ARTICLE – Consequences for financial stability of Nordea's relocation to Finland

In September 2017, the Board of Directors of Nordea Bank AB made the decision to move the parent company to Finland and thereby to the banking union. The decision was approved by the Nordea general meeting of shareholders in March this year. Nordea's relocation could have significant consequences for the Swedish financial system and for Swedish financial stability. A relocation reduces Sweden's responsibility for Nordea, but also its control of and oversight into the bank. In the long run, when the banking union is fully completed, more intensive supervision and increased risk diversification among the countries in the union may lead to lower risks for Sweden. However, the banking union is not fully developed and so far, a large part of the responsibility for managing problems in a bank still lies with the individual member state. If Nordea relocates, Finland will thus have to shoulder this responsibility. One precondition for a relocation not to risk financial stability in Sweden is that Nordea's capital and liquidity requirements will not become lower as a result of the move.

If Nordea relocates to Finland, the bank becomes a part of the Single Supervisory Mechanism (SSM), where the ECB is in charge of the supervision of the significant banks. The relocation, which is planned for 1 October this year, requires that the ECB approves the application for a bank licence for the newly-formed Finnish subsidiary and that Finansinspektionen (FI) in Sweden approves the requested merger. The move is planned to be implemented via a reverse cross-border merger in which the parent company will be merged with a newly formed Finnish subsidiary. This article discusses the aspects of Nordea's relocation deemed to be most relevant from a financial stability perspective and the conditions that should be fulfilled to ensure that a move will not pose a heightened risk of financial instability.

Concentration and interconnectedness will remain

The Swedish banking system's total assets currently correspond to around 400 per cent of GDP.[83] A relocation of Nordea's head office would lead to a reduction in the Swedish banking system's assets to around 300 per cent of Swedish GDP. The banking system would thus remain large in relation to Sweden's economy. At the same time, assets in Finland's banking system will more than double in size, from around 200 per cent to around 400 per cent of Finland's GDP.[84]

Nordea is currently one of the largest agents in Sweden with about 30 per cent of the Swedish banking system's total assets. After a relocation, Nordea will continue to conduct operations in Sweden in a newly-opened branch, as well as through the five existing subsidiaries.[85] After the move, Nordea's share of the Swedish banking system's assets is expected to decrease to less than 10 per cent. It can be noted that, after a move of Nordea to the banking union, about three-quarters of the bank's assets would still be outside the banking union, in Sweden, Denmark and Norway.

As a result of the move, Swedish authorities' formal commitments and responsibilities towards, as well as oversight and control of, the Nordea group, including the Swedish branch, will decrease. Nordea's actual operations in Sweden will nevertheless be largely the same. Thus, the risks associated with concentration and interconnectedness in the Swedish banking system will remain.

The ECB assumes responsibility for microprudential policy

At present, FI has the responsibility for Nordea's microprudential supervision and chairs Nordea's supervisory college.[86] The ECB and the Finnish financial supervisory authority are also members of the college, as they currently exercise supervision of Nordea's Finnish branch and Finnish subsidiaries respectively.

[83] The term 'the Swedish banking system' refers to MFIs according to Statistics Sweden's definition and their total bank assets in Sweden, including bank branches and subsidiaries active in Sweden under foreign management, as well as Swedish banks' branches abroad.
[84] The 200 per cent figure includes Nordea's current Finnish branch, and 400 per cent includes the entire Nordea Group, including foreign subsidiaries.
[85] Nordea's Swedish subsidiaries include Nordea Hypotek AB, Nordea Finans Sverige AB, Nordea Investment Management AB, Nordea Asset Management Holding AB and Nordea Livförsäkring Sverige AB (part of Nordea Life Holding). None of these subsidiaries are funded through deposits.
[86] For banks with operations both within and outside of the banking union, supervision is conducted via so-called supervisory colleges, consisting of the supervisory authorities in the countries in which the banking group has operations.

Following a relocation of Nordea's head office to Finland, the ECB would assume responsibility for Nordea's microprudential supervision, including for the new Swedish branch, since the authority has the supervisory responsibility for the banking union's significant banking groups (about 118 banking groups at present).[87] Within the SSM, joint supervisory groups, consisting of personnel from both the ECB and the national supervisory authorities, are responsible for supervision of all significant banks.[88] The aim is to develop a uniform supervisory culture, with consensus as regards the assessment of risks, methods and processes.

