Nordic Credit Rating

SECTOR COMMENT

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Swedish government overshoots target with bank tax proposal

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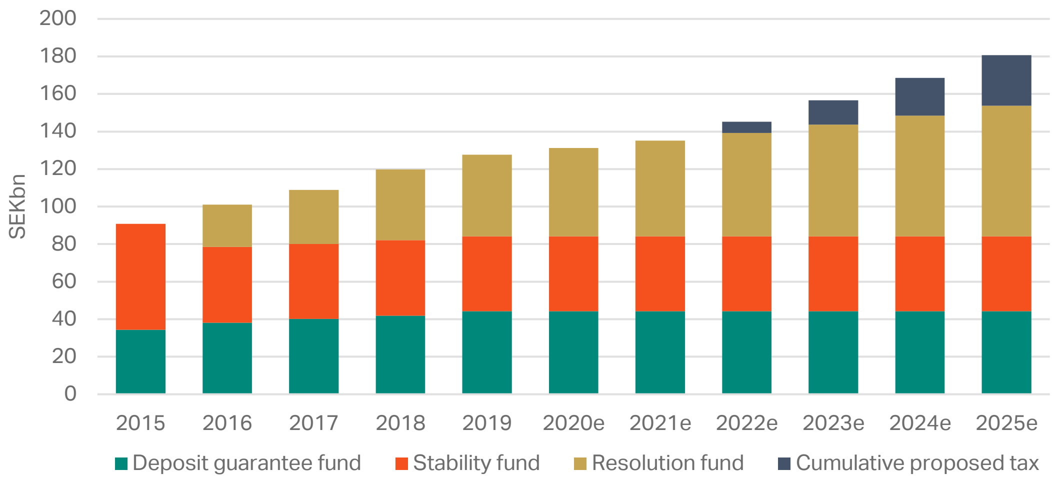
On 17 Sep. 2020, the Swedish government announced plans for a risk tax on the seven largest domestic banks and foreign branches. The proposal would add about SEK 6bn to the banks' existing tax bill in 2022 and about SEK 7bn annually from 2023. The new tax would coincide with declining payments to existing reserves designed to reduce the government's own obligations in future financial crises. While the proceeds from the new bank tax are ostensibly earmarked for defence spending, the rationale for the additional tax focuses on the social and financial consequences of any impending financial crisis.

The proposal would affect only banks that exceed a threshold of SEK 150bn in total debt. We assume that the proposed tax will apply to Svenska Handelsbanken, SEB, Swedbank, Nordea Bank's Swedish branch, Danske Bank's Swedish branch, Länsförsäkringar Bank, and SBAB Bank, which are deemed to be systemically important financial institutions. We further assume that it will not apply to municipality lender Kommuninvest or government-owned Swedish Export Credit Corp, even though they meet the SEK 150bn debt threshold.

The Swedish government is already well prepared for a future financial crisis. By the onset of the proposed new tax in 2022, Nordic Credit Rating (NCR) projects that the Swedish government will have over SEK 135bn in financial crisis reserves in the form of a resolution fund, a stability fund, and a fund backing the country's deposit guarantee scheme. In addition, banks' increased issuance of bail-in-able senior unsecured debt instruments will reduce government costs in future financial crises.

Figure 1. Swedish financial crisis reserves and proposed bank tax payments, 2015-2025e



