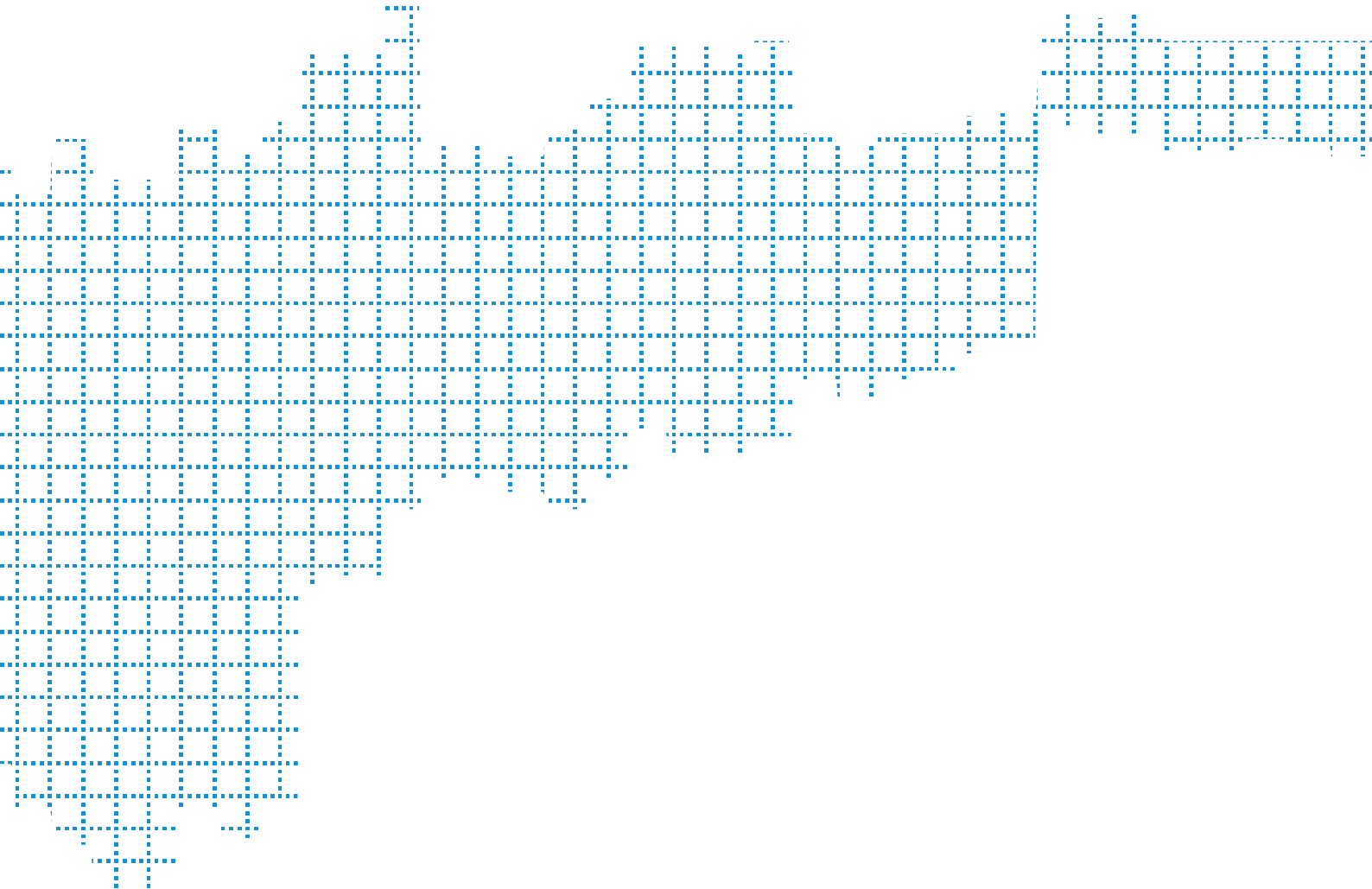




NORWEGIAN MINISTRY OF FINANCE

Meld. St. 21 (2013–2014) Report to the Storting (white paper)

Financial Markets Report 2013



Contents

1	Introduction	5	3.3.3	Paid-up policies with an investment option	46
2	The financial industry and the financial stability outlook	6	3.3.4	Step-up to new mortality rate schedules	46
2.1	Introduction and summary	6	3.4	Securities markets	47
2.2	Overview of the financial industry	6	3.4.1	Benchmark rates	47
2.2.1	Economic role and structure	6	3.4.2	Savings and investment products	48
2.2.2	Government regulation	10	3.5	Measures to enhance financial market competition	48
2.3	The macroeconomic situation	12	3.6	Consumer protection	50
2.4	Credit institutions	13	3.6.1	Consumer considerations in financial market regulation	50
2.4.1	Risk factors	13	3.6.2	Access to information	50
2.4.2	Solvency and earnings	17	3.6.3	New EU provisions on payment services	51
2.5	Insurance and pensions	20	3.6.4	The Norwegian Financial Services Complaints Board and dispute resolution	51
2.5.1	Risk factors	20	3.6.5	Investment advice	53
2.5.2	Solvency and earnings	21	3.7	Ownership limits	53
2.6	Investment firms	22	3.8	Outsourcing	54
2.7	Operational risk in financial undertakings	22	3.9	Financial reporting	55
2.8	Competition in the banking industry	24	3.9.1	Accounting	55
2.8.1	Historical background	24	3.9.2	Auditing	55
2.8.2	The retail customer market	28	3.10	The new EU supervisory system	55
2.8.3	The corporate market	30			
3	Financial market regulatory developments	32	4	Regulatory amendments and licences in major financial market matters	57
3.1	Introduction	32	4.1	Regulatory developments	57
3.2	Credit institutions	32	4.1.1	Banking	57
3.2.1	Capital requirements	32	4.1.2	Insurance and pensions	58
3.2.2	Liquidity coverage and funding structure requirements	37	4.1.3	Securities trading and securities funds	58
3.2.3	Nordic cooperation	38	4.1.4	Estate agency	58
3.2.4	The deposit guarantee scheme	39	4.1.5	Accounting, auditing and bookkeeping	59
3.2.5	Crisis management	41	4.1.6	Miscellaneous	60
3.2.6	EU banking union	42	4.1.7	Enacted regulations	60
3.2.7	Guidelines for prudent lending practices	42	4.2	Administrative licences	61
3.3	Insurance and pensions	44			
3.3.1	New solvency rules (Solvency II and Omnibus II)	44			
3.3.2	Private occupational pension schemes	45			

Financial Markets Report 2013

Meld. St. 21 (2013–2014) Report to the Storting (white paper)

*Recommendation of the Ministry of Finance of 25 April 2014,
approved by the Council of State on the same day.
(Government Solberg)*

1 Introduction

Every year, the Ministry of Finance submits a report to the Storting on developments in Norwegian and international financial markets. This year, parts of the report are made available in English.

Chapter 2 addresses the financial industry and the financial stability outlook in Norway. The chapter discusses, *inter alia*, the macroeconomic situation, financial market conditions, risk developments for financial institutions, as well as the solvency and earnings of such institutions. It also

includes an analysis of the competition situation in the Norwegian banking market.

