The Nordic-Baltic Cross-Border Collaboration Model and the EU Model

Conference on Nordic-Baltic Financial Linkages and Challenges
Tallinn, December 13, 2013
Jukka Vesala
The Nordic-Baltic banking sector is dominated by a small number of cross-border banks

- Each of the six large Nordic banking groups is nationally very significant
- But, their business operations are typically regional
- Major banks are quite reliant on market-based funding
  → Extensive cross-border cooperation essential for both home and host authorities

Local banking groups add heterogeneity to the Nordic banking sector

- OP-Pohjola Group focuses its operations on the domestic market and is one of the two largest banks in Finland
- Additionally, national networks of local cooperative and savings banks
Nordic-Baltic cooperation: Pioneering work in the EU context

- **Long-standing supervisory colleges for Nordic banking groups**
  - Coordination of supervisory plans
  - Regular exchange of information on risks, liquidity and capital adequacy
  - Joint inspections
  - Joint risk assessment and decision making process
    - Input to EBA guidelines and work on colleges in the EU
    - Input to the work of Joint Supervisory Teams (JST) in the SSM

- **Early crises management arrangements**
  - Plans of supervisory colleges for emergency situations
  - Nordic-Baltic Cross-Border Stability Group: Cross-border MoU on crisis coordination
  - Crises management exercises
  - Early exchange of information in emergencies
Challenges in cross-border supervision

- **Groups are managed by business lines, not by legal units**
  - Legal entities do not necessarily cover all banking and administrative functions, or have full stand-alone governance arrangements
  - Significant amount of risk transfers
    → **Difficult to get a full picture of the risks in each entity**
    → **Colleges need to play a crucial role**

- **Centralized liquidity management in cross-border groups**
  - Subsidiaries (and branches) typically deliver surplus-liquidity to the parent
  - Liquidity portfolios are managed centrally, while subsidiaries have capacity to tap funding markets independently
    → **Centralized liquidity management brings about synergies, but also substantial intra-group exposures**
    → **Local liquidity buffers will be demanded by host authorities**

- **While capital can be managed centrally, all legal entities need to meet risk-based capital adequacy requirements (Pillar 2 assessment)**
  → **Nordic agreement on the allocation of Pillar 2 requirements**
Still many open issues for effective cross-border crisis management

- No binding resolution framework for cross-border groups
  - E.g. no compulsory coordination of crisis management and resolution measures

- Possibilities for ring-fencing are embedded in the current framework
  - Both home and host authorities can exercise ring-fencing
  - No guarantee for adequate and timely coordination and information exchange
    - Supervisory colleges and the Nordic-Baltic Stability Group are working further on effective arrangements

- In the EU, the draft BRRD requires that national resolution authorities cooperate with each other and that resolution colleges are established
  - Need for a binding requirement for ex ante coordination of crisis management and resolution actions (joint decisions as far as possible)
  - SSM and SRM will overcome the disparity between international banking and national powers
  - Well-structured cooperation needed between countries participating and not participating in the Banking Union
Timeline for the Single Supervisory Mechanism (SSM)

November 2013
- SSM Regulation adopted

Transitory period
- ECB publishes main elements of the supervisory model
- Implementation of the SSM supervisory model (“parallel run” with national supervision)
- Comprehensive Assessment: RAS, AQT and ST

November 2014
(12 months after SSM Regulation entry into force)
- SSM supervision begins
- Supervisory duties conducted in cooperation between ECB and national authorities
Impacts of the SSM on the supervision of Nordic banking groups

- **Asset quality review and stress test**
  - Intra-Euro Area subsidiaries of Nordic Groups assessed according to SSM methodology
  - Group-level assessment might be based on the similar methodology depending on the choices of the home authorities
    → *Need for active cooperation between SSM and non-SSM authorities*

- **Implementation of common supervisory standards in the SSM**
  → *Need for collaboration between the SSM supervisory manual and EBA guidelines*

