

The Riksbank's operational framework for the implementation of monetary policy – overall description

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The Riksbank's monetary policy operational framework

This document describes Sveriges Riksbank's monetary policy operational framework.

The aim of this document is to describe and explain the actual application of the Riksbank's monetary policy operational framework.

More detailed rules for RIX and the monetary policy operational framework are given in the Terms and Conditions for RIX and Monetary Policy Instruments (the Terms and Conditions), which can be found on the Riksbank's website www.riksbank.se.

1 Objectives and tasks

Under the Sveriges Riksbank Act (1988:1385), the objective for the Riksbank's operations shall be to **maintain price stability**, which means that inflation should be low and stable. The Riksbank has specified an inflation target, according to which the annual change in the consumer price index with a fixed interest rate (CPIF) is to be 2 per cent. The aim of the Riksbank's transactions within the monetary policy operational framework is to steer market rates, which in turn influence other interest rates in the economy and thereby ultimately economic activity and inflation. The overnight interest rate functions as an anchor for interest rates with longer maturities and is the interest rate that is easiest for the Riksbank to control. One operational objective for the Riksbank's Markets Department is therefore that the overnight rate should be close to the policy rate, which is set by the Executive Board. It has been more difficult to formulate an operational target for the Riksbank's purchases of government bonds that were initiated in February 2015. The purpose of the purchases is to push down the general level of interest rates in the economy.

The Sveriges Riksbank Act states that the Riksbank shall also **promote a safe and efficient payment system**. This assignment includes the exclusive right to issue banknotes and coins in Sweden and is responsible for the country's provision of cash. In addition, for eligible institutions, the Riksbank provides a payment system for central bank money in accounts – deposits in accounts in the Riksbank – which is known as RIX. The Riksbank's work on the payment system primarily aims to reduce systemic risk, which is to say the risk that a party's financial or technical problems will spread and threaten the financial system.

The Riksbank has also interpreted this assignment of promoting a safe and efficient payment system as meaning that the bank shall act for the stability of the financial system as a whole through preventive work and crisis management. In a crisis, there may arise a shortage of liquidity because the financial markets that offer funding are then working less efficiently than normal. In such a situation, the Riksbank has several ways of quickly adding liquidity. This could entail providing liquidity assistance to single institutions or general measures to strengthen liquidity. The reason that the Riksbank has this task is due to its unique capacity to provide unlimited liquidity in Swedish kronor, which makes it possible to conduct monetary policy.

2 Counterparties

To manage its tasks, the Riksbank needs to interact with a number of market participants. These can apply to become counterparties to the Riksbank in various kinds of transaction. The Riksbank uses different categories of counterparty depending on the type of transaction in question:

- settlement of payments in Swedish kronor
- monetary policy transactions
- transactions in foreign currency

2.1 Different categories of counterparty

The Riksbank thus has three different categories of counterparty, one category for each type of transaction.

RIX participants

Participants in RIX have the advantage of being able to execute payments without being exposed to any greater credit or liquidity risk. This is desirable from the point of view of the Riksbank and of society, as it limits the systemic risks in the financial system. Credit institutions, investment firms, central counterparties, clearing organisations, central securities depositories, central banks and state authorities conducting operations comparable to those of the Riksbank may become participants in RIX.

Which institutions may become participants in RIX is restricted by the Act on Systems for Settlement of Obligations on the Financial Market (1999:1309). In addition to making requirements for which types of institution may become participants, the act stipulates that all participants shall be subject to adequate supervision by an authority or other competent body in their home country. Institutions that can be participants under the Act on Systems for Settlement of Obligations on the Financial Market have the right to become RIX participants if they comply with the Riksbank's requirements according to the *Terms and Conditions for RIX and Monetary Policy Instruments* (the Terms and Conditions).