Chapter 3 provides an overview of certain key financial market regulation initiatives.

Chapter 4 addresses the main aspects of the regulatory amendments implemented in Norway, as well as the most important financial market licensing cases dealt with by the Ministry of Finance and Finanstilsynet (the Norwegian financial supervisory authority) in 2013.

2 The financial industry and the financial stability outlook

2.1 Introduction and summary

Financial stability is conditional upon the financial system being sufficiently robust to accept deposits and other repayable funds from the public, arrange funding, make payments and reallocate risk in a satisfactory manner. An important prerequisite for this is that banks and other financial institutions are strong and function as intended.

This chapter addresses the structure of the Norwegian financial industry, the financial stability outlook and competition conditions in the Norwegian banking industry. The initial sections provide an overview of the Norwegian financial industry, the work being done in terms of safeguarding financial stability in Norway and the macroeconomic situation. The financial stability outlook is examined in separate sections on credit institutions, insurance, pensions and investment firms. These sections provide overviews and assessments of market conditions, risk developments, as well as the solvency and earnings of institutions. Moreover, the chapter includes a separate discussion of operational risk in financial undertakings. Finally, it provides a review of competition conditions in the Norwegian banking industry.

Much of the background information and data for this chapter have been obtained from Norges Bank and Finanstilsynet.

2.2 Overview of the financial industry

2.2.1 Economic role and structure

The financial system performs payments and facilitates the reallocation of risk by corporations and households. The financial market enables smoothing of consumption over time, purchasing of homes, funding of business ventures, investment of savings, insuring against disability and property damage, as well as saving for retirement pension. A well-functioning financial market promotes security and economic growth.

Total household debt in 2013 was approximately NOK 2,500 billion, of which 88 pct. was

borrowed from credit institutions. The domestic debt of non-financial corporations was NOK 1,400 billion, of which 80 pct. was borrowed from credit institutions. In addition, corporations use the bond and certificate market to fund their activities. 14 pct. of corporate debt is in the form of bond and certificate debt. The bond and certificate market has become a more important source of funding for non-financial corporations in the last couple of years; see Box 2.1.

The financial sector funds economic activity by providing loans and equity, and it channels and manages large sums on behalf of its customers. Norwegian banks manage approximately NOK 1,900 billion in deposits and borrowings from customers. Life insurers manage approximately NOK 1,000 billion set aside for the funding of future pension benefits.

The financial system comprises financial institutions and other market participants, marketplaces and transaction infrastructure. It is important for all economies that the financial transactions resulting from economic interaction can be executed swiftly, securely and at low cost. One characteristic of the Norwegian financial market is the development of an efficient and well-functioning financial infrastructure to handle such transactions. The abolition of paper-based services and the use of electronic solutions have delivered important efficiency gains. The Financial Markets Report 2012 devoted a separate chapter to the financial infrastructure in Norway.

Financial market undertakings hold licenses based on what type of activities they are engaged in. Credit institutions, i.e. banks, credit undertakings and finance companies, are by far the largest group in terms of total assets, followed by life insurance companies in second place, cf. Figure 2.3 and Table 2.1. The figure illustrates developments in the relationship between the total assets of credit institutions and insurance companies, with the exception of pension funds, and mainland Norway GDP. The financial sector has grown as a portion of the overall Norwegian economy over the period from 1970 to 2013. Growth in the total assets of credit institutions, insurance companies

Box 2.1 Growth in the Norwegian bond and certificate market

At yearend 2013, approximately 14 pct. of the domestic debt of non-financial corporations was borrowed in the bond and certificate market. Bond and certificate debt as a portion of total domestic debt has increased over the last couple of years, but bond debt is nonetheless a smaller portion of total debt than, for example, a decade ago, cf. Figure 2.1A. Banks and other financial institutions account for more than 80 pct. of such debt. Like in many other European countries, financial institutions in Norway have a dominant

position in the market for loans to non-financial corporation. In certain other countries, for example the UK and the US, it is more common to engage in borrowing via the bond and certificate market.

Norwegian non-financial corporations have accumulated more bond and certificate debt over the last two years; see Figure 2.1B. In 2012 and 2013, borrowing in the market accounted for 22 and 42 pct., respectively, of the increase in the domestic debt of corporations.

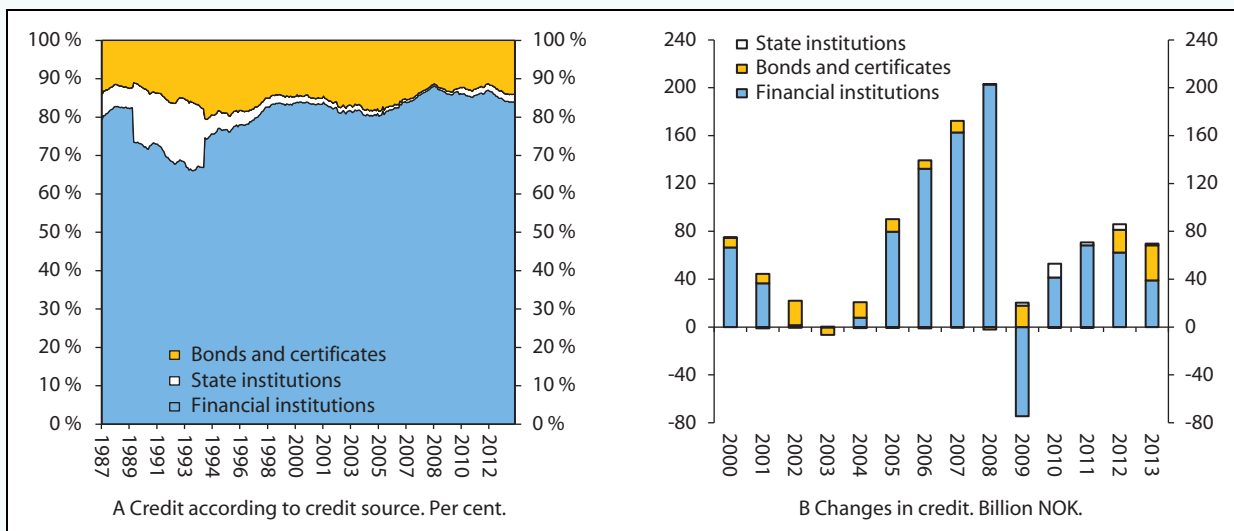


Figure 2.1 Domestic credit (C2) for Norwegian non-financial corporations from different sources of credit¹

¹ Financial institutions, etc., includes credit institutions, insurance companies, pension funds and the statistical grouping «other sources» (primarily lending from Export Credit Norway).

Source: Statistics Norway.

Activity in the Norwegian bond and certificate market is high, especially with regard to corporate bonds in the manufacturing sector, cf. Figure 2.2. In 2012 and 2013, the value of outstanding bonds in this segment increased by 23 and 28 pct., respectively. A number of foreign issuers are also using the Norwegian market, cf. the figure, although the outstanding volume has decreased somewhat in recent years.

Oslo Børs is the largest market in the Nordic region for so-called high-yield bonds, i.e. bonds issued by corporations with non-investment grade credit ratings. Oslo Børs enjoys advantages in other areas as well. It is an internationally important marketplace for, *inter alia*, seafood, energy, petroleum services and shipping.

