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National implications of EU harmonization – the case of banks' reporting requirements in Sweden

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Abstract

The purpose of this paper is to discuss how internationally formulated policies and regulation of banks affect national supervisory practices and what consequences this may have on the form and quality of banking supervision conducted on the national level. Using the case of Swedish banks' reporting requirements, we argue that the last decade of EU level regulatory reforms are motivated by a different "regulatory agreement" (Young 2016) than the Swedish one. In the decade since the global financial crisis 2007-2009, banking regulation reforms appear to be shaped by a view that all financial institutions are more or less immoral and cannot be trusted to self-regulate. The development can be characterized as a move from a dialogue based relationship between the supervisor and the supervised (Roberts, 2009) and being based on fairly high levels of trust (Tomkins, 2001), to a more quantitative and centralized supervision based on collection and comparison of large amounts of standardized quantitative data. We argue that Swedish financial regulation and supervision traditionally were based on the notion of dialogue and mutual trust and less on extensive reporting requirements. Thus, for Sweden to conform to the post-crisis international regulatory framework, this means abandoning what appears to be a fairly well-functioning national arrangement.

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Contents

1 Introduction

The paper discusses how ideas about the proper regulatory arrangement at the EU level has led to substantial policy harmonization in individual EU member states that may both have intended (good) and unintended (not necessarily good) consequences. Using the case of Sweden, an EU-member recognized as an early and willing adopter of commonly agreed rules, we exemplify how the policies on bank regulation and supervision jointly decided in Brussels, appear to be based on a perception of the banking sector that is contrary to the Swedish one.

We argue that financial supervision is ultimately a kind of auditing, which is increasingly conducted in a context of a global governance structure dictated by the aim to reach financial stability through the 'standards-surveillance-compliance' system in which the search for increased transparency is central (Wade, 2007; Humphrey et al., 2009). As discussed by Humphrey et al. (2009), such a perspective entails a particular interest in the wide range of institutions that interact in the supervisory process, and the way that these interactions shape ideas and practices surrounding supervision.

The analysis focuses on the relative importance of accounting information and trust in Swedish supervision over time and the extent to which variation in importance affect the relationship between supervisor and those subject to supervision. The paper examines and discusses how developments and changes in regulation and supervisory practices have evolved over the past decades, and how these changes may affect the efficiency and safety of the banks and the financial system, as well as the regulation itself. To illustrate this development the paper uses the case of Swedish banking supervision and how it has been conducted from the early 1990s until today.

The development described in this paper is not unique to Sweden. Outside of Europe and the US the trend is less profound, even though regulatory reforms proposed by international organisations such as the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) have come to be adopted (more or less) universally. In Europe, the trend is also one of a redistribution of resources and powers. With the creation in late 2014 of the Single Supervisory Mechanism and the Banking

Union within the Euro-area, the European Central Bank within a year increased its staff by over 1,000 employees, staff that mainly came from national financial supervisory agencies and central banks. The costs of the ECB's banking supervision are covered by the participating countries, which have led to a rationale to cut national supervisory costs equivalently (although the Joint Supervisory Teams, responsible for performing the supervisory activities, are still largely made up of national supervisory staff).

As an EU-member but not a Euro-member, Sweden is obliged to commit to the reforms decided by the Union while not being able to draw on the competences and resources of the ECB Banking Supervisor in Frankfurt. Other small EU-countries, such as Finland (a Euro member) use the ECB resources. Consequentially, in the last decade the Swedish Financial Supervisory Authority (SFSA) has largely been left to implement financial regulation that has been decided at the EU level. What impact the supervisor may have on the regulation that ultimately is introduced in Sweden thus comes from international participation in various organizations, technical committees etc. Furthermore, the ability of Sweden as a small non-Euro EU country to influence the regulatory process depends on its ability in finding allied countries in the negotiations. On this note, the UK referendum to leave the EU has caused some concern since Sweden often have found common ground with the UK on many policy and regulatory issues.

The remainder of the paper is organized as follows. Section 2 presents theories of transparency through accounting information or trust. Section 3 outlines the research process, and the empirics are reported in section 4. Section 5 analyzes the results, and section 6 concludes the paper.

2 Theoretical framework

The paper is based on a theoretical framework that addresses three issues: (1) how international policies affect national practices; (2) how the supervisor – bank relationship affects the character and "level" of compliance"; and (3) how calls for more reporting transparency affects the level of trust between the supervisor and the banks.

2.1 National implications of global policy harmonization

Harmonization of national regulation is intended to bring benefits such as a "level playing field" for regulated entities to compete fairly, to reduce bureaucratic "red tape" and to make national jurisdictions and markets more comparable. In the area of financial regulation, harmonization and adoption of internationally negotiated rules are promoted as a means for "best practices", especially to jurisdictions where local regulation and supervision appears to be weak. In the EU context the strive for harmonized regulation and supervisory practices shape regulatory and policy reforms at least since the signing of the Maastricht treaty in 1993 and the adoption of the Financial Services Action Plan in 1999. The motive for greater regulatory harmonization is to achieve an EU-wide inner market for financial services and products, simplify "red tape" for cross-border enterprises and to achieve a "level playing field" in terms of legal requirements for financial companies within the European market.

Global harmonization of policies or regulations is based on an idea of national incentives that must be curtailed, and a "conflict" between the public interest, and the interests of individual actors. Therefore, independence, transparency and objectivity – as well as limited reliance on trust – characterizes the global harmonization movement. This is true both for accounting and for banking harmonization. [Cf. Carrington et al. (2015) and "stronger" references, e.g. in Cooper & Ezzamel (2013).]

