Guarantee Scheme for Banks' Funding in Finland

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Abstract

The collapse of Lehman Brothers on September 15, 2008, and its severe impact on global credit markets impelled governments around the world to enact stabilization measures to calm and protect their domestic economies. The Republic of Finland, though not directly affected, designed preemptive interventions to mitigate disruption to its financial system. Among them was the Guarantee Scheme for Banks’ Funding in Finland (the ‘Guarantee Scheme’), announced on October 22, 2008, and implemented on February 12, 2009, which aimed to support banks and mortgage institutions with their short- and medium-term financing needs. Under the program, the Finnish State Treasury would guarantee up to €50 billion in debt issuances for any Finnish deposit bank or mortgage institution considered to be solvent by authorities. Initially, types of debt covered by the Guarantee Scheme included new certificates of deposits, unsecured bonds, and other non-subordinated instruments with maturities greater than 90 days but less than three years. Covered bonds with maturities of up to five years were also eligible. Although the Guarantee Scheme was amended and prolonged twice, it was never utilized and concluded with the expiration of the issuance window on June 30, 2010.

Keywords: Finland, short-term debt, medium-term debt, mortgage banks, credit institutions, government guarantee

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At a Glance

The bankruptcy of Lehman Brothers on September 15, 2008 caused a massive disruption to international credit markets and prompted governments worldwide to enact stabilization measures to both calm and protect their domestic markets. The Republic of Finland announced on October 22, 2008, a set of interventions that included the Guarantee Scheme for Banks’ Funding in Finland (the ‘Guarantee Scheme’). The program was designed to support the short- and medium-term financing needs of Finnish banks and mortgage institutions by providing for the issuance of up to €50 billion in debt guaranteed by the government, though this was later reduced to €17 billion.

Eligible participants included Finnish deposit banks and mortgage banks, as well as Finnish subsidiaries of foreign financial institutions, which were considered to be solvent by government authorities (i.e. possess a Tier 1 capital ratio of at least 7% at the time of application to the Guarantee Scheme). Initially, instruments covered under the Guarantee Scheme included new certificates of deposits, unsecured bonds, and other non-subordinated debt instruments with maturities greater than 90 days but less than three years. Covered bonds with maturities of up to five years could also be guaranteed. All debt would have to be issued prior to April 30, 2009 in order to be qualified for coverage under the Guarantee Scheme.

Participation fees varied based on the length of maturity of the debt to be guaranteed as well as the soundness of the issuing bank. Initially, there were supposed to have been strict participation requirements imposed on banks throughout their involvement in the Guarantee Scheme, including limits on the aggregate growth in balance sheet volume, wage increases, bonus payments, board remuneration, and bank executives’ severance packages. These restrictions were later lifted or reduced with the February 5, 2009, modifications of the Guarantee Scheme, one week ahead of its official implementation. Despite having been prolonged and amended twice on April 30, 2009, and December 17, 2009, the Guarantee Scheme was never utilized. It was terminated with the expiration of its issuance window on June 30, 2010.

Summary Evaluation

The Finnish government later noted that certain design features, such as a relatively short issuance window and strict conditions for participation, may have contributed to the non-use of the Guarantee Scheme.
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I. Overview

Background

In light of the international credit crunch and severe market volatility following the bankruptcy of Lehman Brothers on September 15, 2008, governments worldwide sought to implement stabilization measures to calm and protect their domestic economies. Although Finnish banks were not under immediate threat of insolvency, it became clear that the frozen money markets and soaring interbank lending costs had the potential to impact the daily operation of healthy institutions at a time when access to liquidity was considerably restricted (“Guarantee Scheme for banks’ funding in Finland”). The Republic of Finland thus authorized the creation of the Guarantee Scheme for Banks’ Funding in Finland in order to support the short- and medium-term financing needs of banks and credit institutions. Along with two other preemptive interventions – a state-funded investment program for deposit banks and a commercial paper acquisition scheme for the State Pension Fund – the Guarantee Scheme was designed to mitigate the negative spillover effects of the global crisis on the Finnish financial system.