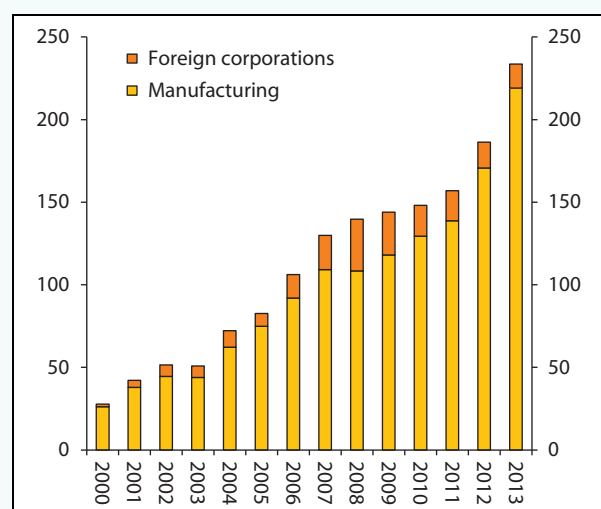


Figure 2.2 Outstanding bonds on Oslo Børs and Oslo ABM. Bonds issued by foreign corporations and Norwegian manufacturing corporations, etc. NOK billion

Source: Oslo Børs.

Table 2.1 The structure of the Norwegian financial market (incl. foreign branches). Number of institutions and total assets (NOK billion) in different sectors. Percent of total assets in different sectors and in total (market share). As at 31 December 2013

	Credit institutions	Securities funds	Non-life insurance	Life insurance	Total
<i>Total assets</i>	5,355	663	210	1,090	7,318
<i>Percent of total assets</i>					
DNB	40	17	1	27	35
SpareBank1/Samarbeidende Sparebanker	15	5	7	3	12
Nordea	11	10	0	7	10
KLP	0.5	15	2	31	6
Storebrand	1	12	1	23	5
Eika group	5	1	2	0	4
Gjensidige	0.5	0	27	1	1
<i>Total financial groups/alliances</i>	73	60	40	92	74
Other companies	27	40	60	8	26
Overall market	100	100	100	100	100
<i>of which foreign branches</i>	14		29	0.3	11
<i>of which foreign-owned subsidiaries</i>	14		0.4	1	10

Total assets of branches and subsidiaries abroad are included for credit institutions.

Source: Finanstilsynet and the Norwegian Fund and Asset Management Association.

and other financial institutions has outpaced GDP growth, apart from in the early 1990s and for the last couple of years. At yearend 2013, the total assets of these institutions were equivalent to 320 pct. of GDP. The Norwegian financial sector is not particularly large as a portion of GDP in international terms.

At yearend 2013, the Norwegian credit market comprised 220 credit institutions. These institutions included 124 Norwegian¹ banks and 54 credit undertakings (mortgage companies and finance companies). In addition, there were 42 branches of foreign credit institutions in Norway. Mortgage companies primarily provide mortgages to fund housing purchases and commercial activities, whilst finance companies primarily engage in financial leasing, car purchase financing, card-based lending and other consumer credit. These credit institutions held total assets of approximately NOK 5,355 billion.

There are 30 securities fund management companies in the Norwegian market. These include both institutions holding Norwegian licenses and foreign branches operating in Norway. These hold total assets of about NOK 663 billion. This is approximately NOK 100 billion more than in 2012.

114 undertakings are engaged in insurance activities in the Norwegian market (institutions holding Norwegian licenses and foreign branches operating in Norway). 95 of these are engaged in non-life insurance. Foreign branches account for a relatively large proportion of non-life insurance providers. Foreign branches accounted for approximately 29 pct. of total non-life insurance activity, measured by total assets.

At yearend 2013, there were 19 life insurance companies in the Norwegian market; 2 less than the previous year. These 19 companies include 10 Norwegian-owned and 2 foreign-owned companies, with the remainder being small branches of foreign undertakings. Life insurance companies held total assets of approximately NOK 1,090 billion. There are 84 pension funds in the Norwegian

¹ This encompasses Norwegian-owned institutions and the Norwegian subsidiaries of foreign-owned institutions.

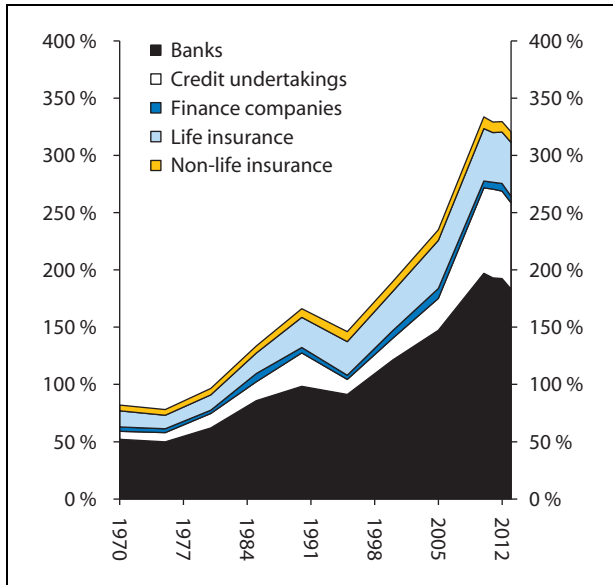


Figure 2.3 Basic value of gross product. Finance and insurance activities as a portion of total economic activity and mainland Norway economic activity. Percent

Basic value is the value accruing to the producer of a product after the payment of value added tax and other product taxes and the receipt of any public product subsidies.
Source: Statistics Norway.

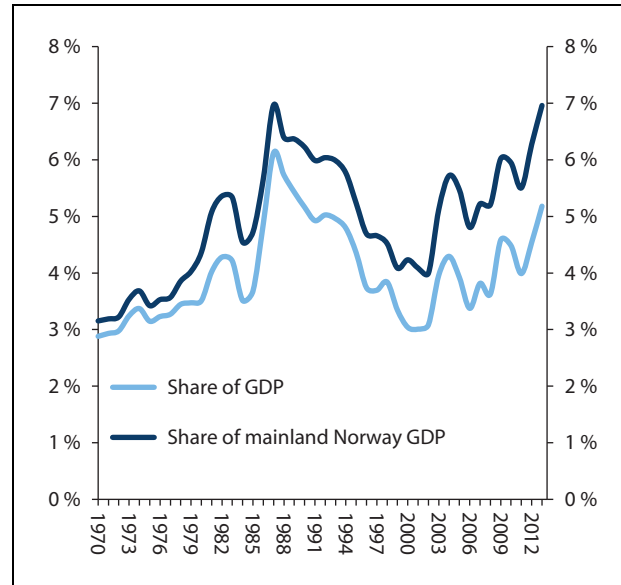


Figure 2.5 Basic value of gross product. Finance and insurance activities as a portion of all industries and of mainland Norway. Percent

Source: Statistics Norway.

market. These hold total assets of approximately NOK 220 billion.

