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C O N S U L T A T I O N   R E S P O N S E

The Riksdag
The Committee on Finance
100 12 Stockholm

FI Ref.16-1142
(Obligatory in replies)

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Review of the Riksbank's Monetary Policy 2010–2015 (2015/16:RFR6)

Summary

In this consultation response, Finansinspektionen (FI) assesses the reviewers' recommendations regarding financial stability and the interplay between monetary policy and financial stability. The main points of FI's response can be summarised as follows:

- FI agrees with the recommendation that FI without further delay should be assigned the requisite authorisations and instruments for its assignment to counteract financial imbalances in credit markets. A framework for macro-prudential policy should be presented promptly. The Government Offices or a special investigator appointed by the Government should be able to prepare such a proposal.

- FI opposes the proposal that FI and the Riksbank shall establish a joint committee for macro-prudential policy. The decision to assign FI responsibility for macro-prudential policy should be left unaltered. Outstanding coordination issues within macro-prudential policy primarily relate to the distribution of responsibility between the Government and FI.

- FI welcomes a clarification of the Riksbank's role in financial stability. This clarification should refer to the Riksbank's specific responsibility and authorisations to support the supply of liquidity in a crisis.

- FI agrees that macro-prudential policy should be evaluated in due course. This evaluation should be done when more experience has been gained from applying macro-prudential policy in Sweden and other countries and thus later than that proposed by the reviewers.

- FI supports the recommendation that the Riksbank should take a pragmatic approach to the numerical inflation target. The Riksbank

should take a more long-term view of the inflation target in situations where it makes the assessment that drastic measures would be required to achieve the target within the normal time horizon. However, there should not be any direct re-prioritisations between the inflation target and other targets, e.g. financial stability.

Introduction

The review, as indicated by its title, focuses on the Riksbank's monetary policy. This is evident, for example, in that all six of the reviewers' conclusions listed in the summary relate to monetary policy. However, the reviewers also make some recommendations regarding financial stability, for example about macro-prudential policy and how the responsibility for this area should be distributed.

FI response will naturally focus primarily on the recommendations presented in the report that refer to the responsibility for financial stability. These recommendations are discussed in the first sub-section.

Normally, there is no reason for FI to discuss monetary policy and its implementation. Monetary policy's primary goal is price stability, and thus falls outside FI's area of responsibility. However, the reviewers note that the monetary policy during this period has been affected by considerations related to financial stability. FI therefore believes there are grounds to also discuss the reviewers' comments on whether the Riksbank, under certain circumstances, should be given the capacity to lower the priority given to price stability to benefit other economic policy targets, such as financial stability.

Finally, FI also discusses the reviewers' recommendations regarding the Riksbank's governance and organisation, and the forms of the imminent review of the Riksbank Act.

FI would like to start by noting that the reviewers apply a very broad definition of the term *financial stability*. Their definition includes FI's macro-prudential policy assignment. This differs from how FI normally uses the term, which is to refer to stability *within* the financial system. The macro-prudential policy assignment is instead primarily linked to risks that financial imbalances shall spread to the economy at large, for example the economic risks associated with high indebtedness of households.[1] For simplicity's sake, FI will predominantly use in this consultation response the same definitions and terms as the reviewers use in the report.

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[1] FI's terminology and view on the relationship is discussed in the report, "FI and financial stability" (http://www.fi.se/upload/43_Utredningar/40_Skrivelser/2014/FI_finansiell_stabilitet_20141210.pdf).

Responsibility for financial stability

The reviewers make four recommendations under the heading Financial Stability (numbered 7−10). These recommendations refer to FI's authorisations within the scope of macro-prudential policy, a joint macro-prudential policy committee consisting of FI and the Riksbank, the Riksbank's role within the area of financial stability and an overview of the macro-prudential policy that should be conducted in 2020. FI presents and comments on each of the four recommendations below.

FI's authorisation within the scope of macro-prudential policy

7. "The Government should ensure without further delay that Finansinspektionen has the legal powers and range of macro-prudential instruments appropriate to its role in promoting financial stability."

