Protect the system, not every shareholder

Sweden's bank-resolution choices and their limits, 1991-97

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The decision

When banks lose funding and their loan losses exceed available capital, a government faces two different problems: keeping essential financial services working and deciding who absorbs losses already incurred. Sweden's response combined a broad liability guarantee with valuation, conditional support and restructuring. The difficult part was connecting these measures without confusing protection of the system with protection of every bank owner. [S1-S4]

Abstract

Sweden's banking crisis forced authorities to distinguish financial stability from protecting bank owners. A guarantee supported creditor confidence, while public capital, loss recognition and restructuring addressed damaged balance sheets. Asset management companies separated troubled loans from continuing bank operations, but moving assets did not make their losses disappear. Official participant accounts describe conditional support, valuation work and private recapitalization alongside state intervention. The banking system returned to aggregate profit in 1994, and the guarantee ended in July 1996. These milestones do not establish that every bank recovered or that society escaped recession costs. Fiscal assessments also differ with timing, scope and treatment of recoveries; gross support cannot be called the final taxpayer loss. Sweden's experience offers Sri Lanka conditional questions about credible funding, legal powers, ownership consequences and transparent accounting. It does not justify an unlimited guarantee without fiscal capacity or a bad bank without valuation, governance and recovery expertise.

Reader's question

If public money supports a bank, what does the public receive in return? Sweden suggests asking about ownership, loss allocation, reporting and an exit path before celebrating a rescue. This is a historical design question, not a claim that a named Sri Lankan bank requires support today.

1. A property boom became a funding problem

Andersson and Viotti's account describes financial deregulation during the 1980s alongside strong demand for credit, tax incentives favoring borrowing and rapid real-estate investment. Banks competed for business without adequate credit-assessment and risk-management systems. The authors also identify weaknesses in supervisory capacity. Their explanation concerns a combination of incentives and institutions, not proof that liberalization alone inevitably causes a crisis. [S1]

Bo Lundgren's March 2009 testimony describes the property downturn beginning in 1990, heavy bank loan losses and recession. He was responsible for financial-sector policy during the crisis, so this is an informed participant account with a stake in how the response is judged. It records the authorities' reasoning, not an independent causal evaluation of every intervention. [S2]

Foreign-currency funding made the problem more urgent. Lundgren describes a general loss of access to such funding in September 1992. The BIS-hosted account also explains how borrowers' foreign-currency debts and reduced foreign credit lines aggravated the crisis around the collapse of the fixed exchange-rate policy. A bank could face both a shortage of immediately available funds and a shortage of capital against losses. [S1, S2]

Liquidity and solvency are different questions

Liquidity support helps an institution meet payments when funding is unavailable. Capital absorbs losses and supports continued operations. A guarantee can improve confidence in claims on a bank, but does not by itself establish the value of its loans or replace missing capital. These distinctions explain why Sweden's response involved several instruments rather than one announcement. [S1, S2, S3]

The choices were uncomfortable

One approach was to address banks separately and hope earnings and economic recovery would repair losses. Another was broad public protection without a sufficiently clear account of asset values or ownership consequences. Sweden moved toward system-wide reassurance while assessing banks individually. This description of the choice follows the participant accounts; it does not imply that the eventual package was costless or the only possible response. [S1, S2]

Judgment: in a systemic crisis, speed and discrimination must work together. Authorities may need to reassure creditors quickly while still distinguishing a temporary funding problem, a viable bank needing capital and an institution that cannot become viable.

2. A guarantee with an ownership boundary

In September 1992, the Swedish government announced a broad guarantee supporting bank liabilities. Lundgren describes it as covering creditors and depositors while excluding risk capital, including share capital and perpetual subordinated loans. The principle was that shareholder capital should absorb credit losses and write-downs first. The original guarantee should therefore not be summarized as protection for every claim of every kind. [S2]

The same testimony describes cooperation with the main opposition party and subsequent substantial parliamentary support. Political agreement mattered because a promise to creditors depended on confidence that the state would sustain its commitment. This is a participant explanation of credibility, not an independently estimated reduction in funding costs. [S2]

Guarantee, cash and capital are not synonyms

The public undertaking helped the central bank provide liquidity, including foreign currency. Separately, support could take the form of loans, guarantees or capital injections. Lundgren says the authorities chose an open-ended financial authorization rather than a predetermined ceiling that might undermine confidence if exhausted. That is a historical policy choice with contingent fiscal exposure, not advice that another government should issue an unlimited promise. [S2]

Creditor reassurance. A guarantee concerns whether protected liabilities will be honored. Its value depends on the credibility and capacity of the guarantor.

Loss allocation. An assessment of bad loans concerns who has already lost value and how much capital is needed. Public capital can change ownership and control.

Recovery. Managing impaired assets concerns what can be collected over time. A later recovery reduces some fiscal exposure but cannot retrospectively erase the disruption to households and firms.