Besides, the financial sector features marketplaces that help to channel capital into various commercial activities. One company in Norway is

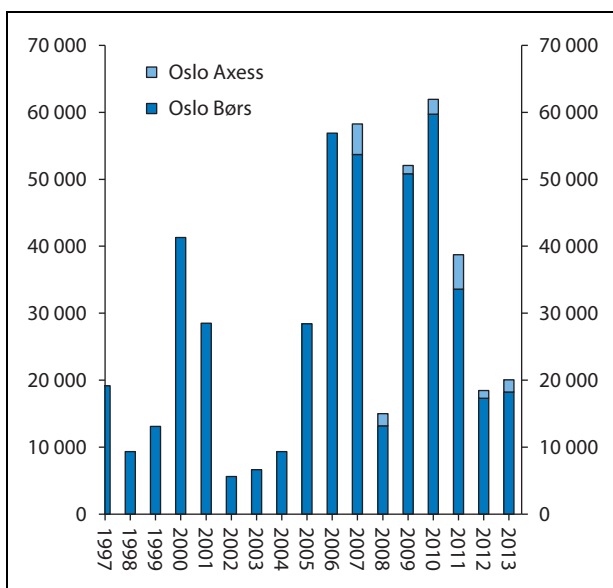


Figure 2.4 Equity issues. Oslo Børs. NOK million.
Source: Oslo Børs.

licensed to operate as a securities exchange. In 2013, the Oslo Børs traded equity instruments valued at more than NOK 800 billion. Equity issues, i.e. the raising of new equity, accounted for approximately NOK 18 billion, cf. Figure 2.4. In addition, new bond loans amounted to about NOK 160 billion.

Oslo Børs largely mirrors the Norwegian economy. Norway is, *inter alia*, one of the world’s largest fish and seafood exporters. This is reflected on Oslo Børs, which is the world’s largest financial marketplace for the seafood sector. Norway is the world’s third largest gas exporter and fifth largest oil exporter. Oslo Børs has the second largest number of listed energy companies in Europe and the second largest number of listed oil services companies in the world. Companies included in the energy index; *OSLO Energy Index*, account for about half of the market value of the Oslo Børs and *Oslo Axess*. Norway is also a shipping nation. This is reflected in Oslo Børs being the exchange in Europe with the largest number of listed shipping companies. Worldwide, only the New York Stock Exchange has a larger number.

Overall, the financial industry makes a major contribution to value added in the Norwegian economy. Figure 2.5 illustrates developments in the gross product of the finance and insurance industries as a portion of the gross product of all industries, and of mainland Norway, respectively.

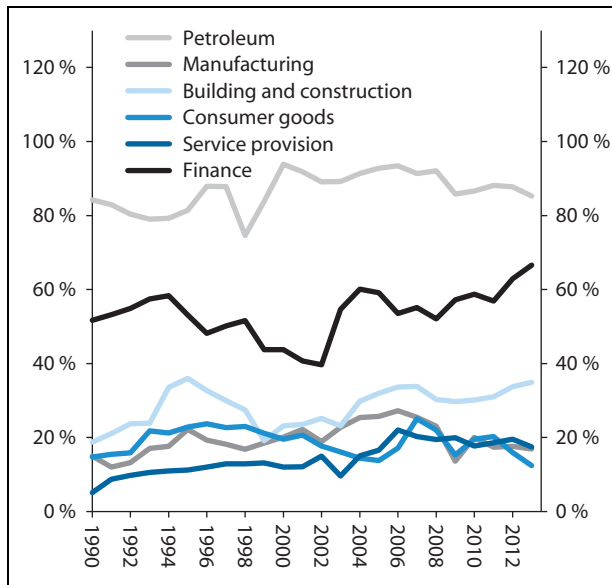


Figure 2.6 Operating profits as a portion of factor income in selected industries

Source: Statistics Norway.

Gross product is a representation of value added, and is defined as production less inputs.

The figure shows that gross product in the financial industry, as a portion of gross product in the Norwegian economy, grew significantly following the deregulation of the financial industry in the 1970s and 1980s, until the banking crisis in the late 1980s and early 1990s. After a decline in the wake of the banking crisis, relative gross product has rebounded since the turn of the millennium.

Value added (factor income) in a sector accrues to the owners of the factors of production, in the form of wage income for the owners of manpower, profits for the owners of real assets, land rent or resource rent for the owners of land and other resources, or taxes for the public sector.

In 2013, bank and insurance employment amounted to about 54,000 man-years, with wage costs of approximately NOK 45 billion. Credit institutions, insurance companies and pension funds registered total operating profits of NOK 89 billion. Wage costs may be considered the remuneration of manpower, whilst profits may be considered the remuneration of capital and natural resource inputs. Figure 2.6 illustrates operating profits as a portion of factor income in selected industries. The figure shows that a relatively large part of financial industry factor income accrues to the owners of capital, although it should be recalled that natural resources, etc., shall also be remunerated from operating profits. The figure

reflects, *inter alia*, the capital intensiveness of the financial industry, which results in wages accounting for a relatively small portion of factor income compared to other industries.

2.2.2 Government regulation

2.2.2.1 Safeguarding financial stability

The authorities seek to prevent solvency and liquidity crises in the financial system through statutory and regulatory requirements, as well as through the supervision of financial institutions and financial markets. In Norway, considerable weight has been attached to comprehensive and consistent regulation, involving, *inter alia*, identical regulation of the same type of risk, irrespective of where it is located, thus preventing risk from accumulating where it is subject to the least regulation. This principle has underpinned Norwegian financial markets regulation for many years. It is also a prerequisite for financial stability, and an important objective in itself, to have good consumer protection in the financial market.

Responsibility for the safeguarding of financial stability in Norway is shared between the Ministry of Finance, Norges Bank and Finanstilsynet. The Ministry of Finance has overarching responsibility for ensuring that the financial system functions well. Norges Bank and Finanstilsynet are charged with promoting the robustness and efficiency of the financial system, and therefore with monitoring financial institutions, securities markets and payment systems to identify stability threats. Moreover, Finanstilsynet supervises financial institutions and marketplaces. Norges Bank is the lender of last resort.

In 2006, so-called tripartite meetings were established between the Ministry of Finance, Norges Bank and Finanstilsynet. At these tripartite meetings, information is exchanged about, *inter alia*, Norwegian and international economic developments and the state of the financial markets. These meetings are held every six months, and more frequently when needed. Two such tripartite meetings were held in 2013, whilst one has been held thus far in 2014.

2.2.2.2 Direct and indirect taxes

The Government will use the tax system to fund communal goods, ensure social mobility, achieve more efficient resource utilisation and improve conditions for Norwegian businesses. The tax system influences labour supply, consumption, sav-

ings and investments. It is therefore important for the tax system to be designed on the basis that society's resources shall be utilised in the best possible manner. These general considerations also apply to financial sector taxation.

Corporate taxation emphasises equal treatment of different investments, forms of funding and organisational structures, as well as symmetric treatment of income (gains) and expenses (losses). Financial institutions are in most respects subject to the same tax rules as other corporations. Interest income is taxed as ordinary income, whilst interest costs are fully deductible on the part of financial institutions. Profits are taxed at a fixed rate of 27 pct., as for other corporations. However, there are special rules on the loan loss provisions of banks and the fund assets of life insurance companies.

