Research Sweden

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Carl Milton, +46 8 568 805 98, carl.milton@danskebank.se
Marcus Söderberg, +46 8 568 805 64, marcus.soderberg@danskebank.se

The government presents the new bank stability plan

- The plan consists of two main initiatives: a compulsory stability fund aimed at recapitalising troubled banks, and a voluntary guarantee facility where the government guarantees against default risk when banks/mortgage institutes refinance maturing debts. In return, the SNDO will charge a case-by-case fee. In this publication we focus on the guarantee facility as we see it as the most interesting part from a market perspective.
- The guarantee facility will be active until April 30, 2009, but could be extended until December 31, 2009. However, the guaranteed instruments are insured until maturity, which can not exceed five years. The volume of insured funding is currently capped at SEK1,500bn. The guarantee facility is only open to solvent banks (primary capital > 6%, capital adequacy ratio > 9%) and will be operated by the SNDO. The guaranteed instruments will receive a risk weight of 0 in capital requirement calculations. Covered bonds are, contrary to what has been the case in other European countries, included in the facility. Structured products are, however, not included. The guarantee facility imposes no restrictions on dividends.
- The fees for participating will be set on a case-by-case basis, but the government's intent is to set the fees in a way that issuers have an incentive to participate. Pricing is the key issue and so far we only know that the SNDO will act as guarantor in return for a fee that will be based on the current market spreads and a normal spread (bank debts over government debt) and that the fee will imply a spread somewhere in between.
- For instance, let us assume that a mortgage institute wants to refinance a maturing loan and decides to issue a two-year bond. The current two-year covered bonds spread over government bonds is near 150bp. Moreover, we assume that the spread is considered to be 20bp in a normal market situation. The fee for using the guarantee facility will in this case be somewhere between 0 and 130bp in this particular type of debt. Let us suppose that the fee is set at 60bp. Consequently, the market spread between the guaranteed bond and government bonds must not exceed 90bp for the facility to be of any interest in terms of costs.
- There are, however, large uncertainties when it comes to pricing of bank papers with an explicit government guarantee. Danish senior unsecured debt with an explicit government guarantee still trades way above the swap curve. It is therefore very difficult to set the fee structure in advance.
- Moreover, there are other factors than costs to consider before participating: there may be a negative signal effect in participating in the facility, even though the government promotes participation. This may be enough to keep some market participants well away from the facility. But if it proves impossible to find funding in the market in a normal fashion, the facility should at least greatly improve the odds of finding emergency funding.

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- **The overall effects of the guarantee facility on current market pricing are difficult to assess at this point. If a mortgage institute utilises the guarantee facility, there is a risk that it will crowd out demand for non-guaranteed bonds. However, it reduces the risk of severe liquidity problems.**
- **The second most important part of the plan is the stability fund, which is a formal arrangement to recapitalise troubled banks. Participation is compulsory and each institute will be required to pay a fee when markets normalise. The long-term goal of the plan is to reach 2.5% of GDP in 15 years.**
- **The government also introduces a framework for recapitalising troubled banks by purchasing preferred shares or by nationalising the banks. The FSA is also put in charge of monitoring that households and companies benefit from the measures, whatever that means in practice.**
- **It is also noteworthy that the government is also considering improving companies' access to funding by providing Svensk Exportkredit (SEK) with additional capital.**

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