



# SWEDEN

August 2020

## TECHNICAL ASSISTANCE REPORT—PROPOSED AMENDMENTS TO THE RIKSBANK ACT

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# **INTERNATIONAL MONETARY FUND**

Monetary and Capital Markets Department



**SWEDEN**

**PROPOSED AMENDMENTS TO THE RIKSBANK ACT**

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**July 2020**

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**GLOSSARY**

ECB	European Central Bank
ELA	Emergency Liquidity Assistance
HR	Human Resources
HRCC	Human Resource and Compensation Committee
IMF	International Monetary Fund
FX	Foreign Exchange
MCM	Monetary and Capital Markets Department
SDR	Special Drawing Rights
SEK	Swedish kroner
TA	Technical Assistance

## PREFACE

At the request of the central bank of Sweden (the Riksbank), the Monetary and Capital Markets Department (MCM) provided technical assistance (TA) on central bank operations by means of a desk review of the proposed amendments suggested by the independent committee to the Swedish Riksbank Act, during the period February 2019 and June 2020. The desk review was led by Mr. Ashraf Khan, and conducted jointly with Mr. Asad Qureshi, Mr. Romain Veyrune, and Mr. Rudy Wytenburg. Additional input was also provided by Ms. Ioana Luca of the IMF's Legal Department and colleagues from the IMF's European Department, Sweden Team.

The purpose of the desk review was to provide advice to the Riksbank on key issues relating to central bank operations, with a particular focus on the central bank's governance, independence, instruments, and internal organization.

It should be noted that the review findings, comments, and recommendations in this report are not representative of views of the IMF or of its Executive Board and are intended for the purpose of contributing to the public discussion in Sweden in the context of the draft Riksbank Act. The comments are also not intended to be complete, nor represent a detailed legal review of the Act. Instead, as noted above, the comments reflect selected key issues from a central bank operations' perspective.

Under guidance of Mr. Jihad Alwazir (Assistant-Director, MCM), and Mr. Craig Beaumont and Mr. Khaled Sakr (respective IMF Mission Chiefs for Sweden), the reviewers met with Ms. Anna Breman (Deputy Governor, Riksbank), Mr. Per Jansson (Deputy Governor, Riksbank), Mr. Eric Frieberg (Chief Legal Counsellor, Riksbank), Mr. Anders Vredin (Head of the General Secretariat, Riksbank), Ms. Pernilla Meyersson (Deputy Head of the General Secretariat, Riksbank), Mr. Thomas Hagberg (Deputy Director, Ministry of Finance), Mr. Nils Friberg (Ministry of Finance), and Ms. Asa Ekelund (Senior Advisor to the Nordic-Baltic Executive Director at the IMF), as well as various other colleagues.

## I. GENERAL COMMENTS

1. **This section will address a number of general comments that, as discussed with the authorities, lie at the heart of the proposed amendments suggested by the independent committee<sup>1</sup> to the Riksbank Act.** The following sections will deal with more detailed comments on a selection of the proposed Riksbank Act's chapters.
2. **All of the comments in this report are based on the Draft Sveriges Riksbank Act, document titled "SOU 2019:46, version of December 2, 2019 (English translation, as provided by the Riksbank)," hereafter referred to as "the Riksbank Act" or "the Act."**
3. **At the core of the proposed Riksbank Act amendments seemingly lies the question of whether it is possible to distinguish more clearly between instruments of the central bank used for price stability purposes (for which the Riksbank has the sole mandate), and those instruments used for financial stability purposes (for which the Riksbank has a shared mandate).** Additionally, this also raises the question on the effects of such a delineated distinction for the Riksbank's independence and operational capacity.
4. **In general, MCM notes that international practices for central banks and in central bank legal frameworks do not make a clear distinction between central bank instruments and the objectives they serve.<sup>2</sup>** The 2019 IMF Policy Paper on the Update of the Monetary and Financial Policies Transparency Code<sup>3</sup> notes that central bank mandates have been expanded over the past decade. It highlights that, more than linking specific instruments to specific objectives, the central bank should instead ensure proper and sufficient transparency over its mandate, including the objectives, functions, and instruments it uses, given the breadth of possible central bank objectives and instruments (see Figure 1 below).

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<sup>1</sup> See also <https://www.government.se/legal-documents/2019/11/the-riksbank-committees-proposal-for-a-new-riksbank-act-summary/>

<sup>2</sup> See, for instance, the IMF's Central Bank Legislation Database (CBLD), and Khan, A., 2017, *Central Bank Legal Frameworks in the Aftermath of the Global Financial Crisis*, IMF Working Paper 17/1010. Washington, D.C.: International Monetary Fund.