FI will continue to be the supervisory authority and make decisions for the Swedish subsidiaries, including Nordea Hypotek AB. FI will thus also be able to be involved and influence decisions in the supervisory college regarding, for example, capital and liquidity for the entire group. However, final rulings for the entire group will be made by the ECB if the supervisory college fails to reach agreement.

Finland assumes responsibility for macroprudential policy

If Nordea relocates to Finland, the Finnish supervisory authority will become responsible for the bank's macroprudential policy. This means that macroprudential policy measures introduced by the Finnish supervisory authority will also apply to Nordea's branch in Sweden.

Macroprudential measures that have already been adopted by FI and which have their roots in consumer protection and that are based on national legislation, such as the loan-to-value limit and amortisation requirement, will also apply to Nordea's branch in Sweden in the future. On the other hand, other macroprudential measures adopted in Sweden to safeguard Sweden's financial stability will not automatically apply to Nordea's branch in Sweden, as it will fall under the responsibility of the Finnish supervisory authority. For these measures to apply, recognition of reciprocity would be needed from the Finnish supervisory authority and the ECB. The Governing Council of the ECB can also set higher macroprudential policy requirements than national authorities do.

Capital requirements should not be lower

Nordea is currently subject to Swedish capital requirement regulations (see Table B:1). However, the minimum requirement and the capital conservation buffer (corresponding to a total of 7 per cent of risk-weighted assets) constitute internationally agreed requirements. Nordea's other CET1 capital requirements are Swedish special requirements.

FI thus makes use of special requirements to manage, among other things, macroprudential risks. On the other hand, the ECB strives to harmonise the banks' capital requirements and to reduce the use of special requirements justified by systemic risks, as macroprudential policy measures. It is therefore not clear whether it will be possible to achieve reciprocity for macroprudential policy measures that currently constitute Swedish special requirements, such as the risk-weight floor for mortgages.

Table B:1. Nordea's capital requirements, Q4 2017
Capital requirement, per cent of risk-weighted assets

Minimum requirement	4.5%
Capital conservation buffer	2.5%
Systemic risk buffer	3.0%
Countercyclical capital buffer	0.7%
Pillar 1 requirements	**10.7%**
Systemic risk	2.0%
Risk-weight floor, Swedish mortgages	1.2%
Capital requirement, Norwegian mortgages	0.4%
Other Pillar 2 requirements	3.3%
Pillar 2 requirements	**6.8%**
Total capital requirements	**17.5%**
Actual CET1 capital ratio	**19.5%**

Note. Only the minimum requirement and the capital conservation buffer constitute internationally agreed requirements. Nordea is also subject to a CET1 capital requirement as a globally systemically important bank, which is included in the systemic risk buffer. The countercyclical capital buffer corresponds to 2 per cent of risk-weighted assets but only applies to Nordea's Swedish exposures. If a bank contravenes Pillar 1 requirements, it may lead to restrictions on share dividends (buffer requirements) or licence revocation (minimum requirement). Pillar 2 requirements are not currently formal requirements.

Source: Finansinspektionen.

However, the Finnish supervisory authority can use the scope for national discretion that exists in the banking union, which implies that it is possible to set higher capital requirements than the general requirements within the SSM. A new Finnish law from 1 January 2018 allows the Finnish supervisory authority to set a systemic risk buffer of between 1 and 5 per cent. However, it would require the approval of the European Commission if the systemic risk buffer were to be set above 3 per cent.

All in all, the shape of Nordea's future capital requirements is currently unclear as these will be determined by ECB and the Finnish supervisory authority. The Riksbank considers it a precondition that Nordea's capital requirements do not decrease in conjunction with a relocation, as Nordea's operations are expected to continue, and the risks related to concentration and

[87] The criteria for significant banks are reported in Council Regulation (EU) 1024/2013 and in the ECB's Regulation 468/2014.

[88] FI invests significantly fewer resources on the supervision of the major banks compared with the SSM. See Sweden, *Financial Sector Assessment Program*, Technical Note on Banking Supervision and Regulation, October 2017. International Monetary Fund (IMF).

interconnectedness will therefore remain. Lower requirements for Nordea would also give it a competitive advantage over banks still under Swedish supervision.