These are analytical distinctions drawn from the support and recovery processes described in the official accounts. They are not three separate measures of the same cost. [S1-S3]

The moral-hazard trade-off remained

Lundgren explicitly recognizes that broad creditor protection can weaken incentives to monitor risk. Conditional support and consequences for owners were intended to counter that problem. They did not make it disappear. Judgment: a crisis response should state both what it protects and what it leaves at risk, then make that boundary operational through law, supervision and ownership terms.

3. Find the losses before filling the hole

Lundgren describes a choice between deferring reported losses and valuing loans and collateral openly. The authorities chose extensive valuation work and created a separate valuation board to check property-collateral assessments. His account also acknowledges a difficulty: distressed prices can make valuations uncertain. Transparency requires methods and challenge, not pretending every valuation is precise. [S2]

The Bank Support Authority became operational in May 1993, with preparatory work previously handled within the Finance Ministry. Lundgren describes classifying banks by whether they could meet capital requirements, might temporarily fall below them but recover, or were unlikely to become profitable in the long term. The institution and the guarantee were different steps in the response, not one simultaneous act. [S2, S4]

Support had to change incentives

The participant accounts describe public capital carrying corresponding ownership consequences. This did not mean every private bank was nationalized. Lundgren records SEB and Swedbank turning to private capital and withdrawing support applications as conditions improved; a guarantee for Föreningsbanken was not drawn. Gota was nationalized and Nordbanken restructured. Specific bank histories should not be flattened into a single outcome for all institutions. [S2]

Stefan Ingves's IMF-published chapter explains the principle: owners unwilling to recapitalize a failed bank should not automatically receive the upside created by state support. Loans, equity and guarantees offer different cash-flow, risk and recovery characteristics. A lender generally receives agreed interest; an equity owner can participate in a recovery of the bank's value. [S3]

A bad bank is a management assignment

Securum and Retriva were created to handle troubled assets associated with Nordbanken and Gota. Separating those assets allowed continuing bank management to focus on ordinary operations and specialists to work on recoveries. But the entities needed capital, expertise and sale strategies. Transferring an impaired loan does not make its economic loss vanish. [S2, S3]

The Swedish arrangement also matters for transferability. Lundgren notes common public ownership of the relevant bank and asset-management vehicle, which reduced the importance of transfer pricing as a dispute between different owners. That does not imply valuation is unimportant, or that buying assets from independent private sellers at an arbitrary price would protect the public. [S2]

Judgment: define the recovery mandate, funding, control and reporting before announcing an asset vehicle. A new name on the same impaired claim is not a resolution strategy.

4. What the dated outcomes show

1994: aggregate bank profitability. The BIS-hosted account says the banking system as a whole showed a profit in 1994 and reports no further Bank Support Authority commitments after 1993. The Yale case study also records a return to modest sector profits in 1994. These are system-level financial milestones, not proof that every bank, borrower or worker had recovered. [S1, S4]

1 July 1996: exceptional guarantee ended. Lundgren reports that the blanket guarantee and special legislation were abolished on this date. Ending an exceptional instrument is a different milestone from selling all public shareholdings or recovering every fiscal outlay. [S2]

By 1997: asset workout substantially concluded in the participant account. Lundgren says the Securum and Retriva operations wound up sooner than initially expected. The Yale retrospective describes sales concentrated in 1995-96 and continuing public bank ownership beyond the crisis period. These descriptions concern different assets and institutional stages; a short asset-workout timetable should not become a claim that all state ownership ended in 1997. [S2, S4]

Keep commitments separate from payments

Andersson and Viotti report total commitments of SEK 88 billion and amounts actually paid of SEK 65 billion. The difference is SEK 23 billion. Paid amounts were 73.9% of reported commitments, calculated as 65 / 88. This ratio describes two figures in that account. It is not a recovery rate, an estimate of avoided losses or proof that the remaining commitments were all identical unused guarantees. [S1]

Lundgren also reports SEK 65 billion paid in bank support, equivalent in his account to a little more than 4% of GDP at the time. Jonung's February 2009 paper reports an initial gross fiscal cost of 3.6% of GDP using a cited crisis database. These ratios should not be silently merged: definitions, sources and denominators differ. The case retains the reported kronor amounts without pretending the percentage measures are identical. [S2, S5]

Bank repair is not the whole recovery

The sources describe recession, financial disruption and later macroeconomic improvement. Jonung emphasizes the wider policy setting, including exchange-rate and interest-rate changes. The case does not assign the return to growth to bank restructuring alone, and does not use an uncertain annual growth turning point as its main outcome. [S1, S5, S6]

5. Why "the rescue cost nothing" is the wrong conclusion

A gross support amount records resources committed or paid before later recoveries. A net fiscal assessment deducts specified receipts and may value remaining public assets. It depends on the accounting boundary, valuation date and treatment of financing costs. Neither is automatically the social cost of the crisis, which can include lost output, employment and disrupted credit. [S1-S6]