FI agrees with this recommendation. It is unsatisfactory that the assignment FI was given in 2013 was not followed up with clearer mandates and authorisations for implementing measures that would counteract financial imbalances.

This lack of legal support has been partly rectified in that FI will soon be entitled to decide on regulations regarding amortisation requirements. However, several types of measures may be needed, both in the short term given the development in household debt and in the long term if other signs of imbalances in the credit market arise. FI therefore needs broader authorisations and more tools. It is also important that FI's tools are not strictly linked to a specific part of FI's assignment, but rather that FI is given the authorisation to use the tools to both promote financial stability and counteract risks of financial imbalances.

A framework for the macro-prudential policy should be adopted without delay. The Government Offices or a special investigator appointed by the Government should be able to prepare such a proposal. In February, in conjunction with a meeting at the Committee on Finance of the Riksdag (The Swedish parliament), FI presented a proposal for the design of such a framework.[2] One of the central points in this proposal was that FI should be responsible for the analysis of the measures that are needed and their implementation. However, some conceivable macro-prudential policy tools have such far-reaching consequences for individuals that FI should obtain the Government's approval before using them. It should thus be possible to give the decision-making model that applies to the amortisation requirement a broader application. FI will return to the topic of the distribution of

[2] See http://www.fi.se/Tillsyn/Presentationer/Presentationer/Listan/FI-foreslar-nytt-ramverk-for-makrotillsynsatgarder/.

responsibility in macro-prudential policy at the end of its comments to Recommendation 8 below.

A joint prudential policy committee

8. "That a joint Prudential Policy Committee (PPC) of the Riksbank and Finansinspektionen be established to meet quarterly to discuss the setting of the main macro-prudential policy instruments. The PPC should make recommendations to the Riksdag from time to time on whether the set of instruments delegated to Finansinspektionen should be expanded or contracted. The PPC should be the primary source of reports on financial stability and should appear before the Finance Committee at least once a year."

The reviewers do not provide any detailed argumentation for this proposal. They refer to differences of opinions between FI and the Riksbank, but they do not say how such a committee would counteract these differences. FI opposes both the proposal and the underlying reasoning.

Responsibility for macro-prudential policy

The responsibility within the financial stability policy area is distributed primarily between FI, the Riksbank and the Swedish National Debt Office (SNDO). Finansinspektionen is responsible for preventive and corrective measures within micro and macro supervision. The Riksbank's primary assignment is related to the supply of liquidity, primarily during crises. The SNDO, as the resolution and deposit guarantee authority, is primarily responsible for managing banks that are in crisis situations. As the principal for Finansinspektionen and the SNDO, and the party responsible for initiating legislation, the Government (via the Ministry of Finance) also has an important role, particularly during crises.

The reviewers discuss macro-prudential policy without setting the area of responsibility into its broader context. The point of departure of the reviewers is primarily monetary policy and its conditions. Their reasoning is therefore incomplete. They ignore the fact that the decision to give Finansinspektionen the responsibility is based on a thorough analysis of the relationship between traditional supervision and the new features that fall under the term "macro-prudential policy". The decision is also based on broad political consensus. As mentioned above, FI believes that a reasonable procedure is for FI to obtain the Government's approval before implementing measures that have far-reaching consequences for individuals. This applies, for example, to measures that target the credit market, such as amortisation requirements and a cap on the debt-to-income ratio.

However, FI finds it difficult to see any reason for joint decisions with the Riksbank on macro-prudential policy measures (or regarding stability reports). The conditions for monetary policy can be affected by macro-prudential policy, just as the need for macro-prudential policy can be affected by monetary policy decisions. However, this is not sufficient justification to give the Riksbank direct influence over macro-prudential policy or for FI to have the opportunity to influence monetary policy (irrespective of the fact that the latter is not allowed according to both EU and Swedish law). It is also natural for FI to be solely responsible for the analyses that serve as the basis for the measures for which the authority is responsible.