Program Description

On November 11, 2008, the Finnish Ministry of Finance introduced to the European Commission a draft of the Guarantee Scheme for Banks’ Funding in Finland (the ‘Guarantee Scheme’). The European Commission found the terms of the program to be in accordance with State aid rules and granted its approval on November 13, 2008, citing the “severely impeded access to liquidity for many banks” (“Guarantee scheme for banks’ funding in Finland”). The program was announced publicly as one of three interventions by the Finnish Cabinet Committee on October 22, 2008, and implemented on February 12, 2009, after having undergone modifications to its terms on February 5, 2009.

The Guarantee Scheme was to be governed by the Act on State Lending and State Guarantees (449/1988) and administered by the Central Government Debt Management branch of the State Treasury. The Finnish program was designed to support the short- and medium-term financing needs of domestic banks.

Per Parliamentary Decision No EV 110/2008 vp of December 12, 2008, up to €50 billion in debt issuances could be guaranteed by the government, though this was subsequently reduced to €17 billion. Eligibility was restricted to all Finnish deposit banks and mortgage banks, including the Finnish subsidiaries of foreign financial institutions, considered to be solvent (i.e. possessing a Tier 1 capital ratio of at least 7%) by Finnish authorities (“Guarantee scheme for banks’ funding in Finland”). Furthermore, deposit banks would be allowed to apply either individually, on behalf of its parent undertaking, or as a representative member of a group. Types of debt eligible for coverage under the Guarantee Scheme included certificates of deposits, unsecured bonds, and other non-subordinated debt instruments with maturities greater than 90 days but less than three years. An exception was made for covered (mortgage-backed) bonds, which could have maturities of up to five years. Debt of any type would have to be issued within six months of the initial notification of the
Guarantee Scheme to the European Union (i.e. by April 30, 2009). The Guarantee Scheme was not subject to any currency restrictions, and there was no minimum amount required for each issuance.

Caps on individual institutions’ participation varied based on the maturity of the debt to be issued. For short-term debt with maturities of up to 12 months, the overall limit would equal the nominal value of such short-term debt outstanding on October 17, 2008. Additionally, the government imposed a monthly limit equal to the total nominal value of the debt that matured during the given month. For medium-term debt with maturities between 12 months and five years, the overall limit would equal the total nominal value of bonds maturing between October 17, 2008, and December 31, 2009. There were no restrictions placed on the issuance of non-guaranteed debt by participants.

Participation fees were assessed in accordance with both Government Decree No. 67\(^2\) and the “Recommendations on Government Guarantees on Bank Debt,” set forth on October 20, 2008, by the European Central Bank. The fee charged for short-term debt with maturities up to 12 months equaled 50 basis points on an annual basis. The fee scheme for medium-term debt with maturities over 12 months was more complex and took into account banks’ credit default swap (CDS) spreads or credit ratings. Banks with neither a credit rating nor CDS data would derive their CDS spread from the median value of the five-year CDS spread over the same period but for the lowest rating category.

Participants issuing medium-term debt with maturities greater than 12 months would also have to pay an add-on fee of 50 basis points on an annual basis. If issuing guaranteed covered bonds, participants would pay a reduced add-on fee of 25 basis points on an annual basis.

This fee structure would remain constant throughout the duration of the Guarantee Scheme unless a participant’s Tier 1 capital ratio fell below 7%, in which case an additional five basis points would be assessed as a supplement to the add-on fee.

In addition to the payment of applicable fees, special conditions for participation included requirements “aimed at eliminating or minimizing any spillover effects which may distort competition” (“Guarantee scheme for banks’ funding in Finland”). The Finnish Supervisory Authority, in particular, was charged with the task of monitoring participating banks to ensure that their aggregate growth in balance sheet volume did not exceed the higher of “the annual growth of Finnish nominal GDP in the preceding year, the average historical growth of balance sheets in the Finnish banking sector during the period 1987-Q3 2008, or the average growth rate of balance sheet volumes in the banking sector in the EU in the preceding six months” (“Guarantee scheme for banks’ funding in Finland”).

Other restrictions included prohibitions on mass marketing of the Guarantee Scheme and the significant expansion of activities that would not have occurred in the absence of the program in addition to limits on wage increases, bonus payments, board remuneration, and bank executives’ severance packages during the guarantee period. There was also a ban placed on buy-back programs through which a bank would repurchase its own shares.