Financial supervision is conducted within a complex organisational structure, but also with an intimate connection to the regulations that the banks must comply with. Researchers such as Wade (2007), Humphrey et al. (2009) and Arnold (2009) use the concept of "standards-surveillance-compliance" system to discuss how financial stability is achieved in a larger system of structures, standards and compliance mechanisms. This larger system exists in a loosely coupled international setting with harmonization as a lead star (Arnold, 2009). National governance structures are replaced by international ones entailing more hierarchical forms of control, and also structures in which large companies are becoming actors in interpreting and implementing regulation rather than being regulated.

Arnold (2009) argues that concerns over financial stability may have contributed to the internationalisation of accounting. Accounting is indeed becoming the language on which international structures for financial supervision is based, which can be seen in the increased similarity between the International Financial Reporting Standards (IFRS) and the supervisory reporting frameworks. The larger system has developed a dependency on transparency and compliance with accounting standards. The reliance on less forceful measures such as accounting, transparency and compliance is according to Wade (2007) the essence of the "standards-surveillance-compliance" system.

Humphrey et al. (2009) suggest that transparency is a key concept in this system. International standards require the global use of similar standards aiming at achieving transparency. Transparency in itself is according to this system able to prevent financial instability as well as creating a level playing field. Humphrey et al. (2009) argue that the "standards-surveillance-compliance"-system is very ambitious on paper but has not been as successful in practice.

Governance is traditionally reliant on trust-based relations among actors with limited independence. As long as these actors have "good" intentions, this governance is considered both efficient and effective.

2.2 Regulatory arrangement and enforcement styles of banking supervision

"Regulatory arrangements" comprise relationships and interactions between stakeholders within the regulatory space (Young, 2017). The nature of these relationships and interactions are occasionally influenced by economic or political crises (Hancher and Moran, 1989; Malsch and Gendron, 2011; Canning and O'Dwyer, 2013). The financial sector and banks in particular seem prone to events that can lead to a revision of regulatory arrangements.

Although the banking supervisor is empowered to set the 'going' interpretation of a regulation or policy, it is affected by competing interpretations of various interest groups (Spiller 1990). And since the costs of enforcing and implementing regulation and policy depends on the level of cooperation of the subjects of the regulation, the bureaucratic agency will most often find it preferable to work out its interpretation in dialogue with the subjects of the regulation (May & Winter 2000).

Supervision based on dialogue may improve compliance by reducing risks of misunderstanding. Given that "many violations stem not from wilful disregard or reckless behaviour, but from ignorance of a particular requirement", the distribution of information may be a very important means to achieve regulatory compliance (Coglianese & Kagan 2007:xvii).

2.3 The Trust-transparency paradox

As mentioned, transparency is a key concept in how the international "standards-surveillance-compliance" system works. At the same time, transparency is achieved using accounting information, which according to Tomkins (2001) may ultimately work to reduce trust.

Roberts (2009) has pinpointed this paradox by arguing that transparency offers the promise of making things visible that would otherwise have remained opaque, which will in turn lead to trust and confidence from stakeholders. At the same time, transparency is an impossible ideal and something that rather starts changing what it tries to make visible. If there is no transparency, we are forced to trust the other party. As soon as we start demanding transparency, some of that trust is lost, and in that way the same type of relationship is found between these two concepts as between "standards-surveillance-compliance" and trust. Moreover, there is no omniscient tool to achieve transparency, the only tool we have is the tool of accounting technology. Even though it is claimed that accounting can provide a full and fair view of an organization, accounting is also a co-creator of what it mirrors.

The aim to achieve transparency also means implementing an organizational model of self-control. Roberts (2009) refers to Powers (2007) in discussing that our growing belief in transparency renders many new forms of financial and non-financial disclosures creating new forms of "self-control and self-observation" (Power, 2007: p. 60). This is even more problematic as the categories offered by such financial and non-financial measures and disclosures are often not particularly relevant in comparison with how technical, local and personal forms of knowledge work in the everyday life of the organization. In this sense, transparency is also a form of obscuring the complexities of the real organization (Roberts, 2009).

Roberts (2009) uses the reasoning of O'Neill (2002) to explain that the ideal of transparency has long-ranging organizational implications. The main problem revolves around the structures and hierarchies that the ideal of transparency and total control gives rise to, entailing large-scale organizations and their use of transparency instruments that are supposed to enable control at a distance. There is, of course, a distinction between intra-organizational management control and regulatory supervision. The former can be expected to have a large impact on the functioning of the organization, while the latter could possibly be handled as a "separate" activity. For our study, the arguments of Roberts (2009) suggests a focus on how structural mechanisms, transparency tools, and the ideal of transparency can set the boundaries for what can be achieved in the supervision practiced by the SFSA.

One of the key points highlighted by Roberts (2009) which is crucial for the focus of this paper is that the ideal of transparency has consequences for the way dialogue between supervisors and those being supervised is carried out. He discusses how trust is mainly achieved through an active dialogue and enquiry, where claims to know are negotiated over time. This way of building trust is most likely hindered by a strong movement towards the organizational structures and mechanisms that has transparency through accounting as a goal.

Previous research has found that in all business relationships there is a fundamental interaction between trust and accounting information (Tomkins, 2001). Both trust and accounting information are needed to make a relationship work. Even though some of the research looking at the role of trust has been focused on business networks and business relationships, we believe much of the insights in this research are applicable in the relationship between supervisors and those supervised as well (cf. Rad, 2017). As there is not much research on trust and accounting information in relationships between regulators and those regulated and supervised, we draw on the general insights on the interaction between trust and accounting information in all kinds of organizational relationships.