Monetary policy counterparties

To be able to steer market rates, the Riksbank needs to be able to execute transactions in Swedish kronor with a number of institutions that are domiciled or have a branch in Sweden and which are active on the Swedish financial market. These institutions make up the Riksbank's monetary policy counterparties. A monetary policy counterparty has access to the Riksbank's monetary policy instruments, the standing facilities and market operations described in section 4 below. Only RIX participants that are credit institutions in accordance with EU law can apply to become monetary policy counterparties. The reason for this is that, if a monetary policy counterparty was not a RIX participant, it would have to act via a correspondent bank that is a RIX participant and this would create unnecessary uncertainty in the monetary policy transactions.

Counterparties in foreign exchange transactions

The Riksbank sometimes needs to conduct exchanges between foreign exchange and Swedish kronor and must also be able to intervene in the foreign exchange market. When making transactions in foreign currency, the Riksbank needs counterparties with sufficient capacity to trade in the relevant currencies. A credit institution that has a share of the foreign exchange market that the Riksbank considers to be sufficiently large can apply to become a counterparty in foreign exchange transactions. Such a counterparty does not need to be a RIX participant as it is of minor significance how settlement is effected as regards the part of the transaction that involves Swedish kronor.

2.2 Requirements for counterparties

For the Riksbank, it is important to ensure that the aim of the operations the counterparty participates in are fulfilled well. In the Terms and Conditions, the Riksbank therefore places requirements that must be fulfilled by potential counterparties at the time of application, as well as ongoing requirements for counterparties that have already been accepted. These include both general requirements for all counterparties and special requirements for each counterparty category.

The requirements are of two different types:

- *qualification* requirements, which are evaluated upon application and regularly followed up
- *commitments*, which the counterparty must fulfil in connection with participation and which are regularly followed up

If the requirements are not fulfilled, this can ultimately lead to suspension (temporary) or exclusion (permanent).

The general qualification requirements include the requirement that the counterparty shall be subject to adequate supervision and shall comply with the regulations applicable in the country where the counterparty is domiciled. If the institution is domiciled outside the EEA, the regulations shall be comparable to those which apply within the EU.

For an institution to be accepted as a *RIX participant*, it must have the operational capacity to participate in RIX and efficiently execute transactions so that the Riksbank's risks as operator of RIX are limited. An institution cannot be accepted as participant if its participation would jeopardise the security of RIX or seriously impair the Riksbank's ability to carry out its tasks. The Riksbank expects each RIX participant to have secure technical systems and to comply with all its obligations related to legislation covering the prevention of money laundering and funding of terrorism.

A *monetary policy counterparty* shall have the operational capacity to act as such. Among other things, this means that the counterparty shall have the capacity to act on relevant markets, to conclude business with the Riksbank and other parties, and to implement transactions. This also means that it has access to the systems support required and is able to manage the risks entailed by its operations. An institution cannot be accepted as a monetary policy counterparty if this would seriously impair the Riksbank's ability to carry out its tasks.

The monetary policy counterparties must act in a manner that promotes the Riksbank's ability to steer market rates. Monetary policy counterparties are also expected to participate actively in the daily balancing of liquidity on the overnight market and to contribute towards increasing the Riksbank's knowledge of how the financial markets function.

3 Accounts and credits

An account balance in the Riksbank has an advantage over an account balance in private banks in that credit risk and liquidity risk are almost non-existent. The Riksbank therefore provides a central payment system – the Riksbank’s system for the transfer of funds in accounts (RIX). RIX is a so-called notified settlement system and is therefore governed by the Act on Systems for Settlement of Obligations on the Financial Market (1999:1309). In addition, RIX complies with international standards for payment systems – CPMI-IOSCO Principles for Financial Market Infrastructures (PFMI). The Riksbank, as operator of RIX, and the RIX participants, as users, are obliged to ensure that the technical conditions and practical management of accounts and payments comply with the demands placed on an efficient financial infrastructure.

