees may be charged to credit institutions to restore the reserve.

The Riksbank's capacity to provide liquidity support

The Riksbank has a number of loan facilities to which, under appropriate conditions, banks in resolution also have access if they are participants in the Riksbank's settlement system RIX or are monetary policy counterparties. To ensure that the payment system functions as smoothly as possible, banks participating in RIX have the option of borrowing interest-free during the day against adequate collateral. As part of the implementation of monetary policy, the Riksbank also provides standing facilities whereby the Riksbank's monetary

² A bridge institution is a company wholly or partly owned by the state and established for the purpose of taking over either the instruments of ownership issued by a bank in resolution or its assets and liabilities. The aim is for the bridge institution to maintain critical activities carried out by the bank in resolution and to endeavour to sell the assets and liabilities transferred to the bridge institution at the appropriate time.

policy counterparties can deposit or borrow Swedish kronor overnight against adequate collateral.

In addition, the Riksbank has the possibility to provide general liquidity support (offered to a group of financial companies) against adequate collateral if this is needed to counteract a serious disruption in the financial system in Sweden. The Riksbank can also provide special liquidity support to an individual viable financial company to temporarily fulfil the company's need for liquidity against collateral and on special terms if this is necessary to counteract a serious disruption in the financial system in Sweden or if there are other exceptional reasons, such as resolution. A bank that is restructured through resolution and is thus under the control of the Swedish National Debt Office shall, as a result of the measures taken by the Swedish National Debt Office, be regarded as viable.

Approach to liquidity provision in resolution

As mentioned above, the starting point is that a bank in resolution should be able to fulfil its liquidity needs on its own. If the bank nevertheless were to need liquidity support, the authorities first assess if it is likely that the bank could manage the liquidity problems if the Swedish National Debt Office were to issue guarantees for new wholesale funding. If such guarantees are likely to be insufficient to secure new wholesale funding for the bank, the Riksbank is prepared to provide special liquidity support, known as emergency liquidity assistance, as described above. Such support will be guaranteed by the Swedish National Debt Office if the bank is unable to fulfil the Riksbank's collateral requirements.

Providing liquidity support to a bank in resolution for a limited period of time supports the effective implementation of resolution and allows the bank to return to market-based funding and stand on its own feet. The Swedish National Debt Office and the Riksbank thus have a key role in safeguarding financial stability in a resolution situation through their respective arrangements for liquidity support. The authorities will cooperate closely and constructively with one another.

In each particular case, decisions on liquidity support are taken on terms adapted to the circumstances prevailing at the time. The aid granted will be designed to maintain market discipline to the maximum extent possible and to ensure that taxpayers' money is not used to cover the costs of the resolution. The support will also be designed to be compatible with both the state aid regulations and the prohibition of monetary financing in the Treaty on the Functioning of the European Union.