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Sweden: Bank Support Authority, Blanket Guarantee, 1992

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Abstract

Following a period of rapid financial liberalization and a record credit boom in the 1980s, Sweden's financial system suffered its worst shock in the post–World War II period. Swedish banks were heavily dependent on foreign credit, which dried up amid signs of instability. The Swedish government announced a blanket guarantee on September 24, 1992, for all banks' obligations except share capital and perpetual subordinated loans. According to a 1995 IMF Working Paper by Drees and Pazarbasioglu, the purpose of the blanket guarantee was "to guarantee the stability of the payments system and to safeguard the general supply of credit." The blanket guarantee gave the Riksbank the option to lend to any commercial bank operating in Sweden, even to those that were on the brink of insolvency, and to extend emergency liquidity assistance to troubled banks without imposing collateral requirements. The government created the Bank Support Authority to administer the guarantee and other measures. The balance sheets of Sweden's banks totaled 1.5 trillion Swedish krona (SEK; USD 270 billion) in 1991, approximately 100% of GDP. The blanket guarantee was never exercised and was replaced by standing deposit insurance on July 1, 1996, with a coverage limit of SEK 250,000. The government guaranteed only depositors, and no other bank creditors, after the blanket guarantee was replaced.

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

[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/.

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Overview

Following a period of deregulation in the mid-1980s, Sweden's financial sector experienced a period of increased credit growth until 1990 (Riksdag 1994). The sharp rise in risky lending and the brewing currency crisis were accompanied by signs the real economy was overheating.

During the early 1990s, economic growth started to slow down, and credit losses gradually increased over 1990–1992. Loan losses peaked in 1992 at nearly 80 billion Swedish krona (SEK; USD 14.3 billion),[3] or 7.5% of total loans, while the banking sector recorded an operating loss of almost SEK 50 billion (MoF 1995). The banking crisis started with nonbank financial companies.[4] Nyckeln, a finance company, announced large losses on real estate loans in August and September 1990. Its September 24 announcement triggered a market run on finance companies' investment certificates (Jennergren 2011). Investment certificates (*marknadsbevis*) were a form of short-term borrowing, like commercial paper, which were then a significant source of funding for finance companies—typically backed by guarantees that banks provided. Nyckeln and two other finance companies defaulted during the fall of 1990 (Englund 2015). The Ministry of Finance (MoF) and the central bank, Sveriges Riksbank, assessed that the finance company crisis was not systemic. However, an MoF review led to a change in the law that allowed finance companies to finance through certificates and bonds (Ingves and Lind 1998). Bank lending to finance companies such as Nyckeln comprised only 4% of total bank lending, and the Swedish Financial Supervisory Authority

Key Terms

Purpose: To "guarantee the stability of the payments system and to safeguard the general supply of credit" (Drees and Pazarbasioglu 1995, 43). The guarantee also allowed the Riksbank to provide banks with liquid assets in domestic or foreign currency so they could unquestionably meet their commitments

Launch Date(s)	Announcement: Sept. 24, 1992 Authorization: Dec. 18, 1992
End Date(s)	July 1, 1996
Eligible Institutions	All banks with a Swedish charter (including their subsidiaries), foreign-owned subsidiaries located in Sweden, and certain other credit institutions with a state affiliation
Eligible Liabilities	All obligations except share capital and perpetual subordinated loans
Fees	None
Coverage	SEK 1.5 trillion (USD 270 billion)
Outcomes	The guarantee was not used. However, the Riksbank utilized the guarantee to deposit SEK 56 billion of its foreign reserves in Swedish banks
Notable Features	Flexibility provided to Riksbank to offer ELA and uncollateralized loans, broad political support, broad coverage, and open-ended funding

[3] Per Bloomberg, USD 1 = SEK 5.56 on December 31, 1991.

[4] Nonbank financial companies primarily engaged in activities such as leasing, factoring, providing installment loans, and offering credit cards but gradually expanded into other forms of lending.

(FSA; Finansinspektionen) persuaded banks to increase their funding to finance companies (Urwitz 1998).