Important that liquidity requirements remain

As from this year, all banks in the EU are subject to joint regulations for how much liquid funds banks must retain overall. In addition, FI places special requirements on liquid funds in euros and US dollars to strengthen the resilience of Swedish banks. With Nordea's relocation to the banking union, responsibility for setting liquidity requirements will be transferred to the ECB. The Riksbank considers it important that all banks in Sweden, including Nordea, continue to have liquidity requirements in all significant currencies, in order to counteract short-term liquidity risks.[89] Along with Swedish kronor, US dollars and euros, which are significant currencies for all the major Swedish banks, the British pound and some of the Nordic currencies are also significant for certain banks, albeit to a varying extent.

A common deposit guarantee system is not in place

The deposit guarantee system reimburses depositors in financial institutions in the event that an institution enters into bankruptcy. The deposit guarantee is funded through fees from the affiliated institutions which are invested in a fund. Current EU regulations require the national deposit guarantee funds to amount to at least 0.8 per cent of guaranteed deposits by 2024 at the latest.

The Swedish deposit guarantee system is administered by the Swedish National Debt Office. At the end of 2017, the Swedish deposit guarantee fund amounted to SEK 40.1 billion. This corresponds to 2.4 per cent of guaranteed deposits from 31 December,[90] which is almost three times what the EU directive requires.

The banking union's third pillar – together with the joint supervision and resolution cooperation – is intended to consist of a joint deposit guarantee system with a joint deposit guarantee fund. However, it is uncertain at present when the banking union's deposit guarantee system will be in place and how it will be designed, including the size of the deposit guarantee fund.

Assets in the Finnish banking system will more than double if Nordea moves to Finland. It will also entail a substantial increase of the Finnish deposit guarantee system's commitments in that the entire Nordea group's guaranteed deposits will fall under the responsibility of the Finnish deposit guarantee system until further notice.[91] As a share of guaranteed deposits the Finnish deposit guarantee fund, will thereby be reduced while the Swedish deposit guarantee system will be strengthened.

It can be noted that, should Nordea fail, the bank would, in all likelihood, be put into resolution (see below) and would thereby not need to rely on the deposit guarantee system. During a resolution process, parts or all of the institution is kept open so that depositors and other customers have access to their accounts and other services, which means that the deposit guarantee would not need to pay out compensation to depositors. However, a strong deposit guarantee system is generally considered important in order to guarantee that the banking system is stable in times of uncertainty.

The resolution fund is being set up

Resolution involves central government assuming control of a failing bank to allow reconstruction or settlement of operations in a controlled manner, without negative effects for financial stability. For the funding of resolution measures, there has to be a resolution fund that is built up based on fees from the banks. The aim is that the bank's owners and creditors shall primarily assume the cost of the procedure – not the taxpayers.

The domicile determines which country has responsibility for resolution, meaning that, at present, the Swedish National Debt Office has the responsibility for any resolution of Nordea. There is no actual resolution fund in the Swedish resolution system. Resolution fees from the banks are placed in a special account for the so-called resolution reserve. However, the money is available to cover central government's current expenditure. The government then incurs a liability to the resolution reserve to a corresponding extent. The resolution reserve can therefore be seen as a claim on central government that can be called on when the need arises. So far, a total of about SEK 30 billion has been paid in, corresponding to 1.7 per cent of guaranteed deposits off 31 December 2016. The aim is for the Swedish resolution reserve to amount to 3 per cent of guaranteed deposits.[92]

If Nordea carries out its relocation as planned, responsibility for the resolution of Nordea's parent company will be transferred to the banking union and the joint resolution authority, the Single Resolution Board (SRB)[93] The SRB is responsible for both systemically

[89] See Chapter 2 for a discussion on significant currencies and the new requirements for liquidity coverage ratios (LCR).

[90] The value of the guaranteed deposits is from the end of 2016, i.e. before Nordea transformed its Nordic operations into branches, which made the Swedish deposit guarantee fund responsible for deposits in Sweden, Denmark, Finland and Norway. In other words, the size of the Swedish deposit guarantee fund, as a proportion of guaranteed deposits, is currently lower than this. Nevertheless, the minimum requirement has still been more than fulfilled.

[91] In the event of a move, the general public's deposits in Nordea (up to EUR 100,000 or about SEK 1.000.000) will be protected by the Finnish deposit guarantee. In conjunction with the relocation, Nordea's paid fees from the last year would be transferred from the Swedish to the Finnish deposit guarantee fund.

[92] At present, the Swedish National Debt Office's resolution reserve has a borrowing limit of SEK 100 billion and a guarantee limit of SEK 200 billion.