Personal taxation includes a number of instances of particularly favourable treatment of certain financial products. One example is the home investment savings scheme for people below the age of 34 years (BSU), which offers tax deductibility up to a specific limit for savings intended for housing purposes. Another example is pension savings. Employers are required, on certain conditions, to provide a retirement pension scheme for their employees; so-called mandatory occupational pension (OTP). Pension savings under such occupational pension schemes are treated more favourably than other savings. Under occupational pension schemes, contributions (premiums) are deductible on the part of the employer, although these are exempted from wage taxation on the part of the employee. The realised, current return on the pension assets is not taxed, and no wealth tax is levied on such assets. Payments from the scheme are taxable as pension income. The combination of mandatory occupational pension (OTP) and the favourable tax treatment has resulted in a large portion of the total assets of life insurers being linked to such occupational pension schemes. Private individuals may also save through tax-stimulated individual pension schemes (IPS).

It is especially in one respect that the tax rules applicable to the financial industry differ from the general tax rules. Financial services are, as a main rule, excluded from the value added tax system. Value added tax is a general tax on the domestic consumption of goods and services, the purpose of which is to raise revenues for the State. Value added tax is collected and transferred to the tax authorities by VATable businesses. The financial service exemption implies that users do not pay

value added tax, but also that financial institutions cannot deduct the value added tax on goods and services purchased by themselves. The background to the exemption is that part of the value added of financial institutions originates from margin-based services, including interest rate margins. It is not possible to tax margins by way of an ordinary value added tax, and this is one of the reasons why one has chosen to make an exemption for financial services. Financial institutions pay some value added tax since they are unable to deduct input VAT, and because they have some turnover of VATable services. Rough estimates nonetheless indicate a shortfall of about NOK 8 billion compared to a situation in which all value added from financial services would be taxed at 25 pct. (except life insurance).

A number of countries levy special direct or indirect taxes on the financial industry. These are partly intended to raise revenues for government, partly to fund any future emergency measures through special reserves, and partly to supplement traditional financial markets regulation, for example by reducing the incentive to assume high risk. Norway has not introduced special direct or indirect taxes for the financial industry, with the exception of the levy payable to the Norwegian Banks' Guarantee Fund. In the NOU 2011:1 Green Paper; Better Prepared for Financial Crises, the Norwegian Financial Crisis Commission proposed, *inter alia*, that the authorities should examine the scope for levying a financial stability fee on the financial industry to correct for the financial advantage enjoyed by that industry through the expectation of a government bailout in the event of crisis, and a so-called financial activities tax on profits and wage payments to correct for the non-payment of value added tax by the financial sector.

Some countries have introduced taxes to partly correct for the exemption of financial services from value added tax. France introduced a special tax on wages in exempted sectors, including the financial sector, in 1968. Denmark has since 1990 levied a special tax on wage costs in a number of sectors exempted from value added tax, including the financial sector. The rate is higher for the financial sector than for other sectors. In 2014, it was 11.4 pct. The rate is to be increased every year until reaching 15.3 pct. in 2021. Such extra taxation of wage costs can in principle capture the value added accruing to manpower, whilst the value added extracted in the form of profits is not captured. In 2012, Iceland introduced a financial activities tax for financial

institutions, with the exception of pension funds, which encompasses both wage costs and large profits. In addition to ordinary tax, remuneration for employees is taxed at 5.5 pct., whilst profits in excess of ISK 1 billion are taxed at 6 pct.

Non-life insurance is taxed in many countries. Australia and New Zealand, for example, have ordinary value added tax subject to certain special rules for non-life insurance. Most EU countries levy special taxes on insurance premiums.

Several countries have introduced so-called financial stability fees or bank levies in the wake of the financial crisis. These fees and levies can differ very considerably from country to country in their particulars, but are generally comparable to the levy paid by banks in Norway to the Norwegian Banks' Guarantee Fund. Such fees and levies often use all or part of the total assets of financial institutions as the tax base. Solutions differ with regard to whether the proceeds are channelled to the treasury or into reserves intended to secure deposits and prevent or pay for future crises in the banking sector.

Sweden, Finland and Iceland have all introduced fees or levies on balance sheet items. In Sweden, moreover, it has been announced that banks shall contribute to the funding of government foreign exchange reserve accumulation, since the international funding of banks imposes a risk on the economy in the form of potential foreign exchange reserve depletion. In Norway, part of the levy payable to the Guarantee Fund is calculated on the basis of balance sheet items, and from 1 January 2013 banks have to pay the levy each year. They previously only paid the levy when the Guarantee Fund was underfunded. The Banking Law Commission is currently looking into a revision of the legislation governing our overall deposit guarantee system in view of, *inter alia*, relevant EU regulations; see section 3.2.5 for further details.

2.3 The macroeconomic situation

Five years after the outbreak of the international financial crisis, some countries still have lower economic activity (GDP) than before the crisis. Global economic growth nonetheless rebounded somewhat last autumn, driven, in particular, by developments in traditional industrialised countries. The US would appear to be experiencing a robust revival, and the Euro zone countries are on their way out of the longest period of negative growth in the history of the currency union.

Important measures adopted by European authorities, not least by the European Central Bank, have reduced the risk of another setback.

The last year has seen financial turbulence in several emerging economies. Prospects for higher returns on financial investments in the US and other traditional industrialised countries caused capital outflows from a number of large emerging economies and depreciation of their currencies. Many of these countries have little freedom of action in economic policy. China has not suffered capital outflows like other emerging economies, but Chinese currency has depreciated somewhat and economic growth is lower than before the financial crisis. A setback in China and other emerging economies may have serious implications for the world economy and trigger an oil price reduction.

The Norwegian economy has been performing well for a long time. Employment is high and unemployment is low. Norwegian export goods have experienced steep price growth since the turn of the millennium, whilst some import goods have registered low prices. A high oil price and a large increase in investments on the Norwegian continental shelf have resulted in high capacity utilisation and low unemployment, whilst having at the same time contributed to a bifurcation of the Norwegian economy. Businesses that make large deliveries to the petroleum industry in Norway and abroad have grown, whilst the situation for businesses competing in more traditional export markets is challenging.

A decade of high oil prices and favourable developments in the terms of trade has resulted in wage increases in Norway outpacing those in other countries for a number of years. Many Norwegian businesses have been sheltered by high prices on their products, but developments have not been equally favourable for all industries. Many Norwegian businesses are vulnerable to price reduction or Norwegian kroner appreciation. 2013 registered significant Norwegian kroner depreciation. Norwegian kroner depreciated by more than 10 pct. over the course of 2013, as measured by the trade-weighted index. The Norwegian kroner depreciation has somewhat improved cost competitiveness in Norway, thus contributing to continued high production and employment in the Norwegian economy.

Housing prices have been growing for a number of years; see Box 2.2 below, whilst there has been a large increase in household debt. High debts and predominantly variable interest rate loans mean that even minor interest rate increases

will swiftly result in a reduction in the purchasing power of households.