\(^2\) Government Decree No 67 on fees applicable to temporary State guarantees to deposit banks and mortgage banks of 12 February 2009
Similarly, savings banks were not allowed to buy back basic funds shares, while cooperative banks were not allowed to refund cooperative capital, additional cooperative capital, or cooperative investment capital except for the purpose of terminating its membership in the cooperative.

In the event that the guarantee were to be triggered, the Finnish State Treasury would assume responsibility for all principal (or deposits) and interest, up to the participant’s individual cap. If the triggering participant were a credit institution, mortgages would need to be transferred to the State (“Guarantee scheme for banks’ funding in Finland”).

On February 5, 2009, a week before the program’s implementation, the European Commission approved a request from the Finnish government to amend the terms of the Guarantee Scheme. Significantly, the modifications included a provision to allow participating banks to roll over some short-term debt (with maturities ranging between 90 days and up to 12 months) to medium-term debt (unsecured bonds with maturities up to three years). According to State aid documents, “participating banks can renew the previously guaranteed short-term debt as medium term debt and still retain the same State guarantee” (“Modifications”). A total of €5 billion of the €50 billion overall cap would be made available for rollovers. The individual cap available under this provision would be the participant’s share of the total lending of all eligible banks as of December 31, 2008. A monthly limit equal to the amount of short-term debt maturing in a given month would also be imposed (“Modifications”).

The February 5 modification of the Guarantee Scheme also provided for the repeal of the participation restrictions regarding balance sheet growth and buy-back programs. Additionally, the conditions for participation regarding management wages and other remuneration would be changed to reflect the principles of the competitive remuneration system for state-owned and associated enterprises of 2007 (“Modifications”). Other restrictions regarding the general prohibition on activities that would not have taken place in the absence of the Guarantee Scheme, as well as the program’s mass marketing, remained in place.

On April 30, 2009, the European Commission approved a request by the Finnish government to amend and prolong the Guarantee Scheme until December 31, 2009. Further alterations were made to the scope of the program, which would now cover any form of eligible debt instrument with maturities greater than 90 days and up to five years. Previously, only covered bonds with maturities of up to five years would have been allowed coverage. These new terms also applied to medium-term debt that had been rolled over under the February 5 modification of the Guarantee Scheme. A maximum of €16.66 billion (i.e. a third of the program’s total cap) would be earmarked for the guaranteed issuance of debt with maturities greater than three years and less than five years.

The Finnish authorities also repealed the requirement that mortgages be transferred to the State in the case that the guarantee were to be triggered.

On December 17, 2009, the European Commission approved a second request by the Finnish government to amend and prolong the Guarantee Scheme until June 30, 2010. According to the European Commission’s assessment of Finland’s position, “renewed difficulties in banks’ access to market funding would cause serious repercussions for households’ and firms’
ability to refinance their own obligations” ("Second Prolongation"). Due to the improved conditions in short-term lending markets, however, two modifications were made to greatly reduce the overall size of the program and focus assistance on banks and institutions issuing medium-term, rather than short-term, debt. The overall cap of the program was reduced from €50 billion to €17 billion, and the minimum maturity for all eligible debt was increased from 90 days to twelve months ("Second Prolongation").

Outcomes

Though in operation for nearly two years, the Guarantee Scheme for Banks’ Funding in Finland was never utilized. A section in the European Commission’s approval of the first prolongation of the program, dated April 30, 2009, detailed potential reasons for the lack of usage. It began by reporting that up until April 17, 2009, no bank or mortgage institution had applied to issue guaranteed debt. This was seen by Finnish authorities as having been due to the relatively short issuance window (February 12, 2009-April 30, 2009), the shortness of the three-year maximum maturity for debt instruments other than covered bonds, the fact that banks could obtain short-term funding from the national central bank and from the ECB with more lenient participation restrictions, and the requirement that mortgage banks transfer their mortgages to the State in the case that the guarantee were to be triggered ("Prolongation").

The program concluded with the final expiration of its issuance window on June 30, 2010.

II. Key Design Decisions

1. The Guarantee Scheme was announced on October 22, 2008, by the Finnish Cabinet Committee on Economic Policy as part of a package of three preemptive interventions enacted in response to the Global Financial Crisis.

The main purpose of the Guarantee Scheme would be to support the medium- and short-term financing needs of banks and mortgage institutions.