The need for joint economic policy decisions should not be overemphasised. There are factors that must be treated as givens in all policy areas. In monetary policy, for example, there are domestic fiscal and tax policies and the monetary policy of other countries. For macro-prudential policy, there are tax policies and monetary policies both within and outside of Sweden, which must be taken into account but cannot be influenced. These factors do not prevent a decentralised decision-making process from working well. The clearer the goals that guide each policy area and the clearer the understanding of the effects of potential measures, the easier it is for the authorities to take independent responsibility for their respective assignments. Clear distribution of responsibility in turn facilitates the follow-up of how each authority is handling its assignment.

This does not preclude improvements to the goal fulfilment process through cooperation and exchange of information between authorities. Such cooperation and information exchanges should particularly occur within new policy areas (such as macro-prudential policy) or when policy is acting in new circumstances (such as monetary policy with extraordinarily low interest rates). In these cases, the risk for undesirable or unforeseen contagion effects between policy areas can be higher than normal. This type of cooperation must be carried out with respect and understanding for the authority's different roles and assignments, however.

Currently, the appointed forum for intra-authority consultation is the Financial Stability Council.[3] The reviewers take the position that the council should be pared down to discuss only macro-prudential policy issues and another group should be activated in crisis situations. Neither the Government nor the SNDO should participate in this pared-down prudential policy council, and the Government should be primarily responsible for the crisis management council.

FI believes that the Financial Stability Council fulfils an important purpose of promoting the exchange of information and opinions between the authorities, but that the cooperation has not fully functioned as intended. For example, it has been difficult to establish a joint view on the authorities' roles and

[3] In addition to the forum provided by the Financial Stability Council, the Riksbank, like other concerned authorities and stakeholders, has the opportunity to comment on FI's proposals regarding regulations and macro-prudential policy through consultation responses. FI also has an extensive unofficial cooperation at different levels with both the Riksbank and the SNDO.

assignments to use as a basis for the discussions. Changing the composition of the council, however, is not a solution to the problem. The solution requires a number of clarifications, including the role of the Riksbank in terms of financial stability. FI discusses this issue in conjunction with Recommendation 9. The model that the reviewers propose was also evaluated but disregarded in the decisions taken based on of the Financial Crisis Committee’s interim report (SOU2013:6) in favour of a council with a broad composition.

FI therefore opposes the proposal to change the assignment and composition of the Financial Stability Council. The Council has also only held a few meetings and it is constantly reviewing the forms of cooperation. There are, therefore, grounds for deferring a decision to make more comprehensive changes.

FI also opposes the proposal to create a prudential policy council that consists of Finansinspektionen and the Riksbank. As presented above, this is not in line with the decided distribution of responsibility between the authorities.

In addition, it is not possible for Swedish authorities to establish joint committees that have the authorisation to make decisions. The reviewers appear not to have sufficiently become familiar with (or been informed about) the legal and institutional conditions in Sweden, in this case about how cooperation between authorities may be organised.[4]

Macro-prudential policy experiences in Sweden

FI is also of the opinion that the reviewers’ discussion about the work with macro-prudential policy in Sweden contains a number of deficiencies. The reviewers make the statement that FI “has been more reluctant than the Riksbank to regard rising indebtedness is a matter for concern” and imply that this is because FI is an authority that is directly responsible to the Government (p. 100).

The first question raised by this reasoning is what degree of concern would have been appropriate. No answer is given, however, since the reviewers appear not to have reviewed the Riksbank’s analyses of the threats to financial stability. There is even less to infer that they have studied FI’s analyses, although they have received these from FI. They are therefore lacking the basis on which to assess which of the authorities has had the best support for their assessments and proposed measures.

FI has implemented a number of measures that have decreased the risks to stability, for example the mortgage cap, the risk weight floor for mortgages and

[4] The ambiguity may have arisen as a result of the translation. The English text does not mention who should establish the committee. However, there are other examples in the report of misunderstandings about institutional conditions, which unfortunately decreases the value of the reviewers’ assessments and recommendations. FI will return to this point in the concluding section below.

higher capital levels for the banks. FI also proposed amortisation requirements after first striving to have such requirements implemented via an industry-wide agreement. The reviewers note FI's measures, but appear to take the position that they have been insufficient. The basis for this assessment is not apparent from the report.

