Journal of Financial Crises

Volume 4 | Issue 4

2022

Finland: Government Guarantee Fund, Blanket Guarantee, 1992

Anmol Makhija
Yale School of Management

Recommended Citation
Makhija, Anmol (2022) "Finland: Government Guarantee Fund, Blanket Guarantee, 1992," *Journal of Financial Crises*: Vol. 4 : Iss. 4, 188-200.
Available at: https://elischolar.library.yale.edu/journal-of-financial-crises/vol4/iss4/8

Finland: Government Guarantee Fund, Blanket Guarantee, 1992[1]

Anmol Makhija[2]

Yale Program on Financial Stability Case Study
December 22, 2022

Abstract

Following a period of rapid financial liberalization and a record credit boom in the 1980s, Finland's financial system suffered steadily increasing loan losses and falling earnings beginning in 1990. The Finnish Parliament created the Government Guarantee Fund (GGF) in April 1992 to support banks with loans, capital, and guarantees. In a press release issued on August 6, 1992, the government said the GGF would "secure the stable functioning of the banking system *under any circumstances* [emphasis added]". Six months later, the Parliament of Finland specifically required the GGF to guarantee that all Finnish banks could meet their commitments. The government provided unlimited funding for this guarantee, stating that the guarantee provided full protection of depositors and other creditors; it specifically stated that the guarantee excluded equity holders, which are not creditors. The GGF never exercised the blanket guarantee to pay depositors or creditors of a failing bank. The Finnish Parliament replaced the facility with standing deposit insurance on December 8, 1998, with a coverage limit of 150,000 Finnish markkaa (USD 27,000) per depositor per bank.

Keywords: banking crisis, bank resolution, blanket guarantee, Finland, Nordic Financial Crisis

[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering blanket guarantee programs. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

[2] Research Associate, YPFS, Yale School of Management.

Overview

Following a period of deregulation between 1980 and 1986, Finland's financial sector experienced increased credit growth. In 1990, economic growth slowed to zero. The collapse of Finnish exports to the Soviet Union in 1991 and weak confidence in the Finnish markka (FIM) further worsened economic conditions (Nyberg and Vihriälä 1994).

Beginning in 1990, Finnish banks suffered from steadily increasing loan losses and falling earnings (Nyberg 1992, 9). In January 1992, the prime minister appointed a working group to review the banking situation. Based on the working group's recommendations, the government announced a broad-based capital injection of up to FIM 8 billion (USD 1.8 billion)[3] in March 1992 (Nyberg and Vihriälä 1994).

In 1992, the stock of banks' nonperforming assets grew rapidly from FIM 42 billion to FIM 77 billion. In April 1992, the Finnish Parliament created the Government Guarantee Fund (GGF) to "secure the stable operation of deposit banks and depositors' claims" (Government Guarantee Fund 1992, 1). Moody's Investors Service said it was comforted that the government had made explicit the implicit support for depositors that had always been in place in Finland (Dow Jones 1992). On August 6, 1992, the Finnish government issued a stronger statement that the GGF would "secure the stable functioning of the banking system *under any circumstances* [emphasis added]" (Government of Finland 1992, 1). Research did not reveal any bank runs in Finland at the time.

Key Terms

Purpose: To "secure the stable functioning of the banking system under any circumstances" (Government of Finland 1992, 1)

Launch Date(s)	Authorization: February 1993
End Date(s)	December 8, 1998
Eligible Institutions	Deposit banks and branches of deposit-taking foreign credit institutions. Available sources do not state whether the blanket guarantee's coverage extended beyond the GGF's members
Eligible Liabilities	Full protection of depositors and other creditors. Equity holders were not covered
Fees	The fund could impose a risk-based fee of up to 0.01% of the balance sheets of banks. Unclear what fee the fund imposed, or if collected fees were earmarked for the guarantee
Coverage	Unclear
Outcomes	The guarantee was not used; however, the government spent FIM 30 billion on bank support after the guarantee was authorized
Notable Features	Open-ended funding and broad political support

[3] Per Bloomberg, USD 1 = FIM 4.49 on March 31, 1992.