As real estate prices started to fall in 1990, the seven largest banks, with a market share of 90%, suffered heavy losses, primarily from loans in the commercial real estate sector (Lundgren 2009, 1). Between 1990 and 1992, bank credit losses increased from 0.2% to 7.5% of the total loan stock. In April 1992, Gota Bank, the fourth-largest bank in Sweden, experienced a minor bank run as SEK 2 billion, or 5% of its deposits, was withdrawn in a week, sparked by an announcement by its parent company that it was unwilling and unable to further support the bank (Urwitz 1998). On September 9, 1992, the government announced a general guarantee for Gota's obligations, including all forms of bank debt and deposits and excluding only equity. On September 16, 1992, Gota AB, the holding company of Gota Bank, suspended payments on its liabilities and the government restated its guarantee of Gota Bank's obligations (Webb 1992).[5] A week after the Gota Bank guarantee, on September 17, as the European Exchange Rate Mechanism (ERM)[6] crisis was unfolding, the krona came under heavy speculative pressure, and the Riksbank raised the overnight rate to 500% to defend the krona and stem capital outflows that reached a record SEK 59 billion (USD 9.8 billion) in the week ended September 21 (Englund 2015; WSJ 1992).

On September 24, 1992, the government announced the blanket guarantee to "guarantee the stability of the payments system and to safeguard the general supply of credit" (Drees and Pazarbasioglu 1995, 43). The government deemed the measure necessary to address the reduced access to foreign currency funding.

The Swedish Parliament, the Riksdag, passed a bill on December 18, 1992, that authorized the guarantee and created the Bank Support Authority (BSA; Bankstödsnämnden) to administer it. The Riksdag stated that all banks with a Swedish charter (including their subsidiaries) and foreign-owned subsidiaries located in Sweden were eligible for the blanket guarantee. Share capital and perpetual subordinated loans were excluded from coverage. The liabilities covered by the blanket guarantee represented approximately 100% of GDP in 1991, totaling SEK 1.5 trillion (Riksbank 2011). The guarantee was provided free of charge (Edmonds 2015). The bill authorizing the guarantee did not identify an end date and stated that the support system must remain in place as long as needed to protect creditors (Measures to Support 1992). The blanket guarantee was never used and was replaced by Sweden's first standing deposit insurance scheme on July 1, 1996, which did not cover senior debt and other nondeposit liabilities (Englund 2015).

Summary Evaluation

The conventional view of Sweden's banking crisis is that the government "did many things wrong in the process leading up to the crisis but many things right in resolving it" (Englund

[5] The government formally acquired Gota Bank for 1 krona through the state-owned Nordbanken in December 1992 (Borio, Vale, and von Peter 2010, 34; Englund 2015, 21–22).

[6] Misalignment of several currencies in the ERM, the outcome of the Danish European Union referendum, and withdrawal of the United Kingdom and Italy from the ERM led to the crisis. For a detailed explanation of the ERM crisis, refer to Higgins (1993).

2015, 37). The Swedish government is largely recognized for providing a timely intervention, lending strong credibility to the blanket guarantee through political unity and strong government finances, providing comprehensive coverage, limiting moral hazard, and issuing a competitively neutral policy (Edmonds 2015). Notably, Sweden did not have an administrative authority to deal with systemic crises or a standing deposit insurance scheme when the government announced the blanket guarantee, so it was unclear how the guarantee would operate. Nonetheless, the market viewed the guarantee as credible because it had broad political support and strong government finances backing it, as the government deficit as a percent of GDP was lower than the Organisation for Economic Co-operation and Development country average (Garcia 2000).

The "Swedish model" for crisis resolution is sometimes hailed as a model for other countries (Englund 2015, 50). However, Englund points out that the success of the blanket guarantee and other support measures was largely dependent on the decision to abandon the fixed exchange rate system, the improving world economy, and the ability of private banks to recapitalize themselves. Since no banks covered by the guarantee failed, there was no need to exercise the blanket guarantee.

Context: Sweden 1991–1992		
GDP (SAAR, nominal GDP in LCU converted to USD)		$274.2 billion in 1991
		$284.3 billion in 1992
GDP per capita (SAAR, nominal GDP in LCU converted to USD)		$31,823 in 1991
		$32,801 in 1992
Sovereign credit rating (five-year senior debt)	1991	Moody's: Data not available
		S&P: Data not available
		Fitch: Data not available
	1992	Moody's: Data not available
		S&P: Data not available
		Fitch: Data not available
Size of banking system		$148.5 billion in 1991
		$149.3 billion in 1992
Size of banking system as a % of GDP		54.2% in 1991
		52.5% in 1992
Size of banking system as a % of financial system		44.3% in 1991
		43% in 1992
Five-bank concentration of banking system		Data not available in 1991
		Data not available in 1992
Foreign involvement in banking system		Data not available in 1991
		Data not available in 1992
Existence of deposit insurance		No in 1991
		No in 1992
Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.		