<sup>3</sup> IMF, 2019, *Update of the Monetary and Financial Policies Transparency Code*, IMF Policy Paper 19/011. Washington, D.C.: International Monetary Fund. The new IMF Central Bank Transparency Code was approved by the IMF's Executive Board on July 2, 2020 and will be published shortly.

**Figure 1. Sweden: Central Banks' Objectives and Instruments**

Policy objectives		Price Stability	Financial Stability				Payment System	Financial Integrity	Consumer Protection	Growth & Employment
			Macro	Micro	ELA	Resolution				
Instruments										
<b>Monetary, Currency, and Payments</b>	For example, OMO, FX reserves management, FX operations, cash currency, payment instruments									
<b>Macro Prudential</b>	For instance, CCB, LTV, DSTI, additional cap. requirements									
<b>Micro Prudential</b>	For instance, licensing, capital, disclosure, and fit & proper requirements, stress tests									
<b>Crisis Management</b>	For instance, ELA, recovery and resolution planning									
<b>AML/CFT</b>	For instance, reporting requirements, KYC/CDD									

Source: IMF, 2019, *Update of the Monetary and Financial Policies Transparency Code*. IMF Policy Paper No. 19/011. Washington, D.C.: International Monetary Fund.

5. **More specifically, central banks are usually free to determine the operational modalities of their interventions with domestic counterparties in the domestic market of the currency they issue to keep financial conditions in line with their monetary policy stance in the pursuit of price stability.** This includes the issuance of securities, the provision of loans, and outright purchase of securities. Prior consultation with institutions for which price stability is *not* the primary mandate (such as a financial supervisor), could create the risk of dominance of considerations other than those related to price stability. This, in its turn, could prevent the selection of the most appropriate instrument and delay the appropriate response to price developments and prospects.

6. **Additionally, a formal linking of instruments to objectives could also entail significant risks for the Riksbank and for Sweden's economy and financial system.** In particular, it would curtail the Riksbank's ability to assess and apply the relevant instrument(s) to achieve its objectives. This holds especially for emergency and crisis situations, where speed and effectiveness in deploying appropriate central bank instruments is crucial, including to ease cross-border liquidity access. This, of course, does not diminish the fact that the Riksbank should be held accountable for its actions *ex post*, by means of giving proper insight into its reasoning. Constraints in the form of overly onerous or formal consultation procedures could critically undermine the Riksbank's autonomy<sup>4</sup> and credibility, in particular in the area of monetary policy operations, in strengthening external buffers, and access to liquidity in an emergency or crisis—where the Riksbank should be able to act swiftly in the interest of maintaining price and financial stability—without the (perception of) undue influence by other institutions or parties.

<sup>4</sup> For the purposes of this report, the concepts "central bank autonomy" and "central bank independence" are used interchangeably. For a further discussion on the occurrence of both concepts in central bank laws, see Khan (2017), as mentioned in footnote 1 above.



7. **Therefore, we suggest that the amendments should place high value on ensuring the operational freedom of the Riksbank in applying relevant instruments to enable it to fulfill its mandates more strongly into account.** This freedom should be balanced with strong Riksbank transparency arrangements, given the need for ex post accountability over such decisions. We understand that tying specific instruments to specific objectives may appear to govern the use of central bank instruments in a more orderly and predictable manner, and thereby promote such accountability. However, by ex ante limiting the operational flexibility of the Riksbank to respond as needed to protect price stability and financial stability, the costs to the Swedish economy may be substantial. If such constraints become binding, they could instead undermine the possibility to hold the Riksbank accountable on working towards fulfilling its mandate—which would run counter to the purpose of the reform of the Riksbank Act.

## II. DETAILED COMMENTS: OBJECTIVES (CHAPTERS 2 AND 3), GOVERNANCE (CHAPTER 11), AND CURRENCY (CHAPTER 4)

8. **As mentioned above, the objectives of the Riksbank should be structured more clearly, allowing operational freedom of the central bank in choosing and applying its instruments.** Currently, Chapter 2, Section 1 lists the Riksbank’s objectives of monetary policy (i.e., price stability and considerations of the real economy), whereas Chapter 3, Section 1 lists the objectives for the financial system (i.e., stability and efficiency of the financial system, ensuring that the general public has (broad) access to the payments system).