But the Finnish Parliament didn't specifically call for a blanket guarantee for banks' liabilities until February 1993, in a resolution attached to an act amending the GGF. The resolution said: "Parliament requires the state to guarantee that Finnish banks are able to meet their commitments on time under all circumstances" (Nyberg and Vihriälä 1994, 33). The government provided unlimited funding for the guarantee and committed to granting all funds needed to guarantee that banks were able to fulfill their commitments. The government said that the guarantee provided full protection of depositors and other creditors, while excluding equity holders (Moe, Solheim, and Vale 2004). The guarantee was never exercised, in that no bank failure required a government payout to depositors or other creditors. However, the GGF did directly take on the liabilities of Arsenal, a bad bank it created after merging 41 failing savings banks into the Savings Bank of Finland. Aggregate loan losses fell below 1% of banks' total assets by 1995 (Borio, Vale, and von Peter 2010). The government replaced the blanket guarantee on December 8, 1998, with a limited deposit insurance scheme (Valori and Vesala 1998). The coverage limit of the limited deposit insurance scheme was FIM 150,000 per depositor per bank (IMF Staff 2003).

Summary Evaluation

The Finnish blanket guarantee has not been studied extensively. A news article published after the blanket guarantee was authorized stated that S&P viewed the parliamentary resolution approving the guarantee as a sign that there was unanimous political support for the government's rescue program for the banking sector. However, S&P pointed out that the authorization of the guarantee would not increase money available for the bank support package (Helsingin 1993).

<table>
<tr><th colspan="3">Context: Finland 1993–1994</th></tr>
<tr><td colspan="2" rowspan="2">GDP (SAAR, nominal GDP in LCU converted to USD)</td><td>$89.2 billion in 1993</td></tr>
<tr><td>$103.3 billion in 1994</td></tr>
<tr><td colspan="2" rowspan="2">GDP per capita (SAAR, nominal GDP in LCU converted to USD)</td><td>$17,609 in 1993</td></tr>
<tr><td>$20,301 in 1994</td></tr>
<tr><td rowspan="6">Sovereign credit rating (five-year senior debt)</td><td rowspan="3">1993</td><td>Moody’s: Data not available</td></tr>
<tr><td>S&P: AAA</td></tr>
<tr><td>Fitch: Data not available</td></tr>
<tr><td rowspan="3">1994</td><td>Moody’s: Data not available</td></tr>
<tr><td>S&P: AAA</td></tr>
<tr><td>Fitch: Data not available</td></tr>
<tr><td colspan="2" rowspan="2">Size of banking system</td><td>$71.8 billion in 1993</td></tr>
<tr><td>$72.0 billion in 1994</td></tr>
<tr><td colspan="2" rowspan="2">Size of banking system as a % of GDP</td><td>80.5% in 1993</td></tr>
<tr><td>69.7% in 1994</td></tr>
<tr><td colspan="2" rowspan="2">Size of banking system as a % of financial system</td><td>Data not available in 1993</td></tr>
<tr><td>Data not available in 1994</td></tr>
<tr><td colspan="2" rowspan="2">Five-bank concentration of banking system</td><td>Data not available in 1993</td></tr>
<tr><td>Data not available in 1994</td></tr>
<tr><td colspan="2" rowspan="2">Foreign involvement in banking system</td><td>Data not available in 1993</td></tr>
<tr><td>Data not available in 1994</td></tr>
<tr><td colspan="2" rowspan="2">Existence of deposit insurance</td><td>Yes in 1993</td></tr>
<tr><td>Yes in 1994</td></tr>
<tr><td colspan="3">Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.</td></tr>
</table>

Key Design Decisions

1. **Purpose: The Finnish government announced the blanket guarantee to "secure the stable functioning of the banking system under any circumstances."**

On August 6, 1992, the Finnish government issued a press release outlining its economic policy and stated the "Government Guarantee Fund will secure the stable functioning of the banking system *under any circumstances* [emphasis added]" (Government of Finland 1992, 1). In February 1993, the Parliament specifically required the GGF to guarantee banks' liabilities. Officials at the Finnish Ministry of Finance stated that the motivation was to reassure foreign creditors of Finnish banks and avoid a major default in the banking sector due to liquidity shortages.