Key Design Decisions

1. **Purpose: The Swedish government, in cooperation with the opposition, announced the blanket guarantee to "guarantee the stability of the payments system and to safeguard the general supply of credit."**

On September 24, 1992, the Swedish government, in cooperation with the opposition, issued a press release outlining measures it expected to formalize later that year to address the financial crisis. The press release stated that the government would honor the obligations of Swedish banks and their subsidiaries, and credit institutions outside the banking sector that had a government affiliation. It noted that the purpose of the blanket guarantee was to ensure that households, enterprises, and other holders of claims felt safe (MoF 1992). The Riksdag approved a bill in December 1992 that authorized the guaranteed (Measures to Support 1992).

The blanket guarantee enabled the Riksbank to lend to commercial banks operating in Sweden, regardless of solvency, and to extend emergency liquidity assistance (ELA) to troubled banks without imposing collateral requirements (Borio, Vale, and von Peter 2010; Lundgren 2009).

Additionally, Jonung (2009a) notes that short-term foreign borrowing represented about 40% of total bank borrowing, and the krona was under heavy speculative pressure. The combination of Swedish banks' significant dependence on foreign financing and currency pressures prompted policy makers to issue a blanket guarantee to alleviate fears abroad that Swedish commercial banks would not be able to meet their foreign obligations (Lundgren 2009). The guarantee was successful in the sense that foreigners' confidence in the solvency of Swedish commercial banks remained intact (Jonung 2009b). The krona was left free to float on November 19, 1992, following which the Swedish economy recovered rapidly and bank losses were limited; thus, banks did not require much further support once the guarantee was in place (Englund 2015).

2. **Part of a Package: The MoF provided support to three banks on an ad hoc basis before the announcement of the blanket guarantee, with capital injections, specific guarantees, and loan subsidies.**

Before the blanket guarantee announcement, the government supported three banks on an ad hoc basis. In October 1991, Första Sparbanken and Nordbanken were supported through a specific guarantee, subsidized loans, and capital injections (Borio, Vale, and von Peter 2010). On September 9, 1992, the government announced a guarantee for all of Gota Bank's obligations, excluding only equity. Two weeks later, it became clear that the crisis was systemic and all banks were facing a funding problem, so the government expanded the Gota guarantee to a blanket guarantee for all creditors in Swedish banks (Englund 2015).

Along with the announcement of the blanket guarantee on September 24, 1992, the government stated that it might undertake other support measures including, "guarantees, loans and supply of capital, or to take other measures to increase or strengthen the capital base of banks and of credit institutions with Government affiliation" (MoF 1995).

Bo Lundgren, the minister for fiscal and financial affairs during the crisis, later said that the blanket guarantee was the "cornerstone" of the package of measures the government implemented in 1992 to address the banking crisis (2009, 2). He said that the government's guarantee enabled the Riksbank to take other measures to further assist Swedish banks. For example, the Riksbank was able to make deposits in domestic and foreign currencies and extend ELA to troubled banks without imposing collateral requirements, since the government had already assumed responsibility for the banks' obligations through the blanket guarantee. To assist Swedish banks whose foreign lenders had pulled out of Sweden, the Riksbank deposited SEK 56 billion of its foreign reserves in Swedish banks (Borio, Vale, and von Peter 2010). Lundgren (2009) finds that the blanket guarantee also allowed banks to resume funding in interbank markets.

The government injected capital into Nordbanken and Gota Bank, which nationalized the two banks; provided funding for the bad bank asset management companies Securum and Retriva; provided a capital adequacy guarantee to Föreningsbanken in 1994; and provided loans to Sparbanksstiftelsen between 1991 and 1992(Borio, Vale, and von Peter 2010). Of the seven major banks, all but Handelsbanken entered discussions with the BSA to receive some support apart from the blanket guarantee (Englund 2015). Figure 1 in the Appendix provides a table detailing all bank support measures undertaken by the state during the crisis.