- **Integration of ECB into supervisory colleges between SSM and non-SSM countries**

- **Non-euro members states could participate in the SSM**
  - Even within such a closely integrated region as the Nordic, there are still differences in the supervisory practices
Example: Supervision of Nordea in the SSM

Nordea College
ECB, EBA, SE, NO, DK and LT supervisors
FI, EE, LV supervisors

ECB’s supervisory functions

EBA
EIOPA
ESMA
ESRB

Fin-FSA

Bank of Finland

NORDEA BANK FINLAND
• Responsibility of group-level supervision under Swedish financial supervisory authority
• Nordea Bank Finland under direct SSM supervision, ECB leadership
• New co-operation arrangements including the ECB
Legal possibilities and implementation of macro-prudential instruments varies across countries

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Sweden</th>
<th>Denmark</th>
<th>Finland</th>
<th>Norway</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Loan-to-value restrictions</strong></td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
<td>NO</td>
<td>YES</td>
<td>YES</td>
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<td></td>
<td>Implemen-ted</td>
<td></td>
<td>Implemen-ted (non-binding)</td>
<td>Implemen-ted</td>
<td></td>
<td>Implemen-ted</td>
<td>Implemen-ted</td>
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<tr>
<td><strong>RWA restrictions on mortgages</strong></td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
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<td>Implemen-ted</td>
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Based on information available from national supervisors as interpreted by the FIN-FSA
On the other hand: Housing prices and lending are not following the same pace.

The annual change of household lending stock

Real Housing Prices (adjusted for inflation) 2000 - 2013

Sources: national central banks, statistical authorities and calculations by Bank of Finland

Source: SDW.
All Nordic countries will apply capital add-ons to systemically important banks – but of different sizes

Additional structural capital buffers
POSSIBLY BASED ON DRAFT LEGISLATIVE PROVISIONS

<table>
<thead>
<tr>
<th>Country</th>
<th>Minimum capital requirement (4.5%)</th>
<th>Capital conservation buffer (2.5%)</th>
<th>Additional capital requirement for systemically important institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finland</td>
<td>2%</td>
<td>9%</td>
<td>Common Equity Tier 1</td>
</tr>
<tr>
<td>Sweden</td>
<td>5%</td>
<td>5%</td>
<td>12%</td>
</tr>
<tr>
<td>Denmark</td>
<td>3%</td>
<td>10%</td>
<td>12%</td>
</tr>
<tr>
<td>Norway</td>
<td>5%</td>
<td>12%</td>
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</tr>
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After 2014-2019 transitional period, excl. counter-cyclical capital buffer
Authorities should have the same legal possibilities to activate macro-prudential instruments
  – Binding LTV ceilings could be an especially effective tool
  – Differences in the ability to set structural capital requirements for SIIIs could lead to unhealthy capital transfers within cross-border groups

Common policy frameworks would be very useful, but the actual use of the tools needs to take into account differences across countries
  – Macro-financial environments and cycles differ considerably even in the Nordic-Baltic area
  – Macro-prudential policies will be partly ECB responsibility in the SSM (can take measures exceeding national decisions)

Full reciprocity in the use of macro-prudential instruments would be very important given the high degree of banking integration in the Nordic-Baltic region
Conclusion

- The need for close Nordic-Baltic supervisory cooperation will remain in place, while smooth cooperation with the SSM needs to be established
  - Nordic and Baltic supervisory authorities should have an active role together with the ECB in the college work
  - Implementation of high level EU supervisory standards is a common objective of Nordic and Baltic supervisors
  - SSM will bring about a consistent supervisory approach that could help foster consistency also in the Nordic-Baltic area

- Nordic and Baltic cooperation arrangements in crisis management and resolution will still be needed
  - Cooperation will need to be established also with the SRM

- The use of macro-prudential tools is still a new area for all authorities
  - Need for exchange of information and cooperation in Nordic – Baltic countries
Thank You!

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