FI has opted to take action on a step-by-step basis within the framework for the authorisations that the authority has been given by the Government and the Riksdag. FI has also emphasised the importance of evaluating the effects of implemented measures. The Riksbank has recommended comprehensive measures in a number of areas, seemingly based on the perception that a crisis has been – and is – imminent, and with no consideration for the measures that have been available. The reviewers appear to lean more toward the Riksbank's approach, but they do not present their own analysis of how large the risks have been and which (additional) measures would have been justified. The fact that the Riksbank in practice decided to take financial stability into account in its monetary policy decisions is not in and of itself grounds for the conclusion that additional or more powerful macro-prudential policy measures had been justified (this is discussed in more detail in the monetary policy section below).

In this context, FI would like to point out one issue that would have benefited from a discussion as part of a review of the work of the Riksbank, namely how the possibilities for achieving the price stability goal would have been affected if all of the Riksbank's proposed financial stability measures had been implemented. Reasonably, the tightening of the credit market that would have followed would have counteracted the interest rate policy's effects on private consumption, which in turn would have restrained inflation even more. Given that the repo rate has been – and is – lower than anyone previously could have imagined and probably is close to its lower bound, such a macro-prudential policy would have made it even more difficult for the Riksbank to get inflation to approach its target. This would have contributed to further threatening confidence in the inflationary target and worsening the dilemma that monetary policy is facing.

FI thinks that it would have been valuable for The Riksdag to receive an external assessment of the consistency between monetary policy and the Riksbank's recommendations within the area of stability. This issue should now be reviewed in a different way, for example in conjunction with the Committee on Finance's preparation of the assessment report.

Regardless of how one views the degree of concern for financial stability, FI takes the position that the link between FI's actions and its relation to the Government is unfounded. FI has been very active within the area of macro-prudential supervision, both in terms of measures and proposals for clearer mandates and expanded authority. FI has also been active from an international perspective in terms of using available macro-prudential policy tools.

The reviewers' comments also reflect a central bank-based view about how public power should be exercised and how authorities should be governed. Looking at the issue from a broader perspective, it is clear that the far-reaching delegation of the responsibility for monetary policy to the central bank is a special situation and one that in most cases has only been around for a few decades.

This structure rests on four conditions. First, experience over a long period of time and from many countries has shown that it can be difficult for institutions governed by party-related policies to take a long-term view on the value of price stability. Second, there is a clear and reasonably measurable goal for monetary policy: price stability (defined as a low, stable rate of inflation). Third, there is reason to assume that monetary policy (if the goal is achieved) in the long run does not have any noticeable impact on real magnitudes, such as average GDP growth and unemployment, or the distribution of income. Fourth, it is enough to delegate one tool –the policy rate – to the central bank for it to be able to meet the target.[5]

Even if it is possible to see some parallels in the area of macro-prudential policy with the risk of short-sighted decision-making, it is obvious that the goal of price stability in other respects has no noticeable similarities to the goal of financial stability. The rate of inflation can be measured on an ongoing basis and with significant precision. The goal of financial stability, on the other hand, is neither very clear nor measurable. In addition, several of the measures that are currently of interest (amortisation requirements, debt-to-income ratio cap, etc.) have clear real economic and distributional effects. And monetary policy normally requires one tool, while macro-prudential policy can require measures in many different areas and with many different features.

As an additional aspect of the goal's ambiguity, *financial instability*, i.e. crises, occurs infrequently. Financial stability policy in the form of business regulations, capital requirements, etc., also has fundamental effects even during normal periods, e.g. by influencing the manner in which and at what cost customers can buy financial services. Consequently, there are important decisions that need to be made regarding the degree of financial stability that should be targeted. A regime that fosters low risks for financial instability is associated with certain types of costs for society in the form of less dynamics and higher costs for customers of the financial sector. If a regime that has more room for greater risk-taking is selected, other kinds of economic costs could arise if the risks materialise in crises.