The RIX participants use their principal accounts in RIX for debits and credits when they effect transfers with each other. So that the participants can effect transfers without unnecessary delays, the Riksbank supplies an intraday credit (credit during the RIX system’s opening hours) that does not incur interest. The size of the amount available for intraday credit is determined by the market value of the securities pledged as collateral by the participant, adjusted with a haircut that reflects the security's risk profile (see section 5 below). For RIX participants with access to intraday credit, the negative balance on the loan account may not amount to more than the available amount for intraday credit.

There are also special accounts connected to RIX. At present, these are accounts used for the settlement of securities. These accounts are managed by the operator of the Swedish system for securities settlement, Euroclear Sweden, in accordance with a consultancy agreement with the Riksbank. This leads to more efficient settlement, as questions regarding whether there are sufficient funds in the account do not have to be exchanged between RIX and Euroclear Sweden for every single settlement. The Riksbank offers intraday credit with the aim of facilitating securities settlement.

Other institutions than those currently having deposit accounts with the Riksbank can also be offered the possibility of having these, but only if there are special grounds. The Riksbank may deem either that stability would benefit or that the efficiency of the payment infrastructure would be promoted if an institution were to make deposits at the Riksbank. One precondition for the Riksbank to provide a deposit account for these reasons is that it does not impair the Riksbank's ability to perform its tasks. The Riksbank can pay interest on these accounts and can also sign consultancy agreements for the administration of the accounts. As of 1 November 2018, the Riksbank offers central counterparties (CCPs) the possibility of applying for access to the Riksbank's deposit facilities overnight.

Another kind of account provided by the Riksbank is a correspondent account in Swedish kronor for central banks and for international institutions and organisations domiciled abroad that the Riksbank deems have a legitimate need for such an account at the Riksbank. These accounts are regulated by the Terms and Conditions for Correspondent Accounts in Swedish Krona.

4 Implementation of monetary policy

In recent years, the Riksbank has chosen to implement its expansionary monetary policy partly by steering the so-called overnight rate, so that it lies close to the Riksbank's policy rate, and partly by purchasing government bonds. As of spring 2020, the Riksbank also buys mortgage and municipal bonds and offers to buy commercial paper and corporate bonds.

To steer the overnight rate, the Riksbank uses standing facilities and market operations with its monetary policy counterparties.

4.1 Standing facilities

By using standing facilities for deposits and loans overnight, the Riksbank can set limits – an interest rate corridor – for the overnight rate, in which the deposit rate forms the floor and the lending rate the ceiling in the corridor. The overnight interest rate should lie inside the interest rate corridor because a bank in need of liquidity can always borrow from the Riksbank against collateral at the lending rate and a bank with surplus liquidity can deposit the surplus in the Riksbank at the deposit rate. As there is a difference between the deposit and lending rates, the banks have an incentive with regard to intraday loans to agree on an interest rate that lies between the rates they would pay to or receive from the Riksbank. The Riksbank can therefore ensure that the overnight rate lands within the interest rate corridor, while the banks can borrow from each other at a cost that is lower than it would be if they were to conduct equivalent transactions with the Riksbank.

The standing facilities thus form an instrument for steering the overnight rate and managing the monetary policy counterparties' liquidity. In the event of temporary imbalances on the market for balancing liquidity overnight, the standing facilities may be utilised by those RIX participants who have access to them.

The Riksbank offers a deposit facility, the standing deposit facility, and two lending facilities, the standing loan facility and the supplementary liquidity facility. In the standing loan facility, the Riksbank offers loans against high-quality collateral (primary collateral volume) at a low interest rate, and in the supplementary liquidity facility the Riksbank offers loans against lower-quality collateral (secondary collateral volume) at a higher lending rate.