To further assist large-scale businesses, the government introduced a state-funded investment program for deposit banks whereby the State Treasury would offer banks interest-bearing subordinate loans that could be considered as Tier 1 capital. Additional provisions would allow the State Pension Fund the right to acquire commercial paper “of significant and financially solid Finnish companies” ("Finland Takes Measures to Boost Financial Markets").

2. Legal authority for the Guarantee Scheme derived from the Act on State Lending and State Guarantees (449/1988), while the overall cap had to be approved by the Finnish Parliament prior to implementation.

According to the Act on State Lending and State Guarantees (449/1988), the Ministry of Finance would decide all design decisions relating to the creation of the Guarantee Scheme, with the exception of the overall cap. Approval for the maximum program size was granted by legislative vote in Parliamentary Decision No EV 110/2008 vp of 12 December 2008.
3. **European Commission approval was required for the implementation of the Guarantee Scheme.**

Having found the proposed framework for the Guarantee Scheme to be in line with State aid rules, the European Commission issued its “Decision not to raise objections” (IP/08/1705) on November 13, 2008 ("Guarantee scheme for banks’ funding in Finland").

4. **The Central Government Debt Management branch of the State Treasury would be responsible for administering the program.**

5. **Initially, up to €50 billion could be guaranteed under the program.**

This maximum amount remained constant until the second modification of the Guarantee Scheme on December 12, 2009, at which point it was decreased to €17 billion.

6. **The Guarantee Scheme would be made available to all Finnish deposit banks and mortgage banks that were considered to be solvent by Finnish authorities.**

Finnish subsidiaries of foreign financial institutions were also eligible for coverage under the Guarantee Scheme.

The applicant could be either a deposit bank or its parent undertaking. If a bank was a member of a group, it could apply either individually or on behalf of the group.

Solvency was determined according to the requirements stipulated in Section 55(1) of the Act on Credit Institutions. At the time of the Guarantee Scheme’s proposal to the European Commission, all Finnish banks were required to maintain a Tier 1 capital ratio of at least 7% and, if not, the add-on fee payable would be 5 basis points higher. At the time of the guarantee, all Finnish banks had tier 1 capital ratios of at least 7%. ("Guarantee scheme for banks’ funding in Finland").

7. **New certificates of deposits, unsecured bonds, covered bonds, and other non-subordinated debt instruments would be eligible for coverage.**

8. **Initially, debt with maturities between 90 days but less than three years could be issued under the Guarantee Scheme.**

An exception was made for covered (mortgage-backed) bonds, which could have maturities of up to five years.

Per the April 30, 2009, modification, all eligible debt with maturities greater than 90 days and up to five years could be guaranteed. Up to €16.66 billion (i.e. a third) of the €50 billion program cap would be earmarked to guarantee eligible debt with maturities greater than three years and less than five years.

On December 17, 2009, the European Commission approved a request by the Finnish government to amend the minimum maturity restrictions from 90 days to 12 months. The Guarantee Scheme would thus cover instruments with maturities only between 12 months and five years. A maximum of approximately €5.66 billion (i.e. a third of the reduced budget
of €17 billion) could be used to guarantee issuances with terms over three years and up to five years.

9. **The government allowed a limited amount of short-term debt to be rolled over into medium-term debt under the Guarantee Scheme.**

On February 5, 2009, shortly before implementation, the government modified the original terms of the Guarantee Scheme to allow some short-term debt (with maturities ranging from 90 days to 12 months) to be rolled over to medium-term debt (unsecured bonds with maturities of up to three years). Participating banks would thus be allowed to “renew the previously guaranteed short-term debt as medium term debt and still retain the same State guarantee” (“Modifications”). Up to €5 billion of the €50 billion program cap could be rolled over under these terms.

The individual cap available under this provision would be the participant’s share of the total lending of all eligible banks as of December 31, 2008. A monthly limit equal to the amount of short-term debt maturing in a given month would also be imposed.

10. **All currencies appear to have been eligible.**

11. **The Ministry of Finance imposed caps on individual banks participation based on the maturity of the debt guaranteed.**

For short-term debt with maturities of up to 12 months, the overall limit would equal the total nominal value of such debt outstanding October 17, 2008. The government would also apply a monthly limit equal to the total nominal value of the debt maturing in a given month.