Transparency is, and has been analyzed in previous research as a mean to achieve trust, but also as something that can reduce trust (Roberts, 2009). By combining the concept of standards-surveillance-compliance and the concepts of trust and transparency, we analyze how trust and accounting information have been used by Swedish supervisors over time and how that have affected the relationships between the SFSA and the banks.

The ideas of the interaction between trust and accounting information is a starting point in our analysis of the relationships between the SFSA and the banks, as we believe that efficient supervision is likely to be a practice that require a high degree of information sharing, the building of knowledge over time, and a high level of trust. Relationships exist not only between two organizations, but also between a large number of interconnected organizations. It must be remembered that organizations cannot have relationships: people and individuals have relationships with each other. Another dimension of business relationships is that they comprise interpersonal relationships (Tomkins, 2001). In personal relationships, trust is fundamental:

> "Trust in people [...] enables us to adopt schemas which leave us free to act without trying to process more information about the world than we are capable of doing. Trusting in someone enables us to act as if the uncertainty that we face is reduced, although it does not reduce that actual uncertainty. Trust is, therefore, ubiquitous: it is a fundamental building block of social life." (Tomkins, 2001, p. 165)

Trust means adopting a belief without complete information. Power (1994, 1997) has previously discussed the interaction between trust and accounting information, however not with a perspective of change that occurs over time. Tomkins (2001) adds a time element to Power's discussion in which there is a tendency in society to require more and more accountability, which brings to the fore questions on how trust is actually achieved. It also brings to the fore the question if accounting may even reduce trust. This is perhaps the most important argument of Tomkins (2001). There is a trade-off between accounting information and trust. Since trust removes the need for accounting information, it could be seen as a substitute for accounting information.

Of relevance to this paper is Tomkin's (2001) acknowledgement of a broader context of relationships. From this follows that the development in one relationship may have long ranging consequences in other relationships.

Wicks et al. (1999) argue that the higher the dependency in the relationship and the higher the cost of a collapse, the higher the degree of trust must be. From this, we suggest that the level of trust between the SFSA and the banks should be high, and that it should be in both parties' interest to keep the level of trust as high as possible.

3 Research process

The principal discussion of the paper on how internationally shaped regulatory principles affect national supervisory practices is empirically supported by a case study of how the Swedish Financial Supervisory Authority's (FI) reporting requirements for commercial banks changed from the early 1990s until today. Information about the reporting requirements, such as on the number and character of reporting items as well as reporting frequency, is believed to be indicative to the "regulatory arrangement" (Humphrey et al 2009) between the Swedish FSA and the reporting banks. We study the effects of these reporting requirements on the pre-existing dialogue-based supervision in Sweden.

This development is then linked to the trend of international, and especially European, regulatory harmonization during the last few decades. This trend is shown by accounting for how and when Sweden adopted these internationally negotiated reporting requirements for banks. While this harmonization first led to an international adoption of market self-regulation during the 1990s and the early 00s, the global financial crisis in 2007-2009 led to a shift towards more regulatory constraints on banks with more and more complex reporting requirements and less room for dialogue. This development is illustrated with an account of the major regulatory reforms of reporting requirements that have been enacted in the last decade.

The research team involved in this paper is highly embedded in the Swedish financial industry from different perspectives (e.g. financial and management accounting, business history and law). The members of the team have spent between 6 to 15 years study-ing the financial industry in Sweden, which means that we have a large collection of material such as interviews transcripts, documents, and quantitative data at our disposal. To complement and update the material we performed a number of interviews with individuals representing the key stakeholders in the study, the FI and the Swedish banks. The purpose of the interviews is to gain a deeper understanding of the role of the reporting requirements and how and why they have changed over time.

FI

We conducted interviews with seven employees of FI in May and June of 2017. Each interview lasted 45-60 minutes, and were recorded and transcribed in full. Interviewees have varying areas of responsibility within supervision of banking and markets (including accounting). They also represent different organizational levels, from management to expert roles.

The Case Banks

Case Bank A and B

Bank A and B are both small independent Swedish savings bank. They have not had any problems with FI and communication between the two banks and FI is at a minimum (an interesting reflection from one respondent is that because they are located in a rather rural area, inspectors from FI do not want to travel there…).

Interviews at Bank A were held during the fall of 2013 with the CEO, the compliance officer, the credit manager and one financial advisor. In addition, a three-hour session was held with the board of directors for the bank. This can be complemented with additional information if we want.

For Bank A

Interviews at Bank B were held in June 2017 with the CEO and the compliance officer and complete access to all correspondence between the bank and FI was granted. We have printed Capital Adequacy Reports (for some selected years), mail correspondence, reporting dates and will receive additional reports if we ask.

For Bank B the last visit from FI was in 1999 and since than the bank has only had one problem (because of a scheduling error by the compliance officer the bank submitted their capital adequacy report one day late and was charged with a late fee of SEK 10,000).

Case Bank C

Bank B is a medium-sized independent Swedish savings bank. We have not yet met them but they recently had some problems with FI.

Case Bank D

Bank C is a large Swedish savings bank that has converted into a joint-stock bank. We have not yet met them but they recently had a site visit from FI.

The large-bank perspective

We have interviews from several of the large banks but so far we have not made any "new" interviews and in the present version of the paper the results are loosely based on these interviews.