9. **First, it would be helpful, and in keeping with international best practice, to list all of the objectives of the Riksbank in a single section, ideally at the beginning of the Act.** This would clarify upfront the Riksbank’s objectives and any hierarchy between them. Chapter 3, Section 1 notes that the financial system objectives should be pursued “without neglecting the price stability objective”—we note that this language could be strengthened further, for instance, by specifying that the financial system objectives are “secondary” to the price stability objective.

10. **Second, listing all the objectives in a single section would also allow more flexibility to the Riksbank.** In particular, this would allow the Riksbank to identify instruments that it primarily relies upon to achieve particular objectives, in line with our general comments above. The current hard-cut split in a monetary policy chapter and a financial system chapter in the Act, with sections accordingly describing the objectives of each of these, automatically leads to a stronger division of instruments as well.

11. **The role of the Riksbank in determining the existence of “exceptional reasons” could be clarified.** Chapter 3, Section 16 (sub 2, last paragraph) indicates that consultation by the Riksbank with the National Debt Office (NDO) does not need to take place if there are exceptional reasons. The Act could consider including non-limitative examples (such as armed conflict, or natural disasters) and indicate explicitly that it would be for the Riksbank

to decide whether something is to be considered an exceptional reason, whilst stipulating that the Riksbank would need to provide a clear overview of its arguments to this extent.

12. **A similar comment holds for the availability of cash to a “satisfactory extent.”** As Chapter 4, Section 1 indicates that the Riksbank would need to contribute to “the availability of cash to a satisfactory extent throughout Sweden,” it would be helpful to clarify that the assessment of what constitutes “satisfactory” would be for the Riksbank to judge.

13. **Provisions for “eKrona” could be clarified. Chapter 4, Section 11 appears to govern the possible future “eKrona.”** But it is not clear if other provisions regarding cash and currency also apply to electronic money, such as Chapter 4, Sections 1 and 2. It would be prudent to ensure any amendments to the Riksbank Act are future proof, as far as is possible.

14. **The arrangements for responsibility and accountability of the governor are not fully clear.** Chapter 11, Sections 14 and 15 indicate that the Executive Board consists of five members, which includes the governor (chair) and four deputy governors. All of these are appointed by the General Council. Nonetheless, Chapter 11, Section 24 subsequently indicates that the governor is “responsible to the Executive Board.” It is not clear why the governor would be held responsible to (or possibly more clearly: “be accountable to”—though this could be an issue of translation into English) the Executive Board, which consists of executive members only, and of which the governor is a member. Instead, in line with international best practices, it would be more logical if the governor, in the position of “head of the authority” (Section 24) would be accountable to the oversight body (i.e., the General Council), rather than to the Executive Board. Of course, the issue of ex post accountability is distinctively different from ex ante collegial decision-making by the Executive Board. If this Section intends to clarify such collegial decision-making arrangements, it would need to be clarified further, as the current wording is opaque.

15. **In summary, the current arrangements in the Act:** (i) create a possible conflict of interest (as the governor is also part of the Executive Board); (ii) create uncertainty about the role of the governor (on the one hand, he/she is the head of the institution; on the other hand, he/she is held responsible by his/her deputies); and (iii) create confusion about the role of the General Council (given its main role of oversight over the central bank and its activities).

### III. DETAILED COMMENTS: INSTRUMENTS (CHAPTERS 2 AND 3)

16. **The addition of “without neglecting the price stability objective” in Chapter 2, Section 3 may be interpreted as setting up the Riksbank for a task that it may not be able to achieve.** If it is determined that the exchange rate is the target, one cannot reasonably assume that the Riksbank would be responsible for price stability. If the Act wishes to address this issue, it should instead mention that the price stability objective would be subordinated to the exchange rate target as long as the exchange rate target applies.

17. **It would be useful to allow the Riksbank to issue its own instruments denominated in domestic currency.** Though the last sentence in Section 4 states that the Riksbank may “issue and trade in its own debt instruments,” this could be helpfully clarified further. While a standard monetary policy instrument, central bank securities are currently not explicitly included in the list Chapter 2, Section 4, which is, otherwise, comprehensive. It could be added to point 1 (deposit) as a liquidity absorbing operation.

