

Management of a financial crisis in banks with cross-border establishments

Memorandum of Understanding (MoU) between the central banks of Denmark, Finland, Iceland, Norway and Sweden

Introduction

The central banks of Denmark, Finland, Iceland, Norway and Sweden all have responsibility for national financial stability and a role as providers of emergency liquidity assistance where necessary. The increasing prevalence of cross-border banks and bank establishments entails risks of a financial crisis in a Nordic banking group having repercussions for financial stability in more than one of these countries. For this reason, the central banks of Denmark, Finland, Iceland, Norway and Sweden have drawn up this MoU with a view to facilitating the management of such a situation.

The MoU is based on the following principles:

- The cooperation between the central banks will be facilitated by the establishment of a structure for crisis management and dissemination of relevant information. In the event of a financial crisis, it is important that the cooperation between the affected central banks works quickly and efficiently.
- A non-legally binding MoU is an appropriate instrument for facilitating cooperation between the central banks without curtailing their flexibility as independent institutions.

The MoU between the Nordic central banks is based on and makes more concrete the Memoranda of Understanding that have been concluded by the central banks and supervisory authorities within the European System of Central Banks (ESCB) in respect of both crisis management and payment systems. The MoU does not affect or bypass the powers of the national authorities or their international undertakings or agreements on cooperation.

The MoU constitutes a general framework. Where deemed appropriate, the Nordic central banks may enter into separate MoUs in respect of more detailed arrangements for cooperation and information exchange for the management of crises in individual, specified banking groups.

The parties to this MoU are in agreement on the following:

1 Scope of cross-border cooperation in crisis management situations

- 1.1 The MoU may be applied in the event of a financial crisis in a Nordic bank with operations in two or more Nordic countries.

2 Conditions regarding solvency and liquidity

- 2.1 The responsibility for managing a financial crisis in a bank rests primarily with its owners and management. It is expected that problems in parts of a banking group will be solved by making use of the collective financial strength of the whole banking group. Thus, emergency liquidity assistance from the central banks will only be provided in exceptional circumstances.
- 2.2 A bank can encounter different kinds of liquidity problems. Usually, the problems affect the entire banking group or group of companies. In exceptional cases, liquidity problems may be local in nature, e.g. due to technical disruptions in the payment systems. However, in general, if the parent bank can not obtain funding in the market or through the central bank's customary sources of liquidity, such as monetary policy credits or intraday credits, neither will the subsidiary banks have this option. Conversely, as long as the parent bank is capable of obtaining funding in the market, it can always fund its subsidiary banks.
- 2.3 Where a liquidity problem affects the banking group as a whole, the provision of emergency liquidity assistance will inevitably benefit the entire group. Consequently, a decision by one or more central banks to provide or not to provide emergency liquidity assistance to a cross-border Nordic bank will have implications for the other Nordic central banks as well.
- 2.4 In all the Nordic central banks, one of the conditions for a decision to provide emergency liquidity assistance is that the bank in question is not judged to be insolvent. In cases where a bank is judged to be insolvent or where its solvency is deemed uncertain, the central banks are required to contact their respective Ministry of Finance immediately.
- 2.5 A solvency problem in a banking group may affect individual institutions within the group and does not therefore have to affect all group institutions or the group as a whole. The parent bank or the group could be insolvent and therefore be forced to sell its solvent subsidiary bank to be able to pay its debts. A subsidiary bank could be insolvent and require financial assistance from its parent bank to be able to pay its debts.

3 Crisis management group

- 3.1 In the event of a crisis, it is necessary that the central banks have a crisis organisation that enables the efficient acquisition and analysis of information to allow a quick assessment of the need for policy measures and make appropriate proposals. In order to ensure this a contact group will be established, consisting of one high level representative from each of the concerned central banks and an alternate who shall take the place of the ordinary representative in his/her absence.
- 3.2 In the event of a crisis, the contact group shall become a crisis management group. All representatives, in their work in the crisis organisation, shall be able to communicate directly with their respective central bank's Executive Board.
- 3.3 The principal aim of the crisis management group is to provide all central banks with quick access to the same information and to enable the direct discussion and coordination of potential measures.
- 3.4 The central bank that is first to identify a potential crisis shall activate the crisis management group. The central bank of the country where the management of the banking group is domiciled in practice shall thereafter be responsible for coordinating the crisis management group's continued work.

- 3.5 Where appropriate and time permitting, each central bank may allow its representative, or the representative's alternate, to attend the crisis management group meeting in person.
- 3.6 Any member of the crisis management group may request that the crisis management group discussion be held in English and that the background material for decisions of the Executive Boards of the central banks (described in more detail in point 4.1 below) be drawn up in this language.

4 Tasks of the crisis management group

- 4.1 The crisis management group will be responsible for producing background material to facilitate potential decisions of the central banks' Executive Boards with regard to emergency liquidity assistance or other relevant measures. This background material should, in addition to presenting information on systemic importance and solvency, clarify any differences of opinion between the affected central banks. Decisions by the respective central bank shall be taken in accordance with its normal decision-making procedures.
- 4.2 The first task of the crisis management group will be to ascertain the bank's liquidity and solvency situation and other relevant factors through direct communication with the management of the banking group.
- 4.3 The crisis management group should contact the supervisory authorities responsible for the banking group in the Nordic countries as soon as possible with a view to exchanging information, and should also request a solvency assessment for the banking group and its different banks.
- 4.4 The crisis management group may also contact other persons, within or outside the central banks, to obtain information or analyse the situation at hand.
- 4.5 The crisis management group shall, when so requested, produce background material for the central banks' and other authorities' contacts with international bodies, such as the European Commission and the ECB, which by agreement or some other means have the right to be informed/consulted.

5 Information management

- 5.1 Internal information between the central banks and external information to the media should, as regards its content, be coordinated through the crisis management group as far as possible.
- 5.2 Communication with the relevant bank's supervisory group, where such a group has been established, shall be handled by the crisis management group. The individual central banks, however, shall handle communication with the respective country's supervisory authority and Ministry of Finance.
- 5.3 Once the crisis management group has been activated, communication with the banking group should primarily be conducted between the crisis management group and the management of the banking group. The management of the banking group is expected to inform its own banks irrespective of their country of location.
- 5.4 In cases where the Nordic central banks draw up a separate MoU in respect of a specified financial group, one of the central banks shall be made responsible for ensuring that a fact book containing relevant public information about the group is updated regularly. The purpose of the fact book is to give the central banks a common body of knowledge about the structure of the group's business activities and balance sheet.

Governors of the Nordic central banks, Stykkishólmur, June 2003

Danmarks Nationalbank

Suomen Pankki

Bodil Nyboe Andersen

Matti Vanhala

Norges Bank

Sedlabanki Íslands

Svein Gjedrem

Birgir Ísleifur Gunnarsson

Sveriges riksbank

Lars Heikensten