FI takes the position that from a perspective of principle it is inappropriate to delegate the choice of which risk for financial instability should be targeted to

[5] Whether or not the fourth condition has been met has been more unclear in recent years. In many countries, including Sweden, central banks have had difficulty raising the rate of inflation by lowering the policy rate. The reasoning here, though, touches on principle grounds for the decision to give the central banks monetary policy independence.

an authority. Decisions involving such fundamental economic consideration should be made at the political level. The fact that it is difficult to make such decisions operational does not change the principle on which they should be based. The governance of FI's activities within financial stability (including macro-prudential policy) deserves to be evaluated within the framework of the investigation on macro-prudential supervision that FI requests above.

One conceivable approach is to try to divide the responsibility between the Riksdag and the Government so the Government has a mandate to regularly decide on the application of stability policy based on a generally designed stability target. Decisions at the political level should also state which authorisation and tools that FI has as the competent authority. Within this framework, FI the should be given a far-reaching independence to carry out its assignments in accordance with accepted principles for the distribution of responsibility between the Government and its authorities.

It is also important that the consultation process is conducted in a transparent process where FI's analyses and proposals are presented publically when they are submitted to the Government. The Government's decisions should be made public in the same manner. This provides a basis for an ongoing evaluation of both FI's proposals and the Government's decisions. This transparency helps link the measures clearly to the goal for the policy area. It is therefore important for the same reason that FI and the Government regularly report to the Riksdag how the assignment is being carried out and the grounds on which decisions are made.[6]

In some cases, as mentioned above, the tools can be of such a nature that even the application should be subjected to political assessment. A model where the Government shall approve proposed measures that an authority presents are unusual but not unique. There was a discussion in the political sphere a few years ago about whether certain authority measures would have large effect on public finances. This later resulted in Government Consent For Decisions in Some Regulations Ordinance (2014:570).[7] Even if in FI's case it is not primarily related to the effects on public finances, the situation is similar.

Role of the Riksbank in the area of financial stability

[6] A parallel can also be drawn to the management of central government debt, where the interaction between the competent authority (the Swedish National Debt Office) and the Government is similar to that which is being outlined here. The management of central government debt is also guided by a similar, hard-to-assess target: long-term cost minimisation taking into account risk and the requirements of monetary policy (see chapter 5 of the Budget Act (2011:203)). Experiences from the governance system are positive (see SOU 2014:8).

[7] The ordinance states in section 2, "Before an administrative authority decides on regulations that when applied could have an impact on expenses for the state, municipalities or local governments that are not insignificant, the Government shall approve the decision to adopt the regulations."

9. "The Sveriges Riksbank Act should be amended to clarify the role of the Riksbank in financial stability, whether limited to participation in the proposed Prudential Policy Committee (see above) or more extensive if macro-prudential powers gravitate to it. The mandate of the Riksbank should include financial stability, and the Riksbank must have some formal powers to enable it to achieve its objective."

FI agrees with the assessment that the role of the Riksbank in the financial stability policy area should be clarified. The Riksbank should also be granted authorisations linked to its assigned role. However, the Riksbank's most important role in protecting financial stability is one that the reviewers do not mention. The clarification should relate to the Riksbank's specific responsibility for handling financial crises and the authorisations that are needed to fulfil this assignment.

Based on the *functions* that are part of a complete framework for financial stability, the Riksbank's main role is to be responsible for the supply of liquidity in crisis situations. This is a direct result of the Riksbank, in its role as central bank (with responsibility for a national currency), having a unique ability to provide liquidity – in the form of assets that can be used for payments – in SEK. In that the Riksbank, through its lending activities can create funds for payment in the form of claims on itself, it is the only institution that never needs to worry about its own payment capacity.