4 Bank supervision in Sweden

Bank supervision in Sweden took form in second half of 19th century and developed in tandem with the modern banking sector (cf., Broberg, 2006; Glete, 1994, Larsson, 1998). Up until the late 1850s, building societies were the most influential players on the Swedish banking market, but during the latter part of the 19th century commercial banks came to dominate and in 1909 they reached an all-time high of 83 commercial banks (Lundström, 1999). With the growth of the bank sector, need for more formal supervision grew as well. In 1907 an independent government agency, the Bank Inspection Board (BIB), was formed to supervise the banks. The commercial banks where required to share their annual reports, lists of owners as well as changes of the corporate statutes with the BIB, and the BIB could enquire banks to share any information it needed. Except for these formal elements, bank supervision was rather informal. The head of the small agency was not shy in airing his views on the capabilities and wits of bank manager candidates, merger plans or other major business decisions.[1] Key to this mode of supervision was its informal, undisclosed nature. The views of the supervisor were not made public other than in exceptional cases. The banks in return were willing to informally disclose plans for new managers, businesses or other affairs with the supervisor, confident in his interest in the further development and professionalization of the still developing banking sector. The formal powers of the BIB to sanction misconduct were limited to sending notes of concern or to ask the Ministry of Finance to revoke a bank's charter to operate. Neither of these forms of sanctions was common. Informal pressure to conform however was.

The first decades of the 20th century was marked by several crises periods for the banking industry, including a banking crisis in 1907-08, a major financial crisis in 1920-22, and economic recession in 1932-33 related to the Krueger crash. A series of regulatory change followed and Sweden moved from free to central banking by giving the Riksbank the sole right to print money. Bank supervision was also gradually moved from the BIB to the Riksbank as several of the new regulatory measures (such as credit, currency and interest rate control) was managed and enforced by the Riksbank. Accordingly the banks started reporting to the Riksbank, which for the coming decades became the de facto supervisor (although the banks still reported to the BIB). The move of supervisory power from the BIB to the Riksbank did not, however, alter the nature of supervision which remained informal and conducted in closed meetings with the Riksbank.

The Swedish banks remained under strict regulatory control until the early 1980s when less favourable economic conditions led to a discrediting of the interventionist state of Keynesian economics and a return of more market liberal ideas. Following waves of deregulation, especially in the US and the UK, the Swedish system of

[1] The personal views of the head of BIB was collected in a notebook and passed on to the next head of BIB. When the BIB was later transformed and made a more formal institution this notebook was published as a testimony of the nature of bank supervision in the early 20th century (see Benckerts Testamente, 1973).

strict banking regulations came into question. Even within the Riksbank, officials started to view the going system as obsolete and easy to circumvent. The form of meetings conducted in the preceding decades where abolished, and the dialogue between the banks and the Riksbank became less and less frequent. In a rapid succession the strict regulations of the banking sector were removed in the first half of the 1980s.

The pecking order with the Riksbank at the top and the BIB at the bottom established during the war and gradually evolved to a situation in which there was a complete lack of communication between the two agencies. The role of the BIB developed into a record keeper of bank information and because the nature of banking changed considerably during the 70s and 80s the BIB did not have the proper experience and understanding to fill its intended role as a bank supervisor when the regulations were dismantled. These shortcomings probably contributed to the bank specific and systemic imbalances of the late 1980s – that ended with one of the largest financial crises in Swedish history 1990-1992. In the critique against bank supervision that followed the crisis, the Riksbank was blamed for the rapid and uncontrolled regulatory constraints whereas the BIB was accused of incompetence and lack of oversight of the banks. Moreover, although not criticized at the time, the merger of the BIB and the Insurance Inspectorate in 1990 to form the FI appears to have been ill-timed given the following events when organisational stability on the supervisor's part would have been preferable.

The financial crisis was followed by extensive regulatory and institutional reform, of which the most significant included the reformulation of the Riksbank's mission and mandate. From being an instrument to accommodate the government's economic politics in general, (attempting to steer and react to inflation and unemployment rates, economic productivity, exchange rate stability, and, at least until the mid-1980s, the control of the banking system) the central bank came to focus solely on price stability. In terms of reforms of bank regulation and supervision, they mainly came in the former area. The creation of FI was so new that a new reform probably was not considered feasible. The experiences and outcomes of the crisis led to a return of the informal and dialogue based banking supervision, only this time it was between the banks and the de jure and de facto supervisor and not the Riksbank.

In the following subsections we focus (i) on the nature of supervision and the role of the FSA in Sweden. Because the early 1990s marks a shift in financial supervision, not only from a national but also from an international perspective we start by a brief background on Sweden's relation to the key international supervisory agency "The Committee of Banking Supervision" or the Basel Committee. Next (ii) we zoom in on FI to illustrate how supervisory practices and reporting requirements have changed over the same period. Finally (iii), we juxtapose the FI view on supervision with the bank's experience in order to complete the picture.

4.1 Towards the internationalization of banking supervision 1990-2017

Sweden was a founding member of the Basel Committee on Banking Supervision back in 1974 and has since been committed to adopt internationally negotiated agreements in the area of banking regulation. Although the Swedish banking system was "deregulated" later than in many other countries, it did its reforms fast and in line with the market liberal ideas of the time. The Basel I agreement was formalized in 1988 and was enforced by law in Sweden in 1992 with the signing of the EEA-agreement.