4.1.1 The standing deposit and loan facilities

The overnight rate is mainly controlled by the standing deposit and loan facilities. The pricing of the standing facilities is such that the deposit rate equals the Riksbank's policy rate minus 0.10 percentage points and the lending rate equals the policy rate plus 0.10 percentage points. In addition, credit in the standing loan facility is only granted against collateral from the primary collateral volume. Assuming that the other applicable conditions have been met, this consists of:

1. securities issued by governments

2. securities issued by central banks
3. other receivables at central banks.

If the balance of a bank's account shows a surplus when the payment system closes, the bank earns the deposit rate on the sum overnight. There is no limit on how much a bank may deposit in the deposit facility. If the balance of a bank's account with RIX shows a deficit when the payment system closes for the day, the bank has to pay the lending rate on the balance borrowed in the facility overnight (that is until the next bank day). The sum that can be borrowed from the loan facility is limited by the adjusted value of the primary collateral provided by the bank. If the negative balance exceeds the value of primary collateral pledged by the counterparty, this will be interpreted as a request from the counterparty to utilise the supplementary liquidity facility for the remaining deficit.

4.1.2 The supplementary liquidity facility

The supplementary liquidity facility is a higher-interest loan facility with lighter security requirements than the standing loan facility. The pricing of the supplementary liquidity facility is such that the liquidity facility rate is equal to the Riksbank's policy rate plus 0.75 percentage points. In addition, credit in the supplementary liquidity facility is only granted against collateral from the secondary collateral volume. Assuming that the other applicable conditions have been met, the secondary collateral volume is made up of:

1. securities issued by international organisations
2. securities guaranteed by governments
3. covered securities, taking restriction rules into account
4. securities issued by agencies
5. other eligible securities

The banks receive credit in the supplementary liquidity facility only if the deficit in their RIX account when the payment system closes for the day, exceeds the counterparty's adjusted value of primary collateral. The bank must then pay the higher liquidity facility rate overnight (i.e. until the next bank day) on the part of the amount loaned in the facility. The sum that can be borrowed from the supplementary liquidity facility is limited by the adjusted value of the secondary collateral provided by the bank.

The interest rate on the supplementary liquidity facility is higher than the interest rate on the standing loan facility. This reflects the yield spread between securities in the primary and secondary collateral volumes respectively, with a supplement. This creates incentives for counterparties to primarily use collateral from the primary collateral volume for credit from the Riksbank and also strengthens their incentives to seek market solutions to manage their liquidity.

4.2 Market operations

It is important for the Riksbank's ability to steer the overnight rate that the liquidity of the banking system towards the Riksbank is well balanced. To ensure that this is the case, the Riksbank conducts regular market operations in the form of weekly issues of Riksbank Certificates (or, alternatively, monetary policy repos or credit against collateral).

4.2.1 Riksbank Certificates

Every week, the Riksbank offers Riksbank Certificates with one week maturities at the policy rate. The Riksbank's monetary policy counterparties are thus given the opportunity to invest in securities with a short maturity issued by the Riksbank. The volume of issues corresponds to the banking system's liquidity surplus towards the Riksbank minus the amount deemed appropriate at each issue. This amount is intended to reduce the risk that some banks will have a significant liquidity deficit at the end of any day during the term of validity of the Riksbank Certificate. In addition, to facilitate liquidity management by the banks, Riksbank Certificates can be resold. If demand for the Certificate is greater than the amount on offer, allocation will take place pro rata, based on the ratio between the amount offered and total demand. If the banking system were to have a liquidity deficit towards the Riksbank, the Riksbank would offer to supply liquidity via weekly repos or credit against collateral, instead of withdrawing liquidity via Riksbank Certificates.

4.2.2 Credit with varying maturities

If it is deemed justifiable, the Riksbank can offer credit against collateral for shorter or longer maturities. During the financial crisis in 2008-2009, the Riksbank offered loans with maturities of up to 12 months. To mitigate the economic consequences of the coronavirus pandemic, the Riksbank has been offering, with effect from March 2020, extraordinary loans with three and six months' maturity to monetary policy counterparties and loans with up to four years' maturity to companies via monetary policy counterparties.