It is likely that the high level of household debt, together with the high cost level, served to subdue the increase in activity in the mainland economy last year. Although household income growth held up, household consumption growth was clearly weaker in 2013 than in 2012. Increased household awareness of the risks associated with high debts may be a contributing factor. The strong production growth in industries supplying the petroleum sector levelled off somewhat last year. Growth in more traditional export industries still remains low.

The interest rate path in the most recent monetary policy report from Norges Bank in March 2014 assumes that the key policy rate will remain at the current level until the summer of 2015, and thereafter be increased gradually. The Ministry of Finance expected, in its supplementary proposition for 2014, mainland Norway GDP growth of 2.5 percent this year. The levelling off in the Norwegian economy throughout 2013 and thus far in 2014 indicates that mainland Norway GDP growth may be somewhat lower than this. The Ministry of Finance will submit new estimates in the revised National Budget in May.

2.4 Credit institutions

2.4.1 Risk factors

Banking involves, *inter alia*, the funding of long-term, illiquid lending and other long-term, illiquid assets by liquid deposits. Differences in the maturity structure of assets and liabilities give rise to a risk that a bank will be unable to refinance assets when needed. The risk that a bank is unable to meet liabilities upon maturity despite being solvent, i.e. the value of its assets exceeding the value of its liabilities, is called *liquidity risk*.

Banks that fund lending by liquid deposits are faced with a liquidity risk, which comes down to the risk that an unusually large number of depositors may request payment of their deposited amounts at the same time. As long as depositors act independently of each other, one can keep fairly good track of such risk and hold sufficient liquid assets to handle said risk. Disquiet amongst depositors may be difficult to handle for one single bank, but the deposit guarantee scheme serves to reduce the risk that disquiet arises.

Borrowing in the capital market has become an important part of the funding of Norwegian banks and other credit institutions over the last

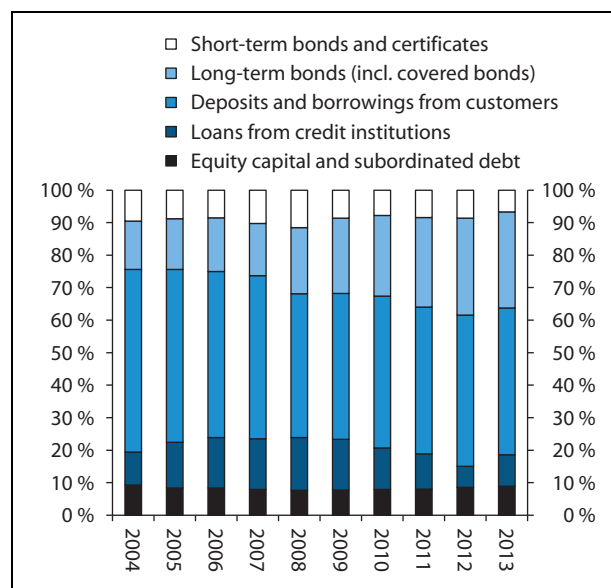


Figure 2.7 Composition of the funding of banks and mortgage companies. Percent of total assets. Percent

Source: Finanstilsynet.

few decades. Market funding means that banks can manage their liquidity risk in a manner not possible with deposits. However, the financial crisis demonstrated that the liquidity risk of a bank may increase swiftly and steeply if these markets become less liquid and the said bank has assumed that new funding will always be available in the market on short notice.

The percentage of short-term market funding on the part of banks and mortgage companies has declined in recent years, cf. Figure 2.7. At the same time, bond loans with a maturity in excess of one year, including covered bonds, have increased significantly as a portion of total funding and now account for about 30 pct. Covered bonds account for the majority hereof. Besides, the maturity of covered bonds and other bond loans has also increased steadily over the years since the financial crisis. Average maturity is currently 6–7 years. These figures suggest that banks are less vulnerable to a decline in access to new market funding. Said figures also suggest that NIBOR and other short-term interest rates are now of less importance to the overall funding costs of banks, cf. the discussion in section 2.8.2.

One of the reasons why covered bonds have emerged as one of the most important sources of funding is that banks have profited from selling off well-secured residential mortgages to mortgage companies that can issue covered bonds, whilst retaining riskier assets on their own bal-

ance sheets. The scope for issuing covered bonds offers more flexibility and access to new funding markets, but this development implies that there will in a crisis be reduced access to secure assets that these institutions can collateralise to secure funding. This may, when taken in isolation, result in less stable access to new market funding.

Banks and mortgage companies issued bond debt in the approximate amount of NOK 440 billion in 2013. This is on a par with the average for the last few years. Covered bonds account for a majority of issuances, most of which are in foreign currency. Foreign currency debt funds lending and other assets denominated in Norwegian kroner, thus giving rise to a not insignificant foreign exchange risk on the part of these institutions. Institutions hedge such risk through foreign exchange swaps in the derivatives market. The need of banks for using the derivatives market to hedge their foreign exchange risk also represents a potential risk that may become evident in case of derivatives market turbulence.

It is important for institutions to manage their liquidity risk well. New requirements to be introduced in accordance with new EU regulations will entail quantitative liquidity risk limitations; see the discussion in Chapter 3. Whilst the liquidity coverage requirement (LCR) shall ensure that institutions have sufficient liquid assets to handle periods of funding market failure, the net stable funding requirement (NSFR) shall ensure that funding is sufficiently stable relative to the maturity of assets. Final formulation of the requirements has yet to be completed, but the reporting suggests that the major Norwegian banks are reasonably well placed for LCR compliance. Small banks generally have lower liquidity coverage than large ones.

Credit institutions are primarily engaged in lending, and hence *credit risk* is normally the most important risk factor for such institutions. Credit risk is closely linked with the ability and willingness of Norwegian households and businesses to pay interest and instalments, and with developments in the value of homes and other mortgaged property.

In recent years, Norwegian credit institutions have, with a few exceptions, been offering credit in a growing domestic market. The credit indicators C2 and C3 are broad measures of the gross debt owed by the public – including, *inter alia*, municipal administrations, non-financial corporations and households – to Norwegian sources of credit and all sources of credit in total, respectively. Whilst twelve-month growth in household

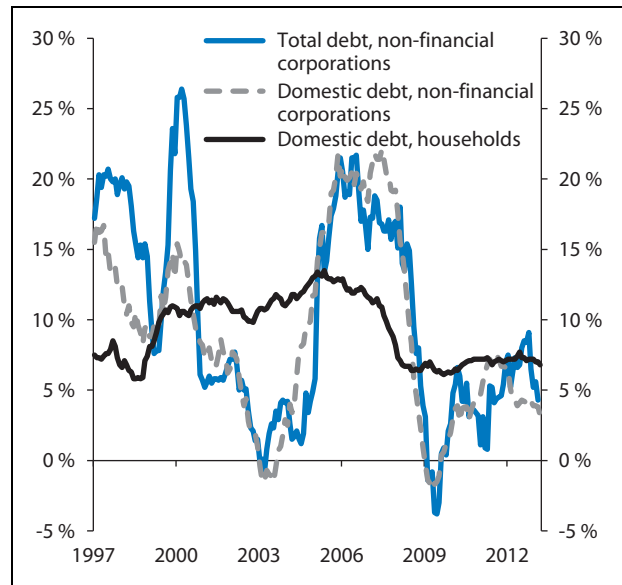


Figure 2.8 Twelve-month growth in domestic credit (C2) and total credit (C3) for households and non-financial corporations, respectively. Percent

Source: Statistics Norway.

credit has remained stable, at just over 10 pct. until the financial crisis and about 7 pct. for the last few years, growth in credit to non-financial corporations has varied by much more; see Figure 2.8. Total growth in credit to corporations has increased quite steadily for the last couple of years, but a change was registered in late 2013; see the figure. A comparison of the C2 and C3 data for corporations shows that the recent reduction in credit growth reflects, in particular, a reduction in the growth of credit from foreign sources.