The simplistic structure of the Basel I framework was criticized for giving rise to pro-cyclicality and regulatory arbitrage. In 2004 it was replaced by the Basel II Accord where more sophisticated views of credit risk were implemented. The concept of operational risk was also added to the framework as it had not been included previously (Kumar, 2014). Basel II also provided a more holistic view on regulation and supervision. It pinpointed the relationship between regulators, supervisors, and financial institutions by introducing the three pillars, which are meant to promote financial stability. Pillar 1 being the minimal capital requirements divided into credit risk (with a standardized approach, an internal rating based approach and a credit risk securitization framework), pillar 2 being guidelines for supervisory review processes, and pillar 3 providing guidelines for market disclosures (Basel Report, Bank of International Settlements).

Basel II was developed in several steps. One important step was to bring in the area of financial supervision, which was done in 1997 with the development of a set of "Core principles for effective banking supervision", which offered a comprehensive description of what the Bank of International Settlements saw as an effective supervisory system. This was then integrated into the first consultation paper that was published in 1999, which was followed by a second and third one in 2001 and 2003, and finalized as a final document in 2004 entitled: Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework".

Also important was that Basel II stated that one of the main objectives of internal supervision in banks was the protection of depositors, and that each bank should be tested to ensure the security of depositors in terms of liquidity. Bringing in operational risk was also a big step, highlighting the importance of internal processes, people, systems and unforeseen external events (Kumar, 2014). In this sense, Basel II entailed a more complex view of the financial institutions as an organization, and emphasizing the responsibility of the individual organization and that financial stability is founded largely in healthy and well-functioning internal systems. As such, Basel II did not intend to simply ensure that financial institutions complied with certain capital requirements, but also that they had a risk management and supervision practices of high quality.

In terms of financial supervision, Basel II stated four key principles. The first principle said that the bank should have the processes internally to assess the capital requirements in relation to risk profile and strategies. The second said that supervisors should review these processes. The third said that supervisors should expect banks to have more capital than the minimal requirement. The fourth said that supervisors should intervene in an early stage in the situation where capital requirements were dropping. In sum, Pillar 2 would allow supervisors to assess the banks' own process with capital adequacy, and not only rely on compliance with minimal requirements. Basel II also introduced the market actors as a kind of supervisory mechanisms. By enhancing greater transparency to the market, the bank would be forced to be even more prudent in their risk management as Pillar 3 would enable markets to penalize and correct banks with poor risk management. Nevertheless, even though it was not fully implemented until 2007, Basel II was also subjected to criticism both related to not being able to remove the pro-cyclical nature of the Basel I regime and because it appeared to lenient towards the banks.

The Basel Accords with its recommendations for internationally active banks have been enacted to a full extent as EU law for all banks within the European Union. The developments in the EU will be presented closer in the next section.

Free movement of services and capital and freedom of establishment have been fundamental values in the EU ambition to create a harmonized market within the union. The cross boarder activity has indeed increased. Effectiveness, competitiveness and enhanced market development were core values when initially regulating this field. However, the financial turbulence and financial crisis in 2007-2009 brought about a vast range of regulatory changes and implementations. The guiding stars are now to achieve financial stability, risk management, consumer and investor protection and to prevent all types of financial turbulence. This can be seen in the material aims of the new regulation, but also in the fact that the amount, strictness and pace of regulatory measures are increasing. Many directives are replaced or complemented by directly binding EU regulations. Banking has been especially targeted in this regulatory agenda.

There are currently about 8300 banks in the EU. Around 150 of these are large, systemically important banks within the euro zone. The reforms of banking regulation of today aim at reducing risk taking, and not only on individual firm level but on a macro level. The markets in large must be supervised and the risk must be diminished on an overall level. Thus, large institutions and banks become specifically targeted with the new regulation, as they are the ones primarily exposed to systemic risks.

The global financial crisis put the European financial stability to a momentous test. The losses of the largest banks in the EU amounted to around 350 billion euro (Commission, European Financial Integration Report, SEC 2009, 1762) The European Central Bank added large volumes of liquidity into the credit markets (ECB, Annual Reports 2008 and 2009) The financial crisis revealed shortcomings in the EU financial system and brought political consensus on reforms. The lack of financial supervisory cooperation and cross-border solutions within EU was especially pointed out as contributing to the crisis.

Financial legislative harmonization, with the Financial Services Action Plan and the Lamfalussy model in process since the millennia shift, had in large achieved an internal market for financial services and common rules and regulations had indeed opened up for augmented cross-border operation of financial institutions. However, the control over the European internal market activity had remained at national level and not been addressed by the EU. A destructive imbalance in the regulatory and supervisory construction thus emerged, which was considered a central matter in the course of the crisis in the Union (The High-Level Group on financial supervision in the EU, Report 2009).

In October 2008, the Commission mandated a High Level Group under the lead of Jacques de Larosière to give advice on the future of European financial regulation and supervision. Based on the Larosière Report the Commission brought forward proposals in September 2009 and exactly one year later the Parliament voted through a new framework for the EU financial markets that came in force in January 2011. The framework consists of a European Systematic Risk Board, which overviews macro prudential risks on Union level. The Board may issue warnings and recommendations. Moreover, the framework dresses three committees with new tasks and powers, thus creating three financial supervisory authorities with micro prudential powers on the EU level: European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA). The authorities work to obtain better information flow and co-ordination between Member States' authorities and likewise within the Union. There are also powers to issue technical standards and temporarily ban risky financial products and activities.

In 2011, the financial crisis became a debt crisis in the Eurozone area. Political discussions led to the proposal of a banking union, specifically for member states that share the euro as currency, but potentially open to any member state. The bank union comprises common rules for bank resolution. As a part of the banking union, a single supervisory mechanism (SSM) was set up. In the banking union, the ultimate supervisory responsibility related to the financial stability of all euro area banks will be borne by the European

Central Bank (ECB). Non-euro states may voluntarily join the ECB supervision scheme. The ECB will cooperate with the EBA, which will keep its supervisory functions.