2. **Part of a Package: The Government Guarantee Fund administered the blanket guarantee along with several other bank support measures, including capital injections, provision of funding for asset management companies, and provision of specific guarantees.**

Several support measures preceded the announcement of the blanket guarantee. In September 1991, the Bank of Finland (BoF) acquired 53% of Skopbank, a commercial bank that acted as a central bank for the Finnish savings banks, following an acute liquidity crisis that was caused by the bank's large portfolio of bad assets (Nyberg 1992). In October 1991, the BoF extended FIM 13.4 billion as overnight credit to commercial banks, mostly to Skopbank (Borio, Vale, and von Peter 2010). In March 1992, the government announced its intention to inject up to FIM 8 billion of capital into Finnish banks. By December 1992, virtually all banks had used the facility (Nyberg and Vihriälä 1994).

The government established the GGF on April 30, 1992, "to help ensure the stability of the banking system, and secure the claims of both domestic and foreign depositors" (Nyberg and Vihriälä 1994, 29).[4] Lastly, in June 1992, the GGF supported 41 savings banks that later formed the Savings Bank of Finland (SBF) by providing a capital injection of FIM 5.5 billion and a guarantee of FIM 1.7 billion for the issue of subordinated loans that was later used.

Following the August 6, 1992, announcement, the GGF provided further capital injections into Skopbank, SBF, and STS-Bank; and funding for asset management companies to manage nonperforming assets. The GGF also provided specific guarantees to Kansallis-Osake-Pankki, Union Bank of Finland, and the cooperative banks, which were not used (Nyberg and Vihriälä 1994).

By the end of 1992, the BoF had FIM 9.5 billion outstanding in the form of stabilization loans to the asset management company Sponda. Appendix A provides a table detailing all bank support measures undertaken during the crisis.

[4] Before 1992, cooperative, commercial, and savings banks all had their own security funds that had nearly identical provisions, but their activities differed in practice. For more information see Valori and Vesala (1998, 12).

3. Legal Authority: The Finnish Parliament approved an amendment to the Act on the Government Guarantee Fund that endorsed the blanket guarantee.

The Finnish Parliament passed the Act on the Government Guarantee Fund on April 30, 1992, to "secure the stable operation of deposit banks and depositors' claims" (Government Guarantee Fund 1992, 1). On February 23, 1993, the Finnish Parliament approved an amendment to the Act on the Government Guarantee Fund and unanimously endorsed the blanket guarantee by stating that "Parliament requires the state to guarantee that Finnish banks are able to meet their commitments on time under all circumstances. Whenever necessary, Parliament shall grant sufficient appropriations and powers to be used by the Government for meeting such commitments" (Nyberg and Vihriälä 1994, 33).

4. Administration: The Government Guarantee Fund administered the blanket guarantee.

The Finnish Parliament established the GGF on April 30, 1992, and stated that the fund's function was "to secure the stable operation of deposit banks and depositors' claims" (Government Guarantee Fund 1992, 1). Before the GGF's establishment, the BoF was solely responsible for upholding systemic stability; its acquisition of Skopbank in 1991 was outside the typical scope of a central bank's responsibilities.

A BoF discussion paper stated that the GGF made extensive use of the staffs of the Bank of Finland and the Banking Supervision Office (BSO). The administration of the GGF initially proved to be inadequate because the fund had no full-time staff. Also, representatives from the BoF and BSO could not act as owners of the troubled banks and perform their supervisory duties without a conflict of interest (Nyberg and Vihriälä 1994).

Appendix B provides a figure outlining the administrative structure of bank support measures in Finland.

5. Governance: The supervisory board and board of directors managed the GGF.

The GGF was managed by the supervisory board and the board of directors. The supervisory board of the fund was made up of the Parliament's banking commissioners, and the chairman and vice chairman of the supervisory board were the chairman and vice chairman of the banking commissioners. The task of the supervisory board was to:

- Elect and dismiss the members and deputy members of the executive board and to appoint the chairman and vice chairman of the board;
- Approve the rules of the fund;
- Confirm the fund's annual budget, income statement, and balance sheet;
- Make a proposal to the Government Council on taking out a loan for the operation of the fund;

- Decide on the organization of the fund's internal audit;
- Decide on the granting of discharge from liability to the board of directors and the agent; and
- Deal with other issues presented by the board of directors. (Government Guarantee Fund 1992)

The GGF's board of directors initially consisted of a chairman and five other members from the Ministry of Finance, the Banking Supervision Agency, the Bank of Finland, and the banks that belonged to the fund. The task of the board of directors was to manage the fund's operations. When the government authorized the blanket guarantee, it implemented an administrative reform of the GGF by reducing the number of board members to five. Only one member in the newly constituted board was a representative of a specific organization, the Ministry of Finance. Although the BoF and BSO were no longer formally represented on the board, they continued as permanent advisers (Nyberg and Vihriälä 1994).

