SWEDISH NATIONAL AUDIT OFFICE

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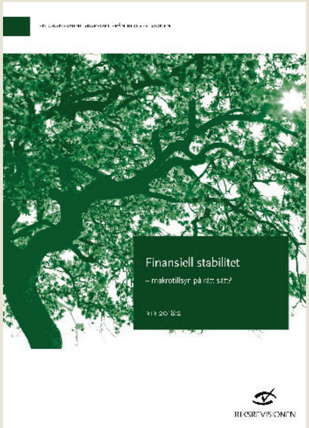


RiR 2018:2

# Financial stability

– macroprudential supervision as it should be?

## Summary and recommendations

### Background

In the wake of the global financial crisis the Government has taken extensive measures to safeguard financial stability. Besides the traditional supervision of individual financial companies, called microprudential supervision, macroprudential supervision has been introduced in which Finansinspektionen (the Swedish Financial Supervisory Authority, FI) has the main responsibility. An effective financial system creates favourable conditions for households to save and borrow and for companies to invest. Macroprudential supervision is expected to contribute to the stability of the financial system and thus to economic growth, but can also affect the functioning of credit markets and ultimately hinder economic growth.

One of the Riksdag's objectives for the financial markets area is the stability of the financial system. The European Systemic Risk Board (ESRB) is responsible for macroprudential supervision in the Union and issues recommendations that the Member States are expected to comply with or provide acceptable reasons for inaction. This means that the recommendations are not binding, but any departure must be justified.

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Since macroprudential supervision has now been in place for a few years there is reason to examine how it has worked so far as regards the objectives of macroprudential supervision, risk assessment, choice of instruments and interaction between the agencies concerned.[1]

## Purpose and implementation

The Swedish NAO has examined the appropriateness of certain parts of the work on financial stability and macroprudential supervision. The questions are as follows:

- Are the Government's purpose and FI's objectives for macroprudential supervision specified in a way that contributes to achievement of the Riksdag's objectives for the financial markets area?
- Does FI have a strategy for macroprudential supervision in which available instruments are used transparently and effectively to contribute to the agency's objectives?
- Has the interaction of the agencies concerned contributed to well-coordinated analyses and clarified the need for appropriate measures?

To assess the work of the agencies on macroprudential supervision and their contribution to financial stability, the Swedish NAO will base its audit on the recommendations of the ESRB.

The Swedish NAO has not audited the organisational base or statutory support for macroprudential supervision.

## Audit findings and conclusions

The implementation structure of macroprudential supervision is relatively new and since 2014 there have been some changes in certain respects. The overall conclusion of the Swedish NAO is that Swedish macroprudential supervision follows the ESRB's recommendations but that it has some atypical elements that the Government and FI should take into account to ensure that macroprudential supervision is conducted as efficiently as possible.

1 For reasons of simplicity the terms "agencies concerned", or "the agencies" are used, by which is meant the Ministry of Finance, Finansinspektionen (Swedish Financial Supervisory Authority), the National Debt Office and the Riksbank (Swedish central bank).

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## The objective of macroprudential supervision is not sufficiently clear

The Swedish NAO considers that the Government's mandate to FI is unclear as regards the objective of macroprudential supervision. This applies in particular to whether, and in that case how, FI should take into account the trade-off that may arise with regard to finding a balance between measures for a stable financial system and for sound economic growth. In addition, FI's broad interpretation of its remit may result in less effective macroprudential supervision and an amplification of any trade-offs.

The audit shows that the Government's overall purpose for financial stability policy is in line with the ESRB's recommendation. The ultimate goal of macroprudential supervision according to the ESRB is to contribute to financial stability, where a stable financial sector in turn is expected to help economic growth. The Swedish NAO notes, however, that in its instructions to FI, the Government emphasises the need for balance between a stable financial system and sound economic growth. Even though this is not contradictory in itself, macroprudential measures can both favour and hinder economic growth, the Swedish NAO considers that the wording is unclear with respect to how the Government views the objectives of FI's activities and how it wishes FI to address potential trade-offs.

As regards FI's interpretation of its objectives for macroprudential supervision, the Swedish NAO considers that it departs from the ESRB's recommendation. The Swedish NAO understands that the FI puts the objective of achieving balanced development on the credit market on an equal footing with the financial stability objective, while the ESRB recommends an interim objective of balanced development on the credit market as an operational specification in order to contribute to stability in the financial system as a whole. The Swedish NAO takes the view here that FI's interpretation of its remit has meant that the authority has taken measures with reference to macroprudential supervision that are not aimed at contributing to financial stability. In addition, the Swedish NAO notes that as a result of this, FI's terms of reference concerning macroeconomic stability extend beyond the Riksdag's objective for the financial markets area.