The Riksbank, thanks to its unique ability to create means for payment, plays a central role in counteracting and handling threats against financial stability that derive from disruptions to the supply of liquidity, e.g. difficulties for banks to secure funding through regular channels. Knowledge about the existence of this function is important to avoid that need to use it. The probability of the occurrence of a liquidity crisis decreases if actors are aware that in the background there is a liquidity guarantee, particularly in the presence of disruptions that can affect the financial system as a whole. In this respect, the central bank has a function that the State needs for effective management of a financial crisis.

This is reflected in current regulations. The Riksbank has an explicit mandate to provide support in the form of emergency loans to individual financial institutions that suffer liquidity problems despite being fully solvent. This provision was applied during the financial crisis to grant loans to a few smaller banks.

Another role that is just as important for effective crisis management is the ability of the Riksbank to provide general liquidity support by offering all institutions borrowing on a large scale. In this way the Riksbank can meet general liquidity strains in a crisis where many or all institutions have difficulties generating funding. The significance of this tool is illustrated by the financial crisis in 2008−2009. The Riksbank offered institutions on a number of occasions the possibility to borrow funds in transactions that totalled SEK

100 billion per occasion. The Riksbank fulfilled a crucial role here in preventing the international financial crisis from spreading further in Sweden.

The Riksbank's ability to provide general liquidity support is not regulated in the Riksbank Act. During the financial crisis, the Riksbank was therefore directed to provisions that primarily relate to monetary policy. It worked, but this approach is questionable in terms of its principle grounds. FI takes the position that this justifies a clarification of the Riksbank's authorisation. It should be expressly stated that the Riksbank may issue loans, buy securities, etc., in order to counteract disruptions to the supply of liquidity.[8]

FI furthermore believes that the formulation of the Riksbank's assignment in financial stability should be reviewed. The current wording in Chapter 1, section 2 of the Riksbank Act states that, "The Riksbank shall also promote a stable and efficient payments system". This encompasses the Riksbank's responsibility for the central payments system and the supply of banknotes. However, it is not a clear base for the Riksbank's work with financial stability. First and foremost, it does not provide any guidance regarding the Riksbank's assignment in the management of financial crises.

FI refrains from proposing a new formulation for the mandate, but would like to emphasise the importance that it is clearly stated that the Riksbank's primary assignment in financial stability is to provide liquidity during crises. It should also be stated more clearly than it is today that the responsibility to supply liquidity is truly an *assignment* issued to the Riksbank by the Riksdag, and not just an option.

The assignment related to the payments system has been used as a basis for the analyses related to financial stability in a wider sense that the Riksbank initiated as early as in the 1990s. The Riksbank, through its stability reports, was a pioneer among both central banks (with and without supervision responsibility) and supervisory authorities. The reports have been influenced at the same time by the fact that the Riksbank does not have any specific tools to promote financial stability (outside of crisis situations). Policy analyses therefore in many cases conclude not with own decisions but with recommendations to other decision-makers, in particular FI, which is responsible for regulations and supervision.

Over the years, the Riksbank's analyses have provided valuable knowledge and influenced both policy decisions and the manner in which financial institutions act. FI welcomes an open debate about the need for policy measures in financial stability, with the Riksbank and others. As FI's mandate has been clarified, FI's analysis work has also developed, and there are currently two stability reports that provide a basis for the policy discussion regarding stability. A corresponding clarification of the Riksbank's mandate in

[8] A proposal with this content is included in the Financial Crisis Committee's interim report; see SOU 2013:6 (more specifically section 11.7).

accordance with the reasoning FI presents above could also contribute to a clearer distribution of responsibility within the analytical work.

A clarification of the goal, mandate and authorisations for the Riksbank's management of liquidity supply in conjunction with financial crises is an important assignment in the review of the Riksbank Act that has been announced. FI believes that work on this matter should begin immediately. As described above, FI believes that the review of the Riksbank Act should be kept separate from the framework for macro-prudential policy.

Overview of the distribution of responsibility in macro-prudential policy

10. "In 2020 the Government should ask a small group of experts to carry out a review of the allocation of responsibility for macro-prudential policy between Finansinspektionen and the Riksbank."