3. Legal Authority: The Riksdag passed a bill on December 18, 1992, that approved the blanket guarantee, and an additional bill on June 10, 1993, that established an Appeal Board for Bank Support Issues.

The Riksdag passed a bill on December 18, 1992, that announced measures to strengthen the financial system, approved the blanket guarantee, and established a Bank Support Authority to oversee the crisis resolution (Riksdag 1994). On June 10, 1993, the Riksdag passed an additional bill that established an Appeal Board for Bank Support Issues (State Aid to Banks 1993).

The day of the announcement of the guarantee in September 1992, the fiscal and financial affairs minister, Bo Lundgren, told the press that the guarantee had the support of the opposition Social Democrats, ensuring its approval in the Riksdag (Mikkelsen 1992). Markets found that commitment sufficient in the ensuing months before the Riksdag made its formal decision.

4. Administration: The BSA administered the blanket guarantee.

Along with the authorization of the blanket guarantee on December 18, 1992, the government created the BSA to administer all support to banks and other credit institutions.[7]

[7] Before the issuance of the blanket guarantee, the MoF handled bank support.

The BSA designed support programs, and banks applied to the BSA for government support. The BSA evaluated and disbursed funds to institutions seeking support based on a thorough analysis of a bank's nonperforming loans and long-term earning potential (Drees and Pazarbasioglu 1995). Those institutions that received funds were required to report their financial statements, including incurred and expected credit losses, collateral values, and other significant balance sheet information, to the BSA (Ingves and Lind 1998). The BSA monitored support recipients and collected repayments.[8] Only the Riksdag, with the passing of a new bill, could end the blanket guarantee (Measures to Support 1992).

The BSA also hired consultants from Arthur Andersen, McKinsey, and Credit Suisse First Boston to analyze banks' internal control systems, strategies, efficiency, and finances (Ingves and Lind 1998).

5. Governance: The BSA was subject to audit by the National Audit Office and was required to submit regular reports to the Riksdag.

The BSA formally began its operations in May 1993, with a staff consisting of a government-appointed board of seven members, including a director general and deputy director general. In implementing and managing support programs, the BSA was responsible for consulting with and providing information on support measures to the Riksbank, FSA, the National Debt Office, and the Swedish Competition Authority on matters that concerned those institutions, with the MoF arbitrating rare disagreements between these agencies (Ingves and Lind 2008).

As a government entity, the BSA was subject to audit by the National Audit Office (MoF 1993). The BSA was required to submit decisions of principal importance to the government for approval (Measures to Support 1992). The BSA was also required to report measures taken frequently and provide an annual report on the budgetary consequences of support measures to the Riksdag (Riksdag 1994).[9]

In 1993, the Riksdag established an Appeal Board for Bank Support Issues to ensure that support agreements were consistent with the state's interest and to establish an appeals process in cases where the state and the institution in question could not reach an agreement, provided the institution would be insolvent without state support. The act that created the Appeal Board for Bank Support Issues also established that the state could redeem shares of an institution if an agreement assessed by the Appeal Board was not accepted, an essential commitment of an agreement was ignored by an institution, or the capital base of an institution fell below 2% of assets (State Aid to Banks 1993).

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[8] Further, the BSA was responsible for managing shares acquired as a result of share capital contribution support or restructuring and for liquidating these shares when it was commercially appropriate.

[9] These reports were submitted in May 1993, September 1993, and in the 1993–1994 budget bill.

6. **Communication: The Swedish government issued a press release on September 24, 1992, stating that the blanket guarantee was to ensure that "households, enterprises and other holders of claims can feel safe."**

When the blanket guarantee was announced on September 24, 1992, no details were given about support measures or the BSA. Regardless, the guarantee succeeded in securing continued international funding because it had broad political support and provided broad coverage (Englund 2015).

To increase government credibility, the activities of the BSA were made as transparent as possible, with exceptions for trade secrets of aid recipients (Measures to Support 1992). Further, the main political opposition, the Social Democratic party, was given complete insight into the BSA's activities and was also represented on the BSA's board (Ingves and Lind 1996).