Lundgren's 2009 testimony says support expenditure had almost entirely been recovered when asset-management results, partial bank privatization and the value of remaining shares were considered together. A retained shareholding is not cash already received. His account is a retrospective participant assessment, not a final independent audit that proves the crisis was free. [S2]

Jonung's 2009 papers similarly offer favorable long-run fiscal assessments. The Yale 2021 case study, by contrast, reports scholarly estimates of net taxpayer costs ranging from 1.5% of 1991 GDP to 2.1% of 1997 GDP, or SEK 35 billion. This case does not average these numbers or choose a preferred result without a common accounting basis. The disagreement is material and remains visible. [S4-S6]

Later receipts cannot pay yesterday's bill in advance

Judgment: even if recoveries eventually offset much of an intervention, the state must finance support when it is needed and bear uncertainty before recovery. An expectation of future value is not a substitute for available funding, legal authority or credible risk management. This matters especially when the sovereign itself faces financing constraints.

Favorable assessments are not independent replications

The two Jonung papers share an author and related analysis. Lundgren participated directly in the response. The BIS-hosted and IMF-published accounts explain operating choices; the Yale study synthesizes documents and later research. This mix helps inspect the case, but six records do not equal six independent causal tests. [S1-S6]

The counterfactual is unresolved here

It is plausible that credible support and loan-loss recognition helped stabilize banks. The sources support that mechanism and the dated milestones. They do not provide a single isolated estimate of how much recession, credit contraction or taxpayer loss would have occurred under every alternative. This case therefore rejects both "bailouts always work" and "any public support only rewards owners."

The useful question is narrower: were the right functions protected, were losses recognized, did support change ownership and incentives, and was recovery managed with a clear account of risk and cost?

6. Conditional lessons for Sri Lanka

Separate the diagnosis from the instrument. Judgment: determine whether the problem is liquidity, solvency, impaired assets, governance or several together. A guarantee, central-bank loan, capital injection and recovery vehicle do different work. Current bank-level evidence is required before choosing among them.

Check the sovereign before making its promise. Judgment: a guarantee depends on credible public capacity. Assess contingent exposure, currency needs, funding sources and the effect on sovereign risk. Sweden's open-ended authorization is not a template for a country with different fiscal and external constraints.

Recognize losses with a defensible method. Judgment: use clear valuation rules, independent challenge and disclosure appropriate to financial stability and legal duties. Avoid both concealment and false precision. Show sensitivities where collateral values or recoveries are uncertain.

Link public capital to public rights. Judgment: specify ownership, control, risk sharing and any eventual sale process. Protecting depositors or payments need not mean preserving every shareholder's position. The legal treatment of each claim must be established locally rather than inferred from a foreign precedent.

Give asset recovery an operating plan. Judgment: define the assets, transfer pricing, staffing, funding, sale options, conflicts rules and reporting. A public vehicle should not be a warehouse for losses that nobody measures or manages. Common ownership in Sweden limits direct comparisons with purchases from private banks.

Report more than one cost. Judgment: publish commitments, disbursements, recoveries, residual exposures and asset valuations separately, with dates and units. Explain financing costs and the accounting boundary. Do not substitute a favorable long-run fiscal number for the experience of borrowers and workers during a crisis.

Where the comparison stops

This case supplies no current assessment of Sri Lankan banks, no recommendation to guarantee a particular liability, and no estimate of a Sri Lankan recapitalization bill. Fiscal capacity, sovereign-bank links, foreign-currency funding, law and administrative capacity must be examined on their own evidence.

Decision. Protect essential financial functions while making losses, control and public risk visible. Sweden's transferable discipline is not "nationalize everything" or "create a bad bank." It is to connect reassurance with credible diagnosis, conditional support, capable recovery and an exit that can be checked.

Sources, calculations and limits

Evidence inspected 14 October 2026 for the 15 October case. Historical accounts are not current banking advice. Independent MacroLens desk research, not affiliated with Harvard Business School; not peer reviewed.

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S4. Natalie Leonard, Journal of Financial Crises, 2021. Sweden 1991 Bank Support Authority, volume 3, issue 3, pages 650-663. Yale retrospective case study. Corroborates institutional timing and 1994 profit; preserves different published net-cost estimates and the longer ownership timeline.
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S6. Lars Jonung, ADBI Working Paper 165, November 2009. Wider account of financial liberalization, crisis, recovery and macroeconomic policy. Related to S5, not an independent replication; assessments are the author's, not an institutional causal finding.
https://www.adb.org/sites/default/files/publication/156020/adbi-wp165.pdf

Calculation. SEK 88bn - SEK 65bn = SEK 23bn; 65 / 88 x 100 = 73.9%. Compares reported payments with commitments, not recovery or final loss. No exchange-rate conversion, common-basis reconciliation of net-cost estimates, counterfactual welfare estimate or Sri Lankan bank diagnosis is supplied.