FI agrees that it is reasonable to evaluate the work on macro-prudential policy in due course. This is a new policy area, and both the goals and the tools have been formulated based on reasoning of principle rather than practical experience. Reviewing the experiences that have been gained – in both Sweden and other countries – is therefore justified.

FI believes that such an assessment should focus on the experiences in general and not primarily on the more narrow question of the distribution of responsibility between authorities, as mentioned by the reviewers. FI also believes that an assessment should be conducted later than in 2020. Given that the framework is not yet in place in its entirety, this will allow for less than four years of experience on which to base the assessment. This is much too short of a period. As a comparison, it can be noted that the first external assessment of the monetary policy was conducted in 2005, ten years after the price stability goal went into effect.

Monetary policy and financial stability

In Recommendation 2, the reviewers write: "Where, in the opinion of the Executive Board, it is appropriate to deviate for a while from targeting inflation some two years ahead, the Riksbank shall explain its reasons and defend them in front of the Finance Committee of the Riksdag. "(p. 10). Based on the comments related to Recommendation 8, it is apparent that the proposal is referring to situations where the Riksbank makes the assessment financial stability needs to be weighed into the monetary policy: "...there may well be imbalances in the Swedish economy for which the sector-specific macro-prudential actions are inadequate to ensure an adjustment towards full employment with price stability. There will be times when it is appropriate for the Riksbank to deviate from the normal and rather narrow focus on meeting the inflation target two years ahead" (p. 101).

FI sees a value in taking a pragmatic approach to the numerical inflation target in the manner described in Recommendation 2. The experiences of recent years show that situations may arise in which it is difficult to steer inflation using the policy rate, for example due to exceptional conditions in other countries. Specifying that the Riksbank has a mandate in such situations to take a more long-term approach to the inflation target and at the same time an obligation using pre-determined channels to explain its behaviour appears reasonable. Such a structure could enable Riksbank to avoid drastic monetary policy measures with the aim of quickly returning inflation to its target. This could also decrease the risk of contagion effects in other policy areas, including financial stability.

This recommendation largely entails that the Riksbank should manage its primary assignment with more flexibility. The thought behind the second quote from the reviewers (above), that the Riksbank should be able to downgrade the priority of the price stability target *to the benefit of* other targets, e.g. financial stability, raises more complex issues.

One such issue is the extent to which the Riksbank's policy rate is an effective tool for promoting financial stability. This is not a given. For example, if households expect that house prices will rise by 5 or 10 per cent a year, large interest rate increases will be required to noticeably decrease the demand for loans. This risks leading inflation far away from its target. The costs in terms of deviations from the price stability target therefore are hardly in proportion to the added value of slightly increased financial stability. In such a situation, quantitative credit market measures, such as a stricter debt-to-income cap and amortisation requirements, are probably more effective. This goes against the reviewers' recommendation to directly involve monetary policy in the work for financial stability.

Another issue is related to how to approach the idea that an authority is given a mandate to decrease the priority of its primary assignment to the benefit of an assignment that primarily lies with another authority. If the Riksbank's change in focus is due to FI not having sufficient measures to fulfil its assignment, the measures could possibly be viewed as complementary. If, however, the Riksbank intervenes because it draws a different conclusion than FI (and the Government) about the stability risks or thinks that FI in other ways is making the wrong prioritisations, there would be two captains steering the ship. This is inappropriate in terms of both principle and practice. An ambiguous distribution of responsibility between the authorities would in particular make it difficult for the Riksdag and the Government to carry out its follow-up work.

The reviewers do not discuss this type of problem, but their solution possibly is expressed in the proposed joint committee. But, as FI emphasises above, such a committee is an inadequate solution for other reasons. It is also not clear how a committee would help bridge differences between the authorities in, for example, their view on how large the threats to stability are or the costs (in a broad meaning) that are reasonable to reduce these threats.