The debt burden and the interest burden are useful ratios for assessing the ability of households to service debts. The debt burden is debt as a percentage of disposable income, whilst the interest burden is interest expenditure as a percentage of disposable income. Debt growth has outpaced income growth for several years, thus implying that the debt burden has increased. The debt burden is currently about 200 pct.; see Figure 2.9. It is still increasing, but at a lower rate than before the financial crisis. The interest burden is relatively low, at 6 pct., but is sensitive to interest rate changes.

There are significant variations behind the average interest burden and debt burden. There is a risk that many households may find it difficult to cope with a major interest rate increase. Calculations from Norges Bank and Finanstilsynet

show that many households would have to devote a large portion of their income to debt servicing in the event of a major interest rate increase. Norges Bank has, for example, been calculating the impact of an interest rate increase and a housing price decline on the number of households that are especially vulnerable to residential mortgage default, i.e. households with high debts, net debts that exceed the value of their homes, and a buffer of less than one month's income after the payment of interest costs and necessary consumption. This group represented 2.4 pct. of all households in 2011. If the residential mortgage interest rate increases by 3 percentage points and housing prices decline by 30 pct., then 7 pct. of households will belong to this vulnerable group, based on the figures as per yearend 2011.² Finanstilsynet has calculated, based on 2013 figures, how many households would have an interest burden in excess of 20 pct. if the lending rate had been higher. If the rate had been 2 percentage points higher in 2013, 19 pct. of households would have been saddled with an interest burden in excess of 20 pct. In fact, 8 pct. of households had an interest burden in excess of 20 pct. in 2013. If the lending rate had been 5 percentage points higher, more than 30 pct. of households would have been left with an interest burden in excess of 20 pct., which group of households would have accounted for close to half of all household debt.³ The growth in the debt burden means that the interest burden is now significantly higher for a given interest rate level than was the case in 1988.

More than half of credit institution lending is in the form of loans to households, of which about 90 pct. are residential mortgages. Consequently, conditions in the housing market have a major impact on loan demand. In recent years, demand for residential mortgages has increased steeply, whilst credit institutions have experienced good access to funding at a low interest rate. The fact that households have enjoyed good access to loans at a low interest rate may have fuelled the housing price increase, which has then increased the need and demand for loans. One may therefore say that supply has contributed to increasing demand. Correspondingly, one might envisage that a reduction in loan supply might reduce housing price growth, and eventually also reduce demand.

² See Chapter 3 of Norges Bank's report Financial Stability 2013.

³ See Chapter 2 of Finanstilsynet's report Financial Outlook 2014.

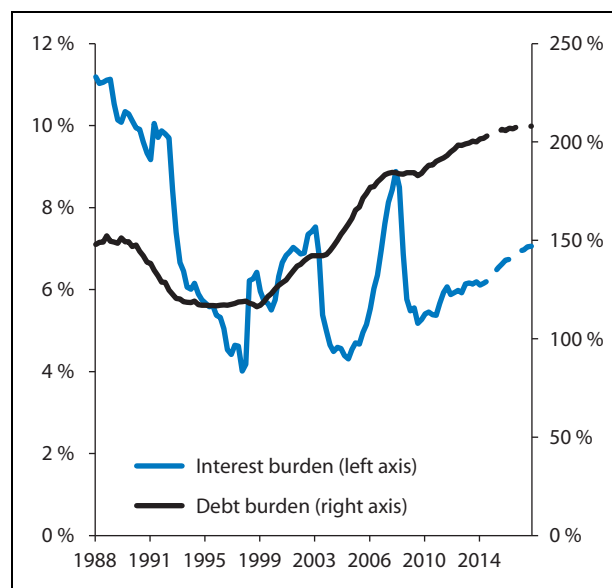


Figure 2.9 Household debt burden (right axis) and interest burden (left axis). Percent

Interest burden is interest expenditure after tax as a percentage of disposable income. Debt burden is gross debt as a percentage of disposable income.

Source: Statistics Norway and the Ministry of Finance.

In 2013, the housing price increase came to a halt, cf. Box 2.2. If housing prices stabilise, it may result in debt growth gradually falling back to a more sustainable level. However, loan demand developments may be completely different. If housing prices fall unexpectedly or the interest rate increases more swiftly than expected, many households may experience an imbalance between assets and liabilities or between income and loan expenditure. Such financial imbalances on the part of households may result in credit institutions incurring higher losses on household loans. History shows that household imbalances may have a significant negative impact on the economy, even when residential mortgage losses are relatively low. This is because many households make entirely rational decisions to restore the balance by making repayments on residential mortgage and cutting back on other expenses, thus reducing overall demand in the economy. Higher savings help to restore the financial balance of individual households, but the outcome may be an increase in financial imbalances on the part of households as a group, for example through a further housing price reduction. It may also be rational for a bank to act in a manner that may deepen a recession. It may for example be rational to tighten lending practices vis-à-vis both businesses and households when the economy is showing signs of recession. However, if many

Box 2.2 Housing market developments

High real wage growth and low real interest rates have, together with a large population increase and, at times, good access to credit, resulted in steep housing price increases over several years. The increase turned into a reduction last year, and at yearend 2013 the price level was somewhat lower than at the beginning of the year. The average price level in 2013 was, nonetheless, 4.6 pct. higher than in 2012. Housing prices were 2.4 pct. higher in 2013 than in 2012 when corrected for retail price growth. The price level is very high, both historically and compared to other countries, cf. Figure 2.10A. Annual real growth in Norwegian housing prices over the period 2010–2012 averaged close to 7 pct.

Housing price growth has been significantly lower when deflated by developments in disposable income and average annual wages, but the housing price level is also historically high when thus measured; cf. Figure 2.10B.

Price developments for the main cities are showing large regional differences. Tromsø has for quite some time been registering the highest twelve-month growth, cf. Figure 2.10C. In February, housing prices in Tromsø were 6.7 percent higher than in the same month last year. Housing prices in Oslo declined by 3.3 pct. over the same period. Kristiansand registered the steepest reduction, with a decline of 6.4 pct.