Source: National Debt Office

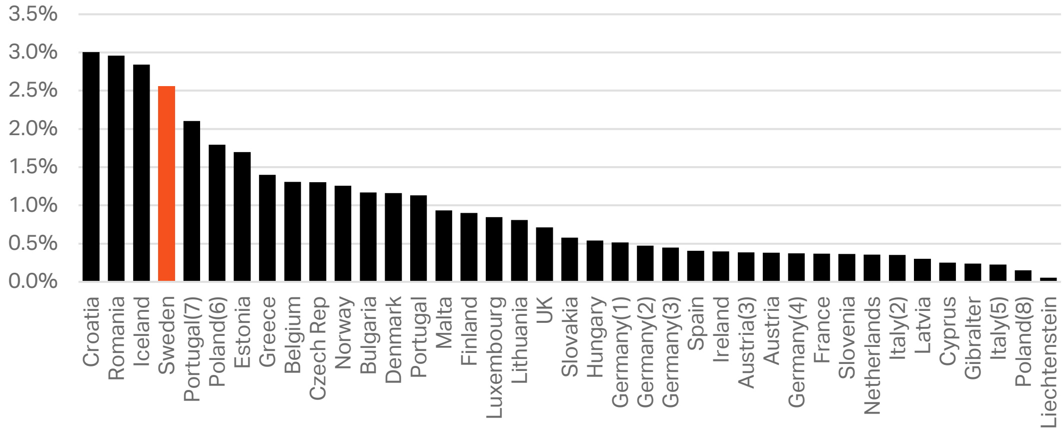
SWEDEN'S FINANCIAL CRISIS RESERVES ARE ALREADY STRONG

There is a strong argument that the funds available for future financial crises are adequate at existing levels. The European Single Resolution Fund targets 1% of guaranteed deposits by 2023, compared with Sweden's resolution fund target of 3% (the current level is 2.7%). Further, the deposit guarantee fund covers 2.7% of outstanding deposits, placing Sweden among the best-prepared countries in Europe and well above the 0.8% minimum EU requirement (see Figure 2).

The assets backing the deposit guarantee fund are managed by the Legal, Financial and Administrative Services Agency (Kammarkollegiet). However, fees to the resolution fund are paid directly into the government's account at the National Debt Office, creating growing liabilities to the banking sector. Each of these funds is backed by an unlimited credit line for use, upon government approval, in the event of a crisis.

In addition, the SEK 40bn in the stability fund, which has been entirely government-financed since banks' contributions were transferred to the resolution fund in 2016, provides a flexible means to support the economy during a crisis. The government could return earmarked funds to the general budget for use on other support programs at any time. In fact, the Swedish National Audit Office recommended that the government be repaid for its contributions to the stability fund as early as 2011, before the establishment of the EU's Bank Recovery and Resolution Directive (BRRD) and the transfer of banks' contributions to the resolution fund.

Figure 2. European countries' deposit guarantee schemes available financial means as a share of covered deposits, 2019



Source: European Banking Authority.
1-Private banks, 2-Coop banks, 3-Savings banks, 4-Public banks, 5-Interbank,6-Banks, 7-Mutual Agriculture Credit, 8-Credit unions

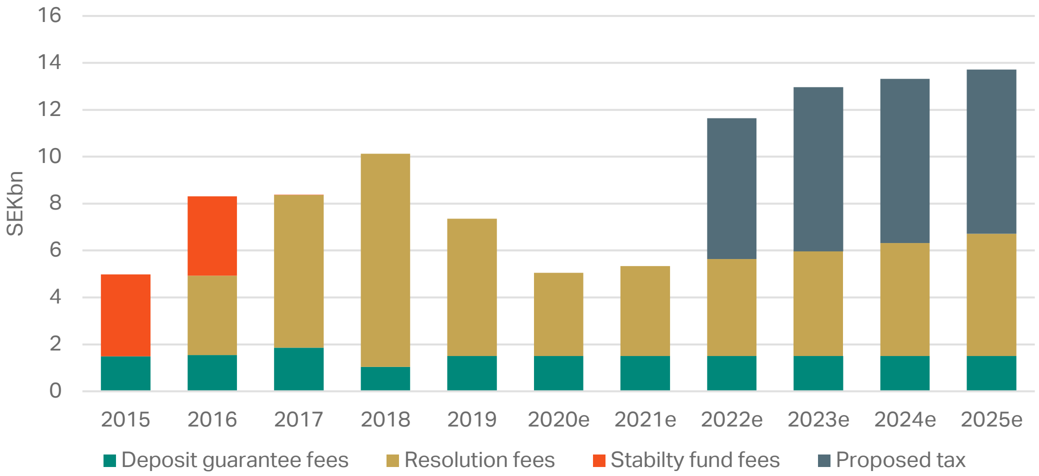
The increasing issuance of bail-in-able senior unsecured debt instruments is also designed to reduce the government's costs in future financial crises. As of 30 Jun. 2020, the nine systemically important financial institutions operating in Sweden have been obliged to meet specific Minimum Requirement for own funds and Eligible Liabilities (MREL) requirements. By 1 Jan. 2024, MREL requirements must be met entirely by subordinated debt instruments. In short, the purpose of these instruments is to pass the burden of recapitalising a failing bank onto subordinated debtholders, rather than onto the government as has been the case historically. Given the BRRD and MREL requirements and EU member states' keen interest in avoiding taxpayer-funded bailouts, NCR does not anticipate that the Swedish government will support failing banks when assigning ratings to financial institutions.

