ANALYSIS

Conversion of Nordea subsidiaries into branches – Nordic interconnectedness increases

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Nordea Group intends to merge its large subsidiary banks operating in other Nordic countries to the Swedish parent company, which is supervised by the Swedish supervisory authority, Finansinspektionen. The importance of the change for Finland is heightened by Nordea's large market share.

In Nordea Group's intended organisational change, the subsidiary banks operating in Norway, Denmark and Finland will be merged into the parent company, the Swedish Nordea Bank. The plan to transfer the Finnish operations to the Swedish parent company was approved by Nordea's Annual General Meeting in March 2016. According to a press release on the Annual General Meeting, the merger is expected to take place in early 2017. Nordea already announced back in 2003 that it was planning such a merger.[1]

Section 3.1 of the merger plan states the following: '… *the business activities which today are conducted by the Transferee Company's Danish, Finnish and Norwegian banking subsidiaries ... after the merger will be conducted by branch offices of the Transferee Company.'* It is also stated that the change will have no effects on employment. The objective is to '*simplify the legal structure ... in order to strengthen corporate governance, decrease administrative complexity and enhance efficiency.'*

Nordea has applied for permission for the merger from the Swedish supervisory authority. A new group entity (Nordea Hypoteksbank) has been established in Finland and will be issuing covered bonds in Finland.

Nordea has controlled a market share of almost 30% of household loans in Finland. Globally, there are scarcely any examples of a branch of a foreign bank being systemically important in its host country, even as a retail bank. Economics literature does not widely discuss how the market activities of a foreign bank's subsidiary and branch differ. In the banking business, however, a group's legal structure is important. Therefore, the merger will probably have an impact on a number of factors.

Nordea's operations in Finland will be moved beyond the scope of the Banking Union formed by euro area countries and of the Union's Single Supervisory Mechanism. Instead of the European Central Bank, the Finnish branch will be supervised by the Swedish supervisory authority. The Finnish Financial Supervisory Authority will only play a limited role, in e.g. conduct of business supervision, and the supervisors may cooperate on some issues. From the perspective of competition neutrality, regulation and supervision should be as uniform as possible for banks that operate on the same markets. This emphasizes the significance of mutual understanding between supervisors.

For example, after completion of the merger, possible changes in the internal ratings based models used for calculating risks to credit granted in Finland will require approval by the Swedish authority. These models affect e.g. the amount of own funds a bank must have and on what conditions it can or should grant loans.

After the merger, Nordea will belong to the Swedish deposit quarantee scheme, albeit there are only minor differences in deposit guarantee schemes among EU countries. The Swedish deposit guarantee scheme does not yet include a specific coverage for funds received from the sale of housing. However, Sweden is revising its deposit guarantee legislation so that assets received from the sale of one's own home and certain other funds received as compensation would be covered to a value of SEK 5 million.[2]

The Swedish markets are characterised by concentration in the banking sector, interlinkages between banks and the large size of banks relative to the economy. These factors can influence authorities' decisions both in crisis situations and in contingency planning. From the perspective of the economy, it is essential that critical functions, such as payment transfers, continue in crisis situations. As a Swedish bank, Nordea is not a member of the Single Resolution Mechanism of the Banking Union, nor are the assets of the Single Resolution Fund available to it. Instead, Sweden's own resolution fund (resolutionsreserven, see the Swedish Resolution Act [lag 2015: 1016]) could be used. The Riksbank has expressed its concern that Sweden's undertaking may increase if supervision and capital adequacy and liquidity buffers are insufficient.[3]

If activities in different countries are branch operations of one single group, there are no country-specific own funds or capital requirements. If the capital adequacy of a bank that operates in many countries as a single group changes because of a factor relating to one country's economy, the possible impact on credit supply is probably very similar in all countries. For example, losses resulting from the bursting of a housing bubble in one country could also affect credit supply elsewhere.

Decisions made and regulations imposed in Finland to ensure financial market stability will not all automatically apply to Nordea after the conclusion of the merger. If Finland imposes a countercyclical capital buffer, the requirement will also automatically apply to Nordea's receivables from Finland. By contrast, a systemic risk buffer, which is currently not included in Finnish legislation, would only apply to a Swedish bank's branch in Finland if the Swedish supervisor were so to decide.

Notes

1. Bank of Finland Bulletin (special issue 2003) Financial stability, p. 42. ↑
2. Government proposal 2015/16:106, proposed section 4c. Submitted to the Swedish parliament in Stockholm on 17 March 2016. ↑
3. ‘Nordea's planned reorganisation increases the Swedish state's undertaking’. Sveriges Riksbank. Press release, 13 April 2016. ↑

Key words

banks, merger, Nordea