For medium-term debt with maturities of over 12 months and up to five years, the overall limit would equal the total nominal value of the bonds maturing between October 17, 2008, and December 31, 2009. There would be no monthly cap imposed on the guaranteed issuance of medium-term debt.

12. **Participation fees were assessed according to the maturity of the debt guaranteed and the soundness of the participating institution.**

Both Government Decree No. 67 and the “Recommendations on Government Guarantees on Bank Debt,” set forth on October 20, 2008 by the European Central Bank, provided guidance on the fee structure.

For short-term debt with maturities up to 12 months, the fee would be equal to 50 basis points on an annual basis.

For medium-term debt with maturities over 12 months, the total participation fee would comprise two separate payments:

(1) A fee based on the banks’ credit default swap (CDS) spreads, determined as follows:

   a. Banks with CDS data would be charged the median value of the five-year CDS spreads from the period spanning January 1, 2007, to August 31, 2008;

   b. Banks with a credit rating but without CDS data (or representative CDS data) would be required to calculate an equivalent CDS spread based on a
“representative sample of euro area large banks” ("Guarantee scheme for banks' funding in Finland"). This derivation would be taken over the same time period for the rating category of the banks in question;

c. Banks with neither a credit rating nor CDS data would derive their CDS spread from the median value of the five-year CDS spread over the same time period but for the lowest rating category;

(2) An add-on fee of 50 basis points on an annual basis.

Guaranteed covered bonds would receive a special pricing structure consisting of the issuing institution’s CDS spreads and a lesser add-on fee of 25 basis points on an annual basis.

Regardless of the type or maturity of the eligible debt, the add-on fee would increase by 5 basis points if the Tier 1 capital ratio of the issuing bank were to fall below 7%.


The Finnish Financial Supervisory Authority would be responsible for ensuring that the aggregate growth in balance sheet volume of participating banks would not exceed the higher of:

1) “The annual rate of growth of Finnish nominal GDP in the preceding year,

2) “The average historical growth of balance sheets in the Finnish banking sector during the period 1987-2008 (Quarter 3), or

3) “The average growth rate of the balance sheet volumes in the banking sector in the EU in the preceding months” ("Guarantee scheme for banks' funding in Finland").

Additionally, the government imposed restrictions on wage increases, bonus payments, increases in board remuneration, and bank executives’ severance packages. Relatedly, banks were generally not allowed to engage in activities that would not have otherwise occurred in the program’s absence, such as the mass marketing of the Guarantee Scheme, “except when required by law or other regulations” ("Guarantee scheme for banks' funding in Finland").

Participating banks would also be prohibited from creating buy-back programs for their own shares. Relatedly, savings banks would not be allowed to buy or otherwise acquire against payment their bank fund shares, while cooperative banks would not be allowed to refund cooperative capital, additional cooperative capital, or cooperative investment capital “for any other reason than termination of membership in the cooperative” ("Guarantee scheme for banks' funding in Finland").

Prior to the program’s implementation, the aforementioned restrictions on balance sheet growth and buy-back programs were repealed in the February 5, 2009, modification of the Guarantee Scheme terms. All conditions on compensation and management wages would also be modified to reflect the principles of the competitive remuneration for state-owned and associated companies ("Modifications").
14. Initially, participating mortgage banks would have been required to transfer their guaranteed mortgages to the State if the guarantee were to be triggered.

Due to the government’s perception that it discouraged mortgage banks’ participation, this requirement was repealed in the April 30, 2009, modification to the Guarantee Scheme.

15. Initially, the window for issuing guaranteed debt was to expire on April 30, 2009. It was ultimately extended to June 30, 2010.


III. Evaluation

As noted in the Outcomes section, the Finnish government notified the European Commission that certain design features, such as the relatively short issuance window and the strict conditions for participation, may have contributed to the limited usage of the Guarantee Scheme (“Prolongation”).

Due to its lack of utilization, there has otherwise been very little formal evaluation of the Guarantee Scheme.

IV. References


V. Key Program Documents

Summary of Program


Implementation Documents


Legal/Regulatory Guidance

Press Releases/Announcements


Media Stories

Key Academic Papers


**Reports/Assessments**