THE PROPOSED BANK TAX WOULD MORE THAN REPLACE DECLINING RESOLUTION FUND FEES

Banks' contributions to the resolution fund declined in 2019 and will decline further in 2020. In 2019, banks paid SEK 5.8bn in fees to the resolution fund, or 9bps of debt less guaranteed deposits (down from 12.5bps in 2018). However, from 2020 they are obliged to pay only 5bps (approximately SEK 3.5bn for 2020, depending on market growth). The result will be a material decline in government receivables from 2020 compared with previous years.

Resolution fund fees could decrease further if the fund reaches its target level. At the end of 2019, the resolution fund amounted to 2.7% of guaranteed deposits placing it about SEK 5bn short of the government's 3% target at which resolution fees would be capped. The original expectation was that this would occur by 2025, but if the 8% annual growth rate in retail deposits over the past decade is maintained, the 3% target level is likely to rise faster than incoming resolution fees, making resolution fee payments a more permanent fixture.

Figure 3. Swedish financial crisis reserve payments, 2015-2025e



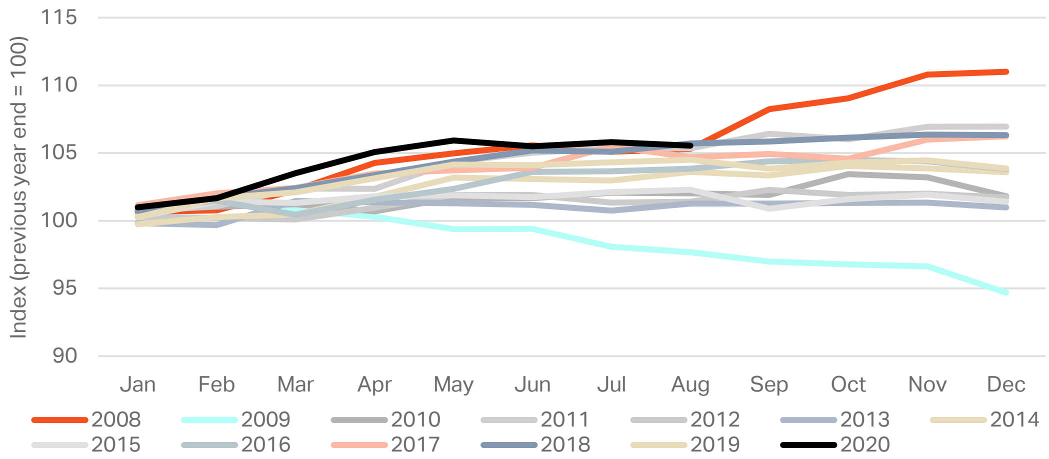
Source: National Debt Office

BANKS HAVE PLAYED A SIGNIFICANT ROLE IN SUPPORTING THE ECONOMY IN RECENT CRISES

The rationale for the bank tax considers the potential negative impacts of a future financial crisis. This was very clear for Sweden in the early 1990s, when government revenues declined and spending increased dramatically, sending government debt to GDP to 73% from 40% between 1990 and 1994. The National Debt Office projects that the COVID-19 pandemic, while not in itself a financial crisis, will increase debt to GDP to 29% from 22% at end-2019 and the response is likely to affect government tax receipts over the years ahead. But Sweden's government finances were not materially affected by the 2008 financial crisis, with debt to GDP levels never rising by more than 0.4% from end-2007 levels, mostly driven by the 2009 decline in GDP. Without drilling into the details, the government turned a significant profit from its support measures and equity injections into the banking sector in 2008 and 2009.