The Act on the Government Guarantee Fund stated that the GGF was required to follow the Accounting Act (655/73) in its accounting and was subject to an annual audit. The auditors were required to provide the supervisory board with a written audit report, which contained statements on the confirmation of the income statement and balance sheet, the granting of discharge from liability, a proposal for measures concerning the fund's performance, and any reminders that affected the confirmation of the income statement and balance sheet. The GGF also published its annual reports in 1993, 1994, and 1995, providing information regarding bank support measures (GGF 1994; GGF 1995; GGF 1996).

6. Communication: The Finnish government issued increasingly strong statements of public support for banks, culminating in a parliamentary resolution in February 1993 that specifically required the GGF to guarantee banks' liabilities.

The government issued a strong statement of public support for banks on August 6, 1992. The press release stated that the "Government Guarantee Fund will secure the stable functioning of the banking system *under any circumstances* [emphasis added]" (Government of Finland 1992, 1). In February 1993, the Finnish Parliament unanimously authorized a more explicit resolution, stating: "Parliament requires the state to guarantee that Finnish banks are able to meet their commitments on time under all circumstances. Whenever necessary, Parliament shall grant sufficient appropriations and powers to be used by the Government for meeting such commitments" (Nyberg and Vihriälä 1994, 33).

Officials at the Finnish Ministry of Finance also stated that there was some informal communication regarding the blanket guarantee between the Swedish and Finnish central banks.

7. Source(s) and Size of Funding: The government provided unlimited funding for the guarantee.

The amendment to the Act on the Government Guarantee Fund that the Parliament passed in February 1993 stated that the Finnish Parliament committed to granting all funds that might be needed to guarantee that banks could fulfill their commitments (Nyberg and Vihriälä 1994).

8. Eligible Institutions: Members of the GGF were eligible for the guarantee and included deposit banks and branches of foreign credit institutions that received deposits from the public.

The GGF's members were deposit banks and branches of foreign credit institutions that received deposits from the public (Government Guarantee Fund 1992). It is not clear whether the blanket guarantee's coverage extended beyond the GGF's members.

9. Eligible Liabilities: The guarantee provided full protection of depositors and other creditors.

The blanket guarantee provided full protection of depositors and other creditors. It is unclear which creditors were excluded from the guarantee, if any. The government specifically said that the guarantee did not cover equity holders, which are not creditors.

10. Fees: The GGF charged an annual fee of not more than 0.01% of the total sum of the most recently confirmed balance sheets of the banks.

The act that established the GGF in April 1992 stated that banks in the fund must pay an annual fee, which would be not more than 0.01% of the total sum of the most recently confirmed balance sheets of the banks. The fund's board was charged with determining the amount of each bank's annual fee based on the risks the bank had taken in its operations. It is unclear who was in charge of determining the annual fee, the supervisory board or the board of directors. The act stated that the fund's calculation basis must be the same for all banks belonging to the fund (Government Guarantee Fund 1992). Available sources did not specify the level of the fee that the fund's board decided to impose on banks. It is also unclear if the GGF earmarked these fees for a specific purpose.

11. Process for Exercising Guarantee: The process associated with exercising the guarantee is not clear.

Research did not reveal the process for exercising the guarantee.

12. Other Restrictions: The blanket guarantee did not impose specific restrictions.

It does not appear that the blanket guarantee imposed specific restrictions. The broad-based capital injection in March 1992 required banks to be flexible toward borrowers having trouble servicing their debt and meet borrowers' needs for new loans. Restrictions associated with other forms of bank support included: management replacement, restructuring, balance sheet and cost reductions, and the previous owners of the savings banks' losing almost all of their capital (Borio, Vale, and von Peter 2010).

13. Duration: The Finnish Parliament required the government to guarantee bank liabilities in February 1993 and replaced this guarantee with a limited deposit insurance system on December 8, 1998.

In the government's statement on August 6, 1992, it did not identify an end date of government support for banks. However, the government said it would revise deposit protection after European Commission (EC) legislation on deposit insurance was approved and the Finnish banks' financial conditions had stabilized (Government of Finland 1992). The EC legislation on deposit insurance was approved on May 30, 1994 (EC 1994). On December 8, 1998, a limited deposit insurance scheme with a coverage limit of FIM 150,000per depositor per bank replaced the blanket guarantee (Garcia 2000; IMF Staff 2003; Valori and Vesala 1998).