Given this background, FI opposes the proposal to give the Riksbank an express mandate to deviate from its price stability target in order to focus on the financial stability goal. A more flexible application of the inflation target appears to be sufficient to reduce the risks of target conflicts. Any potential benefits from a stability point of view from a broader mandate for the Riksbank do not offset the ambiguities regarding responsibility and evaluation possibilities that could arise. The road forward, as FI presents above, is instead to ensure that FI receives more appropriate authorisation to fulfil its assignment as the authority responsible for all types of preventive measures for financial stability.

Other observations

Composition of the Executive Board

The reviewers also provide some recommendations regarding the Riksbank's governance and organisation. One of these relates to the composition of the Executive Board. FI agrees that the composition of the Executive Board and its methods of working should be reviewed. Almost twenty years have passed since the Executive Board was established. This provides a sufficient basis on which to evaluate the advantages and disadvantages of the current structure.

FI does not have an opinion about the reviewers' proposal to divide the Executive Board into two groups, one with both policy and operational responsibilities and one with only policy responsibilities. However, it can be noted that the way the Executive Board works has changed since it was established in 1999. Initially, one of the members of the Executive Board was primarily responsible for the preparation of monetary policy decisions and another for financial stability measures, similar to the manner proposed by reviewers. Today, the Governor leads the entire operations and the Deputy Governors have a less clear operational role. There are grounds to compare the experiences from both of these governance models during a review.

Role of the General Council in the overview of the Riksbank Act

As FI mentioned above, it is crucial that the review of the Riksbank Act is started as soon as possible. FI notes that the reviewers would like the General Council to be assigned responsibility for this review.

FI opposes this proposal. Since the General Council does not have its own analytical and administrative resources, in practice this could mean that the Riksbank's management and staff would have the opportunity to prepare proposals about the rules under which they work. This would be inappropriate. Instead, a regular government inquiry should be appointed. There is already an established structure for the formulation of directives as well as for the appointment of the chair, members, experts and secretariat for such inquiries.

Taking into consideration the Riksbank's special relationship with the Riksdag, the directives should be formulated in collaboration with the Government and the parties in the Riksdag. It would also be appropriate that the membership of the inquiry reflects the composition of the Riksdag to ensure that the proposals that are prepared gain wide political support.

Reviewers' understanding of Swedish institutional conditions

FI takes the position that the idea to make the General Council responsible for the overview of the Riksbank Act demonstrates that the reviewers did not sufficiently become aware of (or become informed about) Swedish institutional conditions. There are other examples of this in the report.

One example is the proposal that the Riksbank Act should be changed to make it clear that the choice of the exchange rate regime is an issue for the Government. However, this is already the case. Chapter 7, section 1 of the Riksbank Act states that the Riksbank shall decide on the application of the exchange rate regime that has been decided by the Government. The instruction is based on the provision set out in Chapter 9, section 12 of the Instrument of Government, which states that the Government is responsible for issues related to general foreign exchange policy. How this responsibility is exercised is set out in the Foreign Exchange Policy Act (1998:1404).

Another example of a misunderstanding of the legal conditions is the idea that the Riksdag can adopt the inflation target. This is not in line with the ECB Articles of Association. (The Bank of England can be subject to a different structure because the United Kingdom is exempt from the EU's central bank regulations.)

FI understands that reviewers who are not knowledgeable about specific Swedish conditions may make these types of incorrect assessments. But this also means that there is a risk that the report will focus on the wrong topics and thus provide a less useful basis for changes to regulations and for the Riksdag's assessment of the Riksbank. In order to decrease this risk, the Secretariat that the Committee on Finance appoints to assist the international experts with future reports should be given a clearer assignment to explain the Swedish institutional conditions for the reviewers.

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FINANSINSPEKTIONEN

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A decision in this matter was made by the Board of Directors (Sven-Erik Österberg, Chair, Anna Pettersson Westerberg, Sonja Daltung, Marianne Eliason, Anders Kvist, Astri Muren, Hans Nyman, Gustaf Sjöberg and Erik Thedéen, Director General) following a presentation by Senior Advisor Lars Hörngren. Per Håkansson (Chief Legal Counsel) and Martin Noréus (Deputy Director General) also participated in the final procedure.