In the meantime, Swedish banks have demonstrated their value to the national economy by remaining strong enough to meet the borrowing needs of non-financial corporates even in times of need. From March to May of 2020 Swedish monetary financial institutions increased their corporate lending by SEK 102bn as the short-term commercial paper and corporate bond markets faltered. Since 2008, the two largest 3-month growth rates for corporate lending occurred from September to November 2008 (5.2%) and from March to May of 2020 (4.2%), periods when capital market access was minimal and liquidity risk for Swedish corporates peaked.

Figure 4. Swedish monetary financial institution loans to non-financial corporates, 2008-Aug 2020



Source: Statistics Sweden

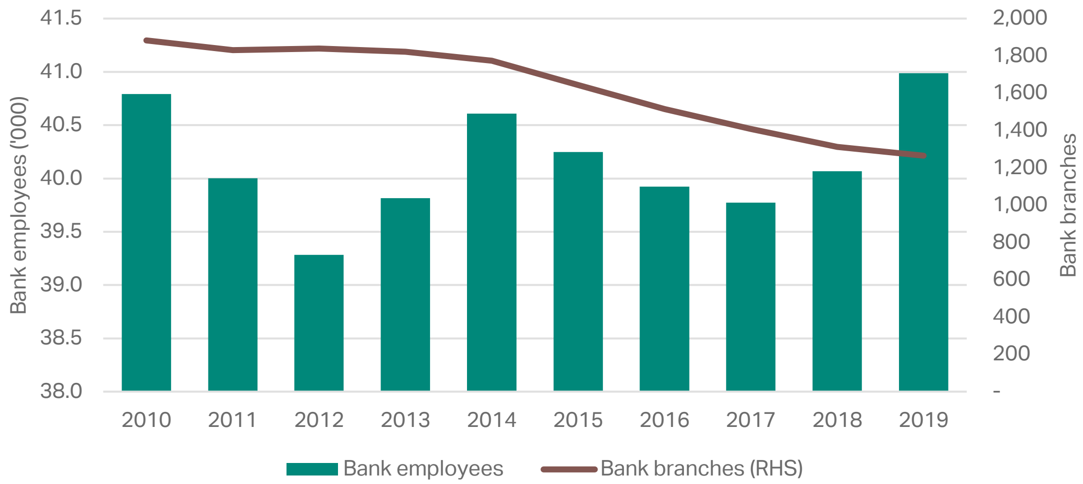
During these periods, Swedish lenders worked together with the government to contribute to the health of the domestic economy. In 2008, government initiatives and guarantees protected banks' own liquidity and, in 2020, an immediate reduction in capital requirements supported banks' ability to lend to corporates when the corporate bond market fell silent. In addition, increased lending by government-owned Swedish Export Credit Corp. and increased government guarantees via the Swedish Export Credit Agency have been vital to the financing of many large corporates during these periods of stress in the capital markets, as well as proving profitable for the government.

HIGHER TAXES WILL LOWER EMPLOYMENT AND REDUCE CASH ACCESS

The implementation of the proposed tax will pressure banks to lower costs, cutting employment in the banking sector and further reducing access to in-person banking services and cash management. Despite a significant upswing in the number of bank employees in 2019, these trends are not solely dependent on a bank tax and also reflect customer behaviour and digitalisation of manual processes. However, the tax is likely to accelerate the longer-term transformation of the banking sector and will no doubt affect the decision making of the seven largest domestic banks and international bank branches that will be subject to it.

Further centralisation and curtailment of banking services and cash access can be expected if the tax is implemented on a permanent basis. Svenska Handelsbanken's September 2020 announcement that it will reduce its Swedish branch network to 200 branches from 380 and cut staff numbers by 1,000 is just one example of curtailed access to cash and in-person banking in Sweden. Among its peer group, Handelsbanken had striven to maintain cash access, rather than focusing on reducing costs and access to cash through its branch network.

Figure 5. Swedish bank employment and branches, 2010-2019



Source: Swedish Bankers' Association

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