References and Key Program Documents

Legal/Regulatory Guidance

(EC 1994) European Commission (EC). 1994. "Directive 94/19/EC of the European Parliament and of the Council on Deposit Guarantee Schemes." May 30, 1994.
EC legislation on deposit guarantee schemes passed in May 1994.
https://ypfs.som.yale.edu/node/22092

(Government Guarantee Fund 1992) Government Guarantee Fund. 1992. "Law 379/1992 Establishing the Government Guarantee Fund." April 30, 1992.
Law 379/1992 establishing the Government Guarantee Fund (in Finnish).
https://ypfs.som.yale.edu/node/21999

Media Stories

(Dow Jones 1992) Dow Jones Newswires (Dow Jones). 1992. "Moody's Cites Stress on Credit Quality of Finnish Banks." April 30, 1992.
News article discussing Moody's view on the bank support and explicit deposit insurance implemented in 1992.
https://ypfs.som.yale.edu/node/22000

(Helsingin 1993) Helsingin, Sanomat. 1993. "S&P Hesitates over Credit Ratings of 5 Finnish Banks." February 27, 1993.
News article discussing S&P's views on the bank support in Finland and credit rating of Finnish banks.
https://ypfs.som.yale.edu/node/22001/

Press Releases/Announcements

(Government of Finland 1992) Government of Finland. 1992. "Declaration on Economic Policy by the Finnish Government." August 6, 1992.
Announcement of the Finnish Blanket Guarantee.
https://ypfs.som.yale.edu/node/22002/

Reports/Assessments

(GGF 1994) Government Guarantee Fund (GGF). 1994. Government Guarantee Fund Annual Report 1993.
Annual Report published by GGF (in Finnish).
https://ypfs.som.yale.edu/node/22004

(GGF 1995) Government Guarantee Fund (GGF). 1995. Government Guarantee Fund Annual Report 1994.
Annual Report published by GGF (in Finnish).
https://ypfs.som.yale.edu/node/22007

(GGF 1996) Government Guarantee Fund (GGF). 1996. Government Guarantee Fund Annual Report 1995.
Annual Report published by GGF (in Finnish).
https://ypfs.som.yale.edu/node/22017/

(IMF Staff 2003) IMF Staff. 2003. "Managing Systemic Banking Crises." International Monetary Fund Occasional Paper No. 224, August 28, 2003.
Paper updating the IMF's work on general principles, strategies, and techniques for managing crises.
https://ypfs.som.yale.edu/library/managing-systemic-banking-crises

(Moe, Solheim, and Vale 2004) Moe, Thorvald G., Jon A. Solheim, and Bent Vale. 2004. "The Norwegian Banking Crisis." Norges Bank Occasional Papers No. 33/2004, October 22, 2004.
Paper discussing Nordic Financial Crisis.
https://ypfs.som.yale.edu/node/22019/

(Nyberg 1992) Nyberg, Peter. 1992. "The Government Guarantee Fund and Bank Support." Bank of Finland Bulletin 66, no. 11 (November 9): 9-10.
Paper published in the BoF Bulletin discussing the GGF and bank support measures implemented.
https://ypfs.som.yale.edu/node/22018

(Valori and Vesala 1998) Valori, Veli-Pekka, and Jukka Vesala. 1998. "Reform of the Finnish Deposit Guarantee Scheme." Bank of Finland Bulletin 72 no. 3 (February 2): 11–13.
A BoF paper discussing the replacement of the blanket guarantee.
https://ypfs.som.yale.edu/node/22003/

Key Academic Papers

(Borio, Vale, and von Peter 2010) Borio, Claudio, Bent Vale, and Goetz von Peter. 2010. "Resolving the Financial Crisis: Are We Heeding the Lessons from the Nordics?" Bank for International Settlements Working Paper No. 311, June 2010.
Paper discussing lessons from the Nordic Financial Crisis.
https://ypfs.som.yale.edu/node/22020

(Garcia 2000) Garcia, Gillian G. H. 2000. "Chapter IV: On Instituting and Removing a Full 'Blanket' Guarantee." In *Deposit Insurance: Actual and Good Practices*. Washington, DC: International Monetary Fund.
Book chapter discussing how to implement and remove a blanket guarantee.
https://ypfs.som.yale.edu/node/21525