At the same time, the work with Basel III was intensified. The intentions of the work leading up to Basel III were potentially good, especially in its aim to achieve a more holistic approach to risk management. However, it is no secret that the results before Basel III was initiated could also be seen as a failure when judging from what lead up to the financial crisis of 2007-2009 with large risk taking and low levels of transparency in many financial institutions, especially in some countries such as the US. This may partly be explained on that many financial institutions relied on market risk models to calculate capital requirements, especially in the trading book (Kumar, 2014). So even though the framework in itself was much more sophisticated and in that sense, more ambitious in its aim to better capture the real risks of financial institutions, they also meant a more wide-spread use of equally sophisticated so called Value at Risk model that appears to have underestimated the risks that financial institutions were actually facing. The way that the framework relied on the banks own processes and systems also opened up for manipulation (Kumar, 2014).

With Basel III there was a return in a sense to the thinking of Basel I in that more strict levels of requirements were stipulated. Stricter levels for reserves for future losses were stipulated, for example. Whereas Basel II would allow for a procyclicality in that losses could be low in good times and high in bad times, Basel III stipulated meaning higher buffers generally against unforeseen stress. Also new was that Basel III became even more detailed, controlling not only capital but also liquidity and leverage (Kumar, 2014).

The Commission proposed in 2011 for the Basel III Accord to be transposed into a new directive together with a regulation, which would replace the earlier EU Capital directives. The so-called CRD IV-package entered into force in July 2013. The rules for capital requirements are covered in the EU regulation, directly applicable and binding for all Member States. It comprises no less than 488 articles, of which some need national implementation in the Member States. The Regulation will follow the pace of the Basel developments and become fully implemented in 2019. The EU is the first jurisdiction where the new Basel framework is being transposed into binding law. In addition to implementing the Basel III standards, the CRD IV-package introduces a number of additional changes to the banking regulatory framework. For example, the reliance by credit institutions on external credit ratings is considered in need of reduction. There is a requirement that all banks' investment decisions are based not only on ratings but also on their own internal credit opinion. Banks with an essential amount of exposures in a certain portfolio should develop internal ratings for that portfolio instead of relying on external ratings for the calculation of their capital requirements.

4.2 Swedish banking supervision 1990-2017

In Sweden, both micro- and macro-supervision are assigned to a single supervisory agency, FI, which was created in mid-1990 when the BIB and the Insurance Inspectorate were merged into one agency. FI is responsible for the supervision of all financial companies, market places and products within the Swedish jurisdiction. Since the Swedish banking crisis, FI has also been responsible for the macro prudential supervision, although this objective is somewhat shared with the Riksbank, which has a mandate to promote a safe and effective payment system for which financial stability is an integral part.

Banks' reporting requirements are detailed in Finansinspektionens författningssamling (FFFS). Sweden's push to implement the Basel II accord came via legislative reforms in 2004-2005, when the major financial company acts where revised.[2] The new acts led to increased reporting requirements for the companies and introduced new sanctioning powers to FI.

During 2016 a new internet-based reporting system was introduced for some types of reporting requirements…

[2] For example Lagen (2004:297) om bank- och finansieringsrörelse (The Banking and Financing Business Act).

Key ratios, FI	**1994**	**1997**	**2000**	**2003**	**2006**	**2009**	**2012**	**2015**
No. of employees	139	149	160	186	212	228	302	375
No. of site visits*	NA	117	59	-	-	-	-	-
Yearly budget (mkr)	NA	108	139	179	240	273	394	555
No. of sanctions	NA	-	-	-	-	-	-	-
Staff turnover %	NA	-	13	2	10	12,5	13,2	16,4
Director	Claes Norgren	Claes Norgren	Claes Norgren	Ingrid Bonde	Ingrid Bonde	Martin Andersson	Martin Andersson	Erik Thedéen

Table x. Key ratios for FI from 1994 to 2015.
Source: Based on FI annual reports.
*This number is related to bank site visits, total visits were 240

Table x above (work in progress) shows a number of key ratios for FI based on their annual reports. It is quite clear from the table that FI has grown significantly over the past two decades. The staff has increased from 139 to 375 and the yearly budget has increased with 500%. Unfortunately FI's reporting practices changed in 2002 making observations of number of site visits less transparent.

1997 marks an important shift in supervision for FI because of several large mergers during this year. Most important was the merger between Nordbanken and the largest bank in Finland; Merita Bank. This was the first large cross-border merger in the Nordic region and as such motivated FI to increase their cross-border cooperation with other FSAs. During this period FI dedicated large resources to site-visits and during the year 117 site visits were conducted in various banks. They conclude in the annual report (loosely translated): "During our site visits several problems were identified and corrected. The majority of corrections were done consensus with the financial institute."

One observation that can be made when looking at the annual reports is the gradual shift towards big bank focus. Considering FI's goal of financial stability this is not surprising, but as will discussed further below, this is also reflected in the interviews with the small banks.[3]

[3] And in the yearly survey that FI conducts among the supervised firms at least since 2000.

Interviews at FI

All interviewees seem happy to work at FI, and emphasize the good work culture within the organization. There is a policy of free and open discussion within FI. This may seem surprising, given that the employee turnover at FI increased from 11% in 2013 to 21% in 2016. Possibly, it is the effect of a good job market in FI's areas of expertise and not dissatisfaction with the work at FI per se.