18. **The Riksbank should be in a position to provide *timely* foreign exchange (FX)-denominated loans to domestic financial institutions.** Monetary policy instruments are those that would keep local currency interest rates in line with the central bank policy rate (not applying, thus, to FX-denominated instruments). However, the Riksbank may have to provide FX-denominated loans to domestic counterparties because Swedish banks have significant FX funding; the rollover of which may become challenging in certain circumstances. This is first and foremost a *financial stability* issue, and the current COVID-19 crisis would likely only exacerbate this financial stability risk. Nonetheless, financial stability issues could subsequently impair monetary policy transmission. Accordingly, the Riksbank should be in a position to provide *timely* FX-denominated loans to domestic financial institutions, with the risk mitigation measures that the Riksbank deems appropriate to protect its balance sheet, to address both financial stability risks and minimize the risk of impairment to monetary policy transmission.<sup>5</sup>

19. **While central banks issuing debt securities in FX is not a common practice, it is however not restricted.** We do not believe that it would be a prudent policy to use central bank securities to build up reserves. It would expose the central bank to negative carry-and-redemption pressures in times of market stress if there are pressures on the exchange rate. Moreover, the rationale for borrowing foreign currency from domestic counterparties, including via the issuance of FX-denominated central bank securities, is not clear and would require careful justification.

20. **The Riksbank should freely decide on the provision of “general liquidity support” (Chapter 3, Section 11).** We understand it as the same type of lending operations as listed in Chapter 2, Section 4 (monetary policy) to address loss of confidence in the domestic funding market. We do not believe general liquidity support should require coordination with other supervisors because: (i) it is of the same nature as monetary operations; (ii) it addresses market disruptions that could impair monetary policy transmission and, thus, the Riksbank’s ability to achieve its price stability objective; and (iii) it does not entail more risks, given that the collateral framework is the same as for monetary policy operations. Coordination with other supervisors could be kept for Emergency

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<sup>5</sup> The operational issues should not be addressed in the law but rather as part of the central bank risk management framework, ensuring the operational flexibility in applying relevant instrument to respond and reduce stress in domestic funding market as needed, independently from distinction between objectives and the overlap between them.

Liquidity Assistance (ELA, Chapter 3, Section 13), when the monetary policy collateral has been exhausted – which requires the active involvement of the supervisor in the preparation and enforcement of funding plans.

21. **We would recommend leaving the modalities of the central bank’s intervention in securities markets open (Chapter 3, Section 12).** This provision targets the market impairment for assets of critical nature for financial stability. As currently drafted, the section seems to prescribe that the central bank should intervene as a “market maker” by setting prices, while it may be appropriate as well to intervene as a price taker to provide liquidity for an orderly asset price adjustment.

22. **Chapter 3, Section 13 could mention the funding plan that the counterparties benefitting from emergency liquidity assistance would have to contract with the monetary authorities.** This plan is the corner stone of ELA, as it contractually defines how the benefitting institutions would repay the central bank’s emergency loans. The plan would cover most of the “special terms and conditions” mentioned in Section 13.

23. **Chapter 10 could clarify if FX swaps are included.** Though defined in the Act, currently Chapter 10 (“The foreign exchange reserves and currency repurchasing agreements”) does not explicitly reference FX swaps. This also raises the question on the applicability of the Memorandum of Understanding signed by the Riksbank in December 2016 with the central banks in the Nordic and Baltic countries on cooperation regarding cross-border operations. A similar question arises with regard to the 2016 IMF Financial Sector Assessment Program recommendation to formalize swap agreements with central banks in the Nordic countries, the U.S. Federal Reserve, and the European Central Bank (ECB), aiming to strengthen the availability of ELA in relevant currencies.<sup>6</sup> It is crucial to strengthen external buffers and access to liquidity in an emergency or crisis—where the central bank should be able to act swiftly in the interest of maintaining stability, without the (perception of) undue influence by other institutions or parties.

#### IV. DETAILED COMMENTS: CAPITAL, PROFIT, AND BALANCE SHEET (CHAPTER 8)<sup>7</sup>

24. **The target for the Riksbank’s total equity (excluding revaluations as provided within the proposed Act) should be set relative to the size of its balance sheet, as opposed to applying an inflationary mechanism.** Inflation itself may not be a good proxy for the Riksbank’s risk exposure. IMF recommendations are to anchor realized capital to

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<sup>6</sup> IMF, 2016, *Sweden—Financial System Stability Assessment*. Washington, D.C.: International Monetary Fund. See Table 1 (Key Recommendations), no. 11: “Seek to establish swap agreements with central banks in the Nordic countries, the Fed, and the ECB, aiming to strengthen the availability of ELA in relevant currencies.”