(Nyberg and Vihriälä 1994) Nyberg, Peter, and Vesa Vihriälä. 1994. "The Finnish Banking Crisis and Its Handling (an Update of Developments Through 1993)." Bank of Finland Discussion Paper No. 7/94, April 18, 1994.
Article discussing the Finnish Banking Crisis and the government's response to the crisis.
https://ypfs.som.yale.edu/node/22021

Appendixes

Appendix A

Figure 1: Overview of Bank Support Measures Taken by Finland, 1991–1993

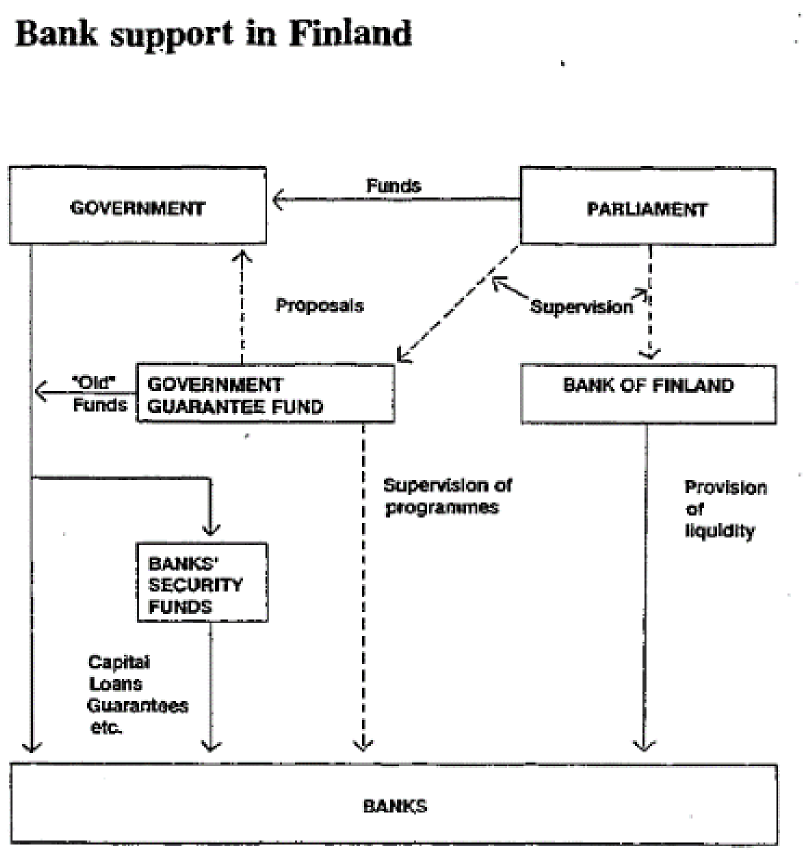
Finland					
Finland (FIM bn)	**Capital injection to specific problem banks**	**Funding for AMCs**	**General capital injections**	**Other transfers**	**SIMPLE SUM**
1991 Skopbank	4.330				
1992 Skopbank	2.772	9.752			
1992 Savings Bank of Finland	11.094		1.400		
1992 Other savings banks	0.160				
1992 Savings banks sec fund			0.500		
1992 Okobank				0.422	
1992 Coop banks				1.108	
1992 Postipankki				0.903	
1992 Union Bank of Finland				1.749	
1992 KOP				1.726	
1992 STS-Bank				0.170	
1992 General capital injections, other banks				1.822	
1993 Skopbank	1.550				
1993 STS-Bank	3.036				
1993 Savings Bank of Finland	2.100				
1993 AMC Arsenal		5.000			
1994 AMC Arsenal		6.000			
1995 AMC Arsenal		8.000			
1996 AMC Arsenal		4.000			
SIMPLE SUM	25.042	32.752	1.900	7.900	67.594
% GDP 1992	5.07	6.63	0.38	1.60	13.69
GDP 1992	493.739				

Calculations do not include revenues from the sale of banks or assets during the period 1991–1996.

Source: Borio, Vale, and von Peter 2010.

Appendix B

Figure 2: Overview of Bank Support Administration in Finland, 1991–1993



Source: Nyberg and Vihriälä 1994.