It is important to note that FI is involved in many different types of supervision, including supervision of markets, accounting, banking, and insurance. The objectives of different types of supervision go from maintaining well-functioning markets to financial stability and consumer protection. While some interviewees see the broad scope of supervision as a challenge to FI, others see it as an advantage as the different areas are connected.

Interviewees discuss several trade-offs that must be made within supervision. One trade-off is how much reliance there should be on self-regulation. An interviewee points out that three criteria must be fulfilled before self-regulation can be used: 1) it must be legally possible, 2) there must be a private organization willing to take responsibility for it, and 3) there must be an alignment in incentives. The three conditions are met in accounting supervision, and that area is – from FI's perspective – self-regulated. Self-regulation is not possible in banking supervision, however, as incentives between banks and the government are not aligned.

Following the financial crisis of 2007-2009, several steps have been taken at EU harmonization. Interviewees point to the harmonized and comprehensive reporting requirements. They maintain, however, that the way the actual supervision is conducted is determined locally, and that FI has substantial autonomy in this regard. In the supervision of banks that are active in more than one EU country, the existence of "supervisory committees" may act as a harmonizing factor, albeit not in a top-down manner.

Several interviewees mention the importance of dialogue-based banking supervision. One call it "principles-based" supervision. FI is in frequent contact with the large banks, and meetings are sometimes set up at the request of banks when questions arise. Due to the risk-based nature of FI's supervision, small banks that are not system-critical may have very infrequent direct contact with FI. The comprehensive reporting requirements that came after the financial crisis have not negatively affected the dialogue-based supervision. Some interviewees even point out that the reporting requirement improve dialogues, as FI has a better knowledge-base when it conducts dialogues. Trust in the relationship between banks and FI is important, and banks have more trust in FI when FI is better informed. An important point made by one interviewee is that dialogue-based supervision is not a negotiation between FI and the banks. It is always clear that it is FI that determines when regulation is not followed, in its role as the supervisory authority.

An interesting point made by several interviewees is that Swedish banking supervision has become more analytical over time. Whereas there was more box-ticking before, in the last few years it has been more risk-based. There is a larger focus on the main issues and the main risks in the financial system.

There are some contextual trends in the development of supervision. There is a trade-off between financial stability and well-functioning markets and economic growth. For example, high capital requirements and restriction on new financial products would increase stability, but probably impede economic growth. Immediately after the financial crisis of 2007-2009, there was a focus on financial stability and strict regulation. In the last few years, this is starting to change, and there is more concern for economic growth. Interviewees point out that some of the regulation that was introduced after the financial crisis was probably too harsh, and is subsequently revised. For example, should small banks have the same reporting requirements as large banks? This is also a question of supervisory efficiency, as it is costly for FI to process all the data it collects from banks that are not system-critical.

4.3 The banks' perspective on supervision 1990-2017

Even though the structure for financial regulation and supervision has undergone comprehensive changes over the recent decades, the structure of the Swedish banking sector has remained largely unchanged. As the changes in financial supervision are done against the background of a fairly stable banking sector, we explain the fundamentals of this sector as a starting point.

Sweden's banking sector is one of the largest in Europe relative to GDP, indicating the importance of the banking system in Sweden. A few large commercial Swedish banks have a very strong position on the market. There is close to an oligopoly because four banks dominate the market shares for loans (The Swedish Bankers Association, 2016). Coexisting with these four banks and a number of relatively smaller banks with a comprehensive service catalogue, are niche players that are often active in few segments. There are also local savings banks, especially in smaller towns and rural areas. Foreign banks have limited activity in Sweden, but are important in some segments. Foreign banks were allowed to enter the Swedish market in 1985 (although there were some limitations), and as shown in Table XX (in the appendix) several foreign banks set up subsidiaries. However, as noted by Elliot (2015:36) "except from Danske Bank, which acquired Östgötabanken in 1997, the influence of foreign banks has remained limited in Sweden." This may be due to the dominating position of the four largest Swedish banks. To account for the differences between the banks we have purposefully selected both large and small banks to provide their experiences from bank supervision over time.

Interviews with the small banks

The relationship between the interviewed small banks and FI is based on an arms-length perception rather than on actual experience. Neither of the two small banks have had any site visits within the past decade and the compliance officer of Bank B even expressed that:

"Because we are located in such a rural area I don't think that the people from FI are very interested in coming here – it is not fancy enough for them."

However, the perception among the respondents can best be described in terms of fear and they are doing what they can to stay out of the FI spotlight. Several respondents compare FI to the Swedish tax authorities and conclude that while the tax authority is responsive, helpful and open to a dialogue, FI is very bureaucratic and do not answer any questions (CEO Bank B):

"The relationship with FI has changed from being based on mutual understanding where the implicit goal of FI is to help the bank improve based on a dialogue, whereas today we are instructed via letters without any dialogue. This

may partly be related to the level of experience among FI staff, since they tend to have less practical experience today than they did previously they also rely more rigorously on the rules and regulations."

The bureaucratic and formal procedures of FI are also illustrated in the number of reporting instances, which has increased tremendously over the past decade. In addition, the amount of financial data that needs to be reported on a regular basis has exploded. As an example, the capital adequacy report from Bank B was 13 pages long in 2002, whereas today it is 513 pages. Despite this vast increase in the amount of data that needs to be submitted the compliance officer of Bank B withholds that:

"Even though we report all of these pages, the information content is basically the same."