## Unclear links between risks and actions

The Swedish NAO notes that FI has developed a framework that in broad terms explains how the FI works to identify vulnerabilities in the financial system and how it intends to use the macroprudential instruments that fall within its competence. To this extent macroprudential supervision in Sweden can be said to meet the ESRB's recommendation on the framework. However, the Swedish NAO considers that the macroprudential supervision is not sufficiently transparent and comprehensible, which the ESRB recommends it should be. For example, there is no description of how FI, using its method, views the links between the (lack of) vulnerabilities and the final objective of macroprudential supervision and the (existence of) vulnerabilities and the choice of macroprudential instruments.

The Swedish NAO considers that the FI has a macroprudential supervision strategy with indicators to supervise the development of systemic risks, that is in line with the ESRB's recommendation. However, the Swedish NAO takes the view that FI's implementation of macroprudential supervision, in terms of identifying systematic risks and the need for action, lacks transparency. The Swedish NAO cannot see that the FI has a policy strategy for decisions on macroprudential supervision measures that is in line with the ESRB's recommendation, i.e. guided by indicators, with the exception of FI's decisions on the countercyclical capital buffer. By "guided by indicators" the ESRB means that decisions on measures must be made on the basis of a set of indicators together with an expert assessment. In this the Swedish NAO sees no contradiction to FI's macroprudential supervision framework, according to which decisions on measures must be preceded by a thorough analysis, since decisions include balancing benefits against risks and costs.

As vulnerabilities, according to FI, fill the same purpose as the ESRB's interim objective, the Swedish NAO considers that FI could specify in advance which macroprudential instruments (one or more) that may be relevant for dealing with various vulnerabilities. The Swedish NAO takes the view that FI's application of macroprudential instruments departs from the ESRB's recommendations in that FI's accounts of alternative measures are considerably narrower than is reasonable. The Swedish NAO's view is that FI's accounts of alternative measures should be extended to more closely follow the ESRB's indicative list of macroprudential instruments linked to various interim objectives, but adapted to the set of vulnerabilities FI uses as operative support.

## Well-functioning but limited interaction

The Swedish NAO assesses that interaction on macroprudential supervision between agencies obliged to contribute to financial stability largely functions well, but that some aspects of interaction concerning the choice of macroprudential instruments is characterised by restrictions. Within the framework of the Financial Stability Council there are no comprehensive comparisons of the effectiveness of different types of measures that can contribute to financial stability.

The interaction that exists between relevant agencies concerning vulnerabilities and risks to financial stability functions well. FI, the Swedish National Debt Office and the Riksbank have access to partially different sources of information and base their stability assessments on partially different premises. The Swedish NAO takes the view that these partly complementary assessments probably improve the ability to identify vulnerabilities and disruptions that constitute risks to financial stability. The ESRB's recommendation on an appropriate coordination mechanism with relevant bodies at national level is therefore fulfilled.

The Swedish NAO considers that the authorities involved have an appropriate coordination mechanism with relevant bodies at national level in the form of the Financial Stability Council. However, as regards interaction between agencies involved in the choice of macroprudential instruments there is room for improvement. FI's decisions on macroprudential measures are assessed as benefiting from both the Riksbank's analyses and regular meetings in the context of the Financial Stability Council. In relation to the ESRB's recommendations, however, the Swedish NAO's view is that there is a lack of broad analysis and constructive discussions in the choice of appropriate instruments.

For the macroprudential measures that require the consent of the Government, the Swedish NAO's view is that the process surrounding consent is satisfactory. The Government's reasons for requiring consent were that some macroprudential measures can have a potentially great impact on the Swedish economy and public finances as well as possibly intervening in individual finances. Consequently, in the opinion of the Swedish NAO it is important that the Government gives a detailed account of its assessment of the consequences in these respects since this contributes to transparency in the use of macroprudential instruments. In the cases of the original and stricter mortgage requirements the Government has not published any of its own analyses or assessments.

## The Swedish NAO's recommendations

Macroprudential supervision is a relatively new feature in Swedish politics and analysis methods as well as forms of cooperation have changed during the period audited. Much has fallen into place, but it is important to continue to develop and adapt governance so as to ensure that the intended objectives are achieved as effectively as possible. Bearing this in mind, the Swedish NAO makes the following recommendations:

- The Government should clarify the objective of FI's macroprudential remit and at the same time make it clear how FI is to rank various trade-offs.

- FI should indicate interim objectives in line with the ESRB's recommendations, or more clearly justify and describe how vulnerabilities are used as operative support for decisions on measures.
- FI should develop and implement a more detailed framework document in order to ensure the effectiveness of macroprudential supervision and make it more transparent and predictable. In that context, FI should explain more clearly than at present the pros and cons of the different instruments.
- The Government should provide reference material for its positions on macroprudential measures that require its consent, and thus supplement FI's analyses with macroeconomic and distribution policy analyses.
- The agencies who are obliged to contribute to financial stability should continue to develop cooperation on the choice of instrument, so that more types of measures are analysed and compared in order to effectively achieve financial stability.