[93] After the relocation, it will still be possible for Nordea's Swedish subsidiary to be wound up or entered into bankruptcy or resolution in accordance with Swedish law.

important banks and cross-border banking groups, criteria that the new Nordea parent company will fulfil.

Within the banking union, there is a joint fund, the Single Resolution Fund (SRF), which can contribute with funding during a resolution procedure. However, this fund is still being set up and is not expected to be fully set up until 2024 at the earliest. The aim is for the fund to have a value of 1 per cent of guaranteed deposits, the equivalent of EUR 55 billion. In 2017, the fund contained about EUR 17.4 billion, corresponding to about 0.3 per cent of guaranteed deposits.

Until the SRF is fully developed, it is divided into national departments based on each country's deposits. Each country is allowed to take a successively smaller proportion of funding from its own national department and an successively larger proportion from the joint funds until finally, in 2024, all funding of resolution processes comes from the SRF.[94] Until then, Finland would thus have to bear considerable economic responsibility for any resolution of Nordea.

Bank of Finland expected to provide emergency liquidity assistance

Nordea bank Abp, the new Finnish parent company, will probably apply to become both a RIX participant and a monetary policy counterparty to the Riksbank. As RIX participant, Nordea Bank Abp's Swedish branch will have access to the Riksbank's intraday credit and, as monetary policy counterparty, it will have access to the so-called standing facilities, which is to say overnight lending and deposits in Swedish kronor. These two are the Riksbank's normal liquidity facilities.

As the Riksbank has emphasised many times, it is important for banks to, first and foremost, manage their own self-insurance by holding adequate liquidity reserves. If, despite everything, a situation arises in which Nordea needs to be supplied with liquidity, the responsibility lies with the Bank of Finland, which will be expected to manage an application for emergency liquidity assistance from Nordea, including its foreign branches, even as regards liquidity in Swedish kronor.[95] Even if the responsibility lies with Bank of Finland, there are still legal possibilities for the Riksbank to assist as a last resort with extraordinary liquidity facilities in a crisis situation.

Greater risks for financial stability in the short run

Fully developed, the banking union should be able to contribute to a more robust European banking system with significant risk-sharing among the participating member states, more intensive supervision without national 'home bias',[96] a joint deposit guarantee system and a joint resolution fund. In the long run, a relocation of Nordea's parent company to Finland could thereby reduce the risks that may jeopardise financial stability in Sweden.

As regards supervision, the SSM is largely already in place, with joint supervisory groups. At the same time, there is political disagreement on the elements of the banking union most clearly aimed at sharing the risks among the participating member states. For example there is still no final guarantor for the Single Resolution Fund, which could lead to problems in the event of large payouts. From a risk-sharing perspective, it can also be noted that, as yet, a relatively small part of the fund is available for joint financing. Neither has it been possible to reach an agreement on a single European deposit guarantee system, which means that depositors are still dependent on their own member state's ability to guarantee the system.

The banking union is therefore not fully developed and a substantial part of the responsibility for managing banking problems within the banking union still lies with the individual member state. If Nordea relocates its main office, this would mean increased responsibility for Finnish authorities and, ultimately, for Finnish taxpayers.

A condition for a relocation to be implemented without leading to increased risks for financial stability is that Nordea's capital and liquidity requirements do not become lower as a result of the relocation. Apart from lower resilience, lower requirements can also give Nordea competitive advantages over Swedish and Nordic banks, which may lead to greater risk-taking both by Nordea and the Swedish banks and hence to negative effects for financial stability.

The move highlights problems surrounding the authority of home countries and host countries for foreign bank branches and the importance of host country authorities having sufficient insight into the supervision and resolution plans for the entire banking group. For Sweden, the relocation implies a substantial reduction in not only the responsibility for a systemically important financial institution in Sweden, but also the control and insight as regards supervision, deposit guarantee and resolution for the entire group. This, in turn, may lead to reduced scope for safeguarding Swedish interests, which may increase stability risks in Sweden in a crisis situation. Increased cooperation and information exchange between the Nordic countries in terms of supervision and liquidity provision continues to be very important.

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[94] The Finnish national department currently amounts to about 2 per cent of the funds collected by the SRF.

[95] *Memorandum of Understanding on Cooperation regarding Banks with Cross-Border Establishments between the Central Banks of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden*, December 2016.

[96] "Home bias" refers here to the tendency to turn a blind eye to problems on the domestic front.