7. **Source(s) and Size of Funding: The government provided the BSA with unlimited funding.**

The blanket guarantee covered the balance sheets of Sweden's banks, which were approximately 100% of GDP in 1991, representing SEK 1.5 trillion (Riksbank 2011).

The Riksdag provided the BSA with open-ended funding and did not set a predetermined budget, to avoid the risk of the BSA being forced to go back to the Riksdag to ask for additional funding at a later stage (Jonung 2009b).[10]

8. **Eligible Institutions: All banks with a Swedish charter, including domestic subsidiaries and foreign-owned subsidiaries located in Sweden, and certain state-affiliated credit institutions were eligible for support.**

All banks with a Swedish charter (including their subsidiaries) and foreign-owned subsidiaries located in Sweden were eligible for the blanket guarantee (Measures to Support 1992). In addition to these banks, the legislation authorizing the blanket guarantee identified eight specific credit institutions[11] with a state affiliation that were deemed eligible to receive support because they were integral to the stability of the payment system (Drees and Pazarbasioglu 1995). The central bank considered these credit institutions to have systemic importance since several were important in specialized fields, such as providing export credits to farmers.

[10] The Finnish experience of setting a limit to bank support and subsequently revising the limit at considerable political cost served as a warning for the Swedish Parliament.

[11] The credit institutions covered by the guarantee were the Kingdom of Sweden's City Mortgage Fund, Sveriges Allmänna Hypoteksbank, Svenska skeppshypotekskassan, Statens Bostadsfinansieringsaktiebolag, SBAB, AB Svensk Exportkredit, AB Industrikredit, and Lantbrukskredit AB.

9. Eligible Liabilities: All obligations were covered except share capital and perpetual subordinated loans.

All obligations were covered except share capital and perpetual subordinated loans (Riksdag 1992).

10. Fees: There were no fees associated with the blanket guarantee.

The BSA provided the blanket guarantee free of charge (Edmonds 2015).

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 have specific restrictions related to it.

It does not appear that the blanket guarantee had specific restrictions related to it. Restrictions associated with other forms of bank support included: restrictions on dividend payments, management replacement, setting recapitalization targets, implementation of cost-cutting measures, and forced write-downs of shareholder equity (Borio, Vale, and von Peter 2010).

13. Duration: The Swedish government authorized the blanket guarantee on December 18, 1992, and replaced it with a limited deposit insurance system on July 1, 1996.

The bill establishing the blanket guarantee did not identify an end date and stated that the support system must remain in place as long as needed to ensure the interests of creditors were not jeopardized (Measures to Support 1992). An MoF memorandum in November 1995 proposed that the state terminate the blanket guarantee from July 1, 1996 (MoF 1995). This recommendation was based on a FSA assessment of the 114 banks covered by the guarantee that found that the banking system had recovered, and the program was terminated as proposed in the MoF memorandum (Ingves and Lind 1996). The blanket guarantee was replaced by standing deposit insurance on July 1, 1996, with a coverage limit of SEK 250,000 (Demirgüç-Kunt et al. 2008; Garcia 2000).

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Appendix

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

State bank support
SEK million

	Total commitment	Paid out	Carried on the Budget
Savings bank foundations			
guarantee	3 250	0	0
interest subsidies	1 028	1 028	1 028
Total	**4 278**	**1 028**	**1 028**
Nordbanken			
share subscription 1991	4 191	4 191	4 191
share purchase 1992	2 055	2 055	2 055
capital contribution 1992	10 000	10 000	10 000
Total	**16 246**	**16 246**	**16 246**
Securum			
guarantee 1 1992	9 850	9 850	9 850
guarantee 2 1992	13 150	13 150	13 150
share purchase 1993	1 000	1 000	0
guarantee 1993	10 000	0	0
Total	**34 000**	**24 000**	**23 000**
Gota Bank			
capital contribution 1993	20 000	20 000	20 000
guarantee on shareholders' capital	231	231	231
Total	**20 231**	**20 231**	**20 231**
Retriva			
capital contribution 1993	3 800	3 800	0
guarantee 1993	3 500	0	0
Total	**7 300**	**3 800**	**0**
Föreningsbanken			
capital ratio safeguard 1993	2 500	0	0
Total	**2 500**	**0**	**0**
TOTAL BANK SUPPORT	**84 555**	**65 305**	**60 505**

Source: MoF 1995.