<sup>7</sup> This section includes comments based on the document provided to MCM by the Riksbank, titled “Economic capital and profit model” (referred to in this section as “the proposal”). This, in turn, is an overview of the recommendations of the Swedish committee on the conditions for profit allocation of the Riksbank. The document also includes an assessment of those recommendations by the Riksbank.

“monetary liabilities” to avoid the possibility of manipulation by either the government or the central bank.

25. **In addition, consideration should be given to a profit-sharing mechanism (for example, distribute 30 percent, and retain 70 percent) between the two trigger points:** (i) when equity is below the maximum (equity which all profits are distributed), and (ii) above the recapitalization trigger. Such an approach reduces the likelihood of the government pressuring the Riksbank to distribute retained reserves. Another approach to consider is profit sharing above the “target level” as defined in the proposal. Finally, unrealized revaluation gains should not be considered or utilized as a backstop to realized losses or realized negative equity. A modern central bank’s financial strength is based on the capacity of its realized reserves to cover realized losses, if and when such losses occur. Revaluation reserves can and should be used to absorb revaluation losses, both of which can fluctuate significantly.

26. **Profit distribution formulas should be encoded in the Act and should not be discretionary.** The proposal indicates that profit distributions can be approved, adjusted or dismissed. If profit distributions are discretionary, this will impede the Riksbank’s autonomy.

27. **The role of the Riksbank with respect to Sweden’s obligations under the IMF membership is not clear.** If the Riksbank is to act strictly as agent to the government on such transactions, the wording could be clarified. While it appears that the relevant clauses try to indemnify the Riksbank, the Riksbank continues to be exposed to FX revaluation risk—this may be intentional. Conversely, if all transactions between the Riksbank and the Swedish Ministry of Finance are to be denominated in Special Drawing Rights (SDR)—hence eliminating the FX exposure—this should be explicitly noted. The Act should be clear as well on which of the IMF accounts will be included in the balance sheet of the Riksbank, and more clarity about Section 7 and 8 in Chapter 6 should be provided. We note that countries differ in practice as to which accounts lie in the accounts of the government versus the central bank.

28. **The General Council should only “adopt” the balance sheet, profit and loss account and allocation of profits upon completion of the external audit, and having received the external auditors’ report on the accuracy and completeness of the Riksbank’s financial statements.** Given the February deadline for adoption, it is not readily apparent whether this practice is to be followed.

## V. DETAILED COMMENTS: AUDIT AND OVERSIGHT (CHAPTER 11)

29. **The Act should clearly state that the Riksbank’s internal audit function complies with the standards for internal auditing of the Institute of Internal Auditors.** Application of these standards will provide the General Council greater assurance that risks are being assessed and addressed adequately. Further, requiring that the Executive Board adopt an audit plan for the internal audit appears to contravene typical internal audit reporting

relationships. The General Council should review and adopt the audit plan of internal audit, not the Executive Board—even though we understand the Executive Board has a somewhat hybrid set-up, and roles and responsibilities, and any changes to this would entail a significant overhaul of the Riksbank’s governance. Ideally, the Executive Board should be responsible for taking appropriate measures based on the observations and recommendations raised by internal audit.

30. **The Act should provide for engaging an independent external audit firm as a co-auditor along with the National Audit Office.** The external audit firm should be an international organization that complies with the auditing standards for external auditors. The external audit function is a key component of a central bank’s governance. The external auditors’ compliance with international standards provides the General Council with confidence in the opinion provided by them.

## VI. DETAILED COMMENTS: OTHER

31. **External experts:** (see Chapter 11) The General Council should have the authority to call on external experts as necessary to provide an independent assessment of the Riksbank’s effectiveness in its conduct of its policy operations. This would enhance (ex post) central bank accountability further.

32. **Real property:** (see Chapter 9, Section 7) Requiring the Riksbank to seek authorization of the Riksdag for the sale or acquisition of real property in excess of SEK 20 million seems to overtly circumvent the accountabilities of the General Council.

33. **Human Resources (HR):** (see Chapter 11, Section 30) The more broadly accepted practice of having a Human Resource and Compensation Committee (HRCC) as opposed to a Staff Disciplinary Board could be considered, given that an HRCC is a standard sub-committee of a Board which approves HR policies, compensations levels, high-ranking hires, terminations, etc. A more narrowly defined “disciplinary” board appears to be just that—a committee created to discipline staff. This might be less conducive to an effective work environment.