There is, however, some consistency between FI's and the small bank's view on supervision in terms of regulatory interpretations. The CEO of Bank A expressed it as follows:

"FI tend to have an initial view on the regulations that is usually a very strict interpretation but gradually they adapt to reality and find a more moderate way".

This resonates well with the views expressed by the FI and is probably reflective of the massive regulatory change that has characterized the years since the financial crisis. However, the key issue brought up by most of the respondents is the understanding among FI staff for the nature of small scale banking and the utilization of the proportionality principle. The simplistic nature of these banks, with less than 50 employees and one or a few offices primarily focused on retail lending should, according to the interviewees be accounted for to a greater extent in the supervisory practices of FI.

Some reflections from the large banks

The size of the large banks makes the experiences with, and perceptions of, FI less homogenous. The number of employees working in the compliance departments of the large banks has increased tremendously over the past decade and, for example, Nordea has more 1200 people working directly or indirectly with compliance issues. In general the large banks have more dialogue with FI and they cooperate with FI regarding several projects for collecting statistics over the financial markets.

There is a wide perception among the large Swedish banks that the new regulatory environment is too extensive and prescriptive. However, because regulation is also increasing entry barriers and protects the established players in the market regulation is not considered bad per se. The problem is more directly related to the consistent and quickly changing regulatory landscape, which creates a lot of regulatory uncertainty for the banks. There is some similarity between the experiences from the small and the large banks in terms of the speed in which FI is requiring compliance (very fast), which is not consistent with how quick FI is to respond (very slow).

Another area where the small and large banks have similar experiences relates to regulatory fatigue. Over the past decade, large amounts of time and resources have been directed towards regulatory compliance and this process may inflict upon the usefulness of regulation and supervision. It is common among the large banks to express that "if FI wants to find faults, they can always find faults because there is just so much regulation that it is impossible to be fully compliant with everything".

5 Analysis

Swedish banks' reporting requirements have increased significantly since the global financial crisis. The reports have also become more formalistic in nature, giving less room for bank specific conditions.

However, unlike expectations in the literature, interviews at FI suggest that the dialogue-based supervision not only survived the reporting requirement, but were actually strengthened by them. Tomkins (2001) talks about a trade-off between trust and accounting. Accounting can support trust, but too much reliance on accounting can destroy trust. In the case of banking supervision, FI interviewees claim that reporting requirements do support trust rather than destroy it. Our conclusion is that the Swedish dialogue-based banking supervision, which appears to have served the country well since the 1990's, is resilient in the face of EU harmonization.

6 Conclusions

A central question is how a small EU- and BCBS member country can uphold a national regulatory arrangement while still adhering to the good intentions and principally sound of in international level policy negotiations. At risk is of course not only the credibility of the country in these negotiations, but also of the material outcomes of the negotiations. If not even the BCBS members are not ready to implement the committee´s recommendations, then other countries will hesitate. In the EU context, the stakes are even more tangible. The ESA authorities (EBA, EIPOA and ESMA), may address decisions towards national supervisors in case of breach of binding EU law. If a national supervisor does not comply with such a decision, the decision may instead be addressed towards the specific financial institutions that are affected by the decision. They also have powers to mediate and settle disputes between national financial supervisors if they fail to agree on a cross border issue.

However, the powers of the European supervisory authorities may seem far-reaching, and indeed the reform is comprehensive regarding the approach to EU supervision before the financial crisis, but notably there are no sanctions to enforce the decisions for the EU authorities. Two exceptions are credit rating agencies and trade repositories (the latter collect and maintain the records of derivatives), which are supervised fully and directly by ESMA. The lack of sanctions is generally not considered a problem, since there are strong political incentives to comply with the decisions. However, in a financially turbulent period, there might however be different views on how to solve a problem and not all national authorities might agree on the EU regulation or the interpretation thereof in a precarious situation. In such a situation, where enforcement might be most needed, there would be no way to legally enforce a decision on EU level vis-à-vis a non-compliant national supervisor or financial firm. For a small country like Sweden, where banking regulation and supervision practices developed in the EU in the last decade has put strain on what appears to be a working national regulatory arrangement, this lack of formal sanction powers may be important to build a credible case for national discretion in shaping appropriate means to a common goal of sound banking.

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Appendices

Table xx
Banks in Sweden from 1980 to 2016

Type of Bank	**1980**	**1983**	**1986**	**1989**	**1992**	**1995**	**1998**	**2001**	**2004**	**2007**	**2010**	**2013**
Swedish Commercial Banks	14	14	14	14	9	14	15	25	26	28	33	37
- Large Banks	3	3	3	3	6	5	4	4	4	4	4	4
- Converted Savings Banks	0	0	0	0	0	1	4	11	12	11	14	14
- Niche Banks	0	0	0	0	0	5	5	8	10	13	15	19
- Other Banks	11	11	11	11	3	3	2	2	0	0	0	0
Foreign Banks	0	0	12	10	6	11	17	21	22	31	29	29
- Subsidiaries	0	0	12	10	5	0	2	2	3	4	3	2
- Branches	0	0	0	0	1	11	15	19	19	27	26	27
Savings Banks	164	154	119	109	91	90	85	77	76	65	50	49
Co-operative Banks	420	395	389	383	0	0	0	2	2	2	2	2
Total	598	563	534	516	106	115	117	125	126	126	114	117

Source: Data from The Swedish Bankers Association: this will be updated when the new report arrives at the end of the year

Tex:

Bank's reporting requirement	**1990**	**1995**	**2000**	**2005**	**2010**	**2015**
No. of reports annually	12	24	24	36	72	144
Reporting items	20	22	27	24	60	200
No. of pages						

osv.