4.2.3 Purchases of government bonds and other assets

In recent years, monetary policy has been made more expansionary through purchases of government bonds. The purpose of such purchases is to push down the general level of interest rates in the economy. However, according to the ban on monetary funding in Chapter 8, Section 1 of the Sveriges Riksbank Act (1988:1385), the Riksbank may not acquire debt instruments directly from the state. Consequently, the Riksbank cannot purchase government bonds when the Swedish National Debt Office carries out issues on the primary market. The purchases made by the Riksbank must be justified by monetary policy and be made on the secondary market.

The Riksbank's purchases take place by means of auctions in which the Riksbank's monetary policy counterparties and the Swedish National Debt Office's primary dealers have the opportunity to participate. A reverse auction is a lowest-bid auction in

which the bidder offering the highest interest rate (lowest price) receives the first allocation. After that, the bidder offering the second-highest interest rate receives allocation and so on until all the volume on offer has been allocated. In this way, the pricing and allocation of the Riksbank's transactions made clear to the market.

To mitigate the financial consequences of the coronavirus pandemic, the Riksbank decided in spring 2020 to purchase mortgage and municipal bonds and to offer to purchase commercial paper and corporate bonds.

4.2.4 Operations in the foreign exchange market

Sweden's EU membership entails monthly contributions to the EU's budget. These are made in Swedish kronor to a central bank within the euro system. The receiving central bank needs to exchange the kronor into euro and, in the first instance, the Riksbank is asked to exchange this amount. If the amount is so large that it could affect the krona exchange rate, the Riksbank can choose to exchange the EU payment. The Riksbank neutralises the effect of the exchange on liquidity in kronor by selling kronor spot for euro to one of the Riksbank's counterparties in foreign exchange transactions and, at the same time, repurchasing the same krona amount forward. The transaction thereby has no monetary policy consequences.

5 Collateral

One of the Riksbank's tasks is to supply liquidity to the financial system. However, this is expected to be conducted in a way that does not involve the Riksbank risking its capital. The Riksbank therefore has to take over collateral that is sufficiently adequate to prevent this happening. The Riksbank places certain demands for something to be approved as collateral and decides how this collateral is to be valued. For collateral to be adequate, it is demanded that its value does not risk decreasing if the borrower providing the collateral encounters financial problems.

So that the Riksbank shall not risk its capital, the probability that collateral will significantly lose value needs to be very small. Assets provided as collateral must therefore have a very high credit rating. Collateral is mainly comprised of various types of Swedish or foreign securities with high credit ratings. In the Riksbank's assessment, those countries whose debt instruments are accepted as adequate collateral shall be considered to be comparable with Sweden as regards protection for investors, among other things. The kind of securities that can be accepted is specified in the Terms and Conditions. To a certain extent, foreign exchange can also be used as collateral. For such currency to be considered adequate, the currency is required to be in an account in a central bank approved by the Riksbank.

Another precondition for collateral to be considered adequate is that there exists a secure arrangement through which the Riksbank receives collateral in the asset in question. The Riksbank must determine how its connection to the securities depository in which the collateral is stored shall be arranged for this to be considered secure. The requirements for this are described in the Terms and Conditions.

The Riksbank's collateral is valued at market value. But for the collateral to be adequate, the Riksbank must take account, during valuation, of the possibility that the value may decrease due to price changes or changes in exchange rates. The Riksbank therefore makes deductions from the market price when valuing collateral to cover for potential price risk and foreign exchange risk (haircut). In addition, the haircuts are calculated conservatively.

If the collateral pledged at the Riksbank consists to a large degree of a single asset type, the Riksbank faces a concentration risk. To reduce this concentration and thereby improve diversification, limit rules can be applied. For example, structural risks and vulnerabilities linked to securities of a certain kind can justify the application of limit rules. These are applied to covered bonds in the manner described in the Terms and Conditions.



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