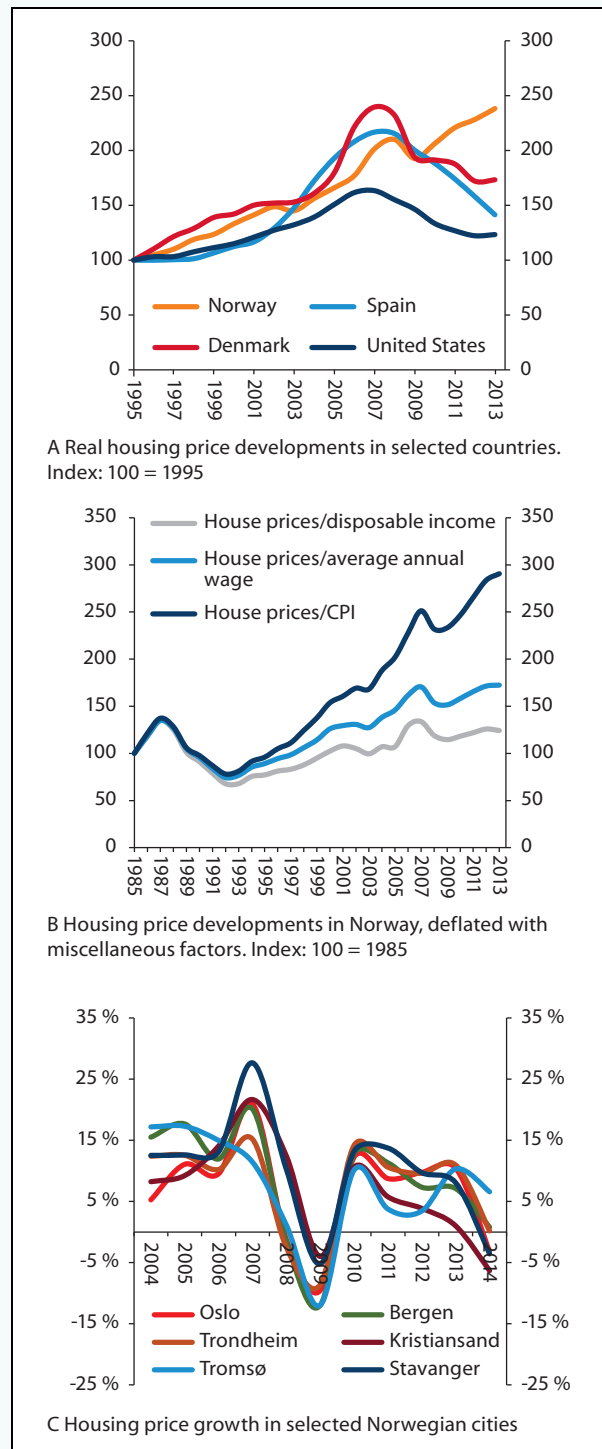


Figure 2.10 Real housing price developments in selected countries (A), housing price developments in Norway, deflated by miscellaneous factors (B) and housing price growth in selected Norwegian cities (C)

Source: Federal Reserve Bank of Dallas, EFF, Finn, Eienomsverdi, Macrobond, Statistics Norway, Norwegian Technical Calculation Committee for Wage Settlements (TBU) and the Ministry of Finance.

banks do so simultaneously, the recession will happen more quickly and become deeper. Consequently, banks that are able to maintain a fairly stable lending practice into a recession may help stabilising the economy.

Moreover, the lending practices of banks during an upturn have an impact of stability in the economy. The risk of mounting financial imbalances on the part of households is especially pronounced during a long period of strong economic expansion, or when interest rates remain low for a long time, thus implying high loan demand for an extended period. If the residential mortgage practices of banks are too lenient during such lengthy periods of high loan demand, large imbalances may arise.

Every year, Finanstilsynet surveys the residential mortgage practices of banks. The most recent survey was conducted in August and September 2013⁴ and shows, *inter alia*, that 23 pct. of new residential mortgages had a loan-to-value ratio, i.e. loan as a percentage of the value of the home, in excess of 85 pct. In comparison, 27 pct. of the loans in the survey from 2012 had a loan-to-value ratio in excess of 85 pct. The proportion of loans with a loan-to-value ratio in excess of 100 pct. declined from 11 to 8 pct. Unsurprisingly, young borrowers are especially likely to apply for loans that a large relative to the value of their home. Moreover, the residential mortgage survey for 2013 shows a significant reduction in both the number of interest-only loans and the duration of interest-only periods. In the 2013 survey, 12 pct. of residential mortgages were interest-only loans, as compared to 25 pct. a couple of years ago. The average interest-only period has been reduced by about one year over the same period of time. The residential mortgage survey is, *inter alia*, used in the follow-up of Finanstilsynet's guidelines on prudent lending practices for residential mortgages; see the discussion in Chapter 3.

Lending to non-financial corporations accounts for about 40 pct. of overall lending by Norwegian credit institutions. A large portion of lending to corporations is in the form of loans to corporations engaged in shipping or commercial property, which industries are especially sensitive to cyclical developments.

Bank loans constitute the main source of funding for Norwegian corporations, but large corporations, in particular, have in recent years raised

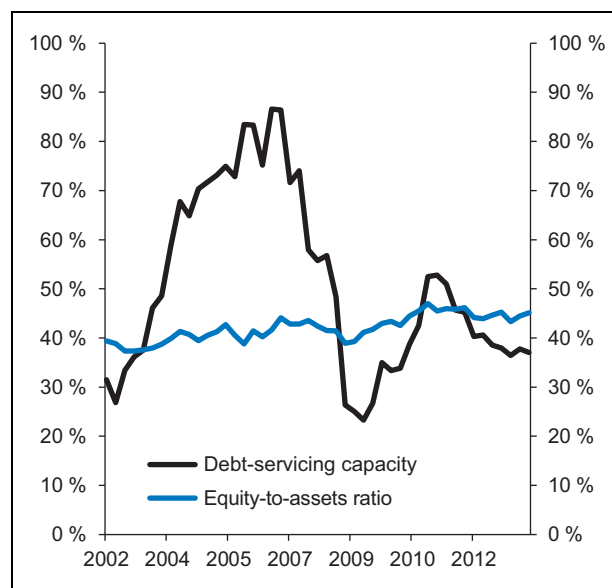


Figure 2.11 Equity-to-assets ratio and debt-servicing capacity of listed corporations. Percent

Source: Norges Bank.

more of their funding in the bond and certificate market.

Levelling off in the Norwegian economy and lower investment activity on the Norwegian continental shelf are resulting in a weaker earnings outlook for Norwegian corporations, cf. section 2.4 over. Levelling off in the Norwegian economy and uncertainty about international cyclical developments may have an impact on supply and demand in major parts of the market for loans to corporations. The debt-servicing capacity of listed corporations has declined somewhat over the last year, cf. Figure 2.11.

2.4.2 Solvency and earnings

The capacity of a bank to absorb loss without depositors and other ordinary creditors incurring any loss is highly dependent on the quantity and quality of the total assets of such bank. The new capital adequacy rules adopted in 2013 stipulate that common equity tier 1 (CET1) capital shall constitute no less than 4.5 pct. of risk-weighted assets. CET1 capital is predominantly equity, and is the type of capital offering the highest capacity to absorb loss. In addition to the minimum requirements, institutions shall have a CET1 capital buffer of no less than 4.5 pct. of risk-weighted assets, thus implying that the sum total of the minimum requirement and the buffer requirement is 9 pct. The new buffer requirements will be gradually increased until 1 July 2016. By that date the

⁴ The 30 largest banks participated in the survey. These account for approximately 88 pct. of all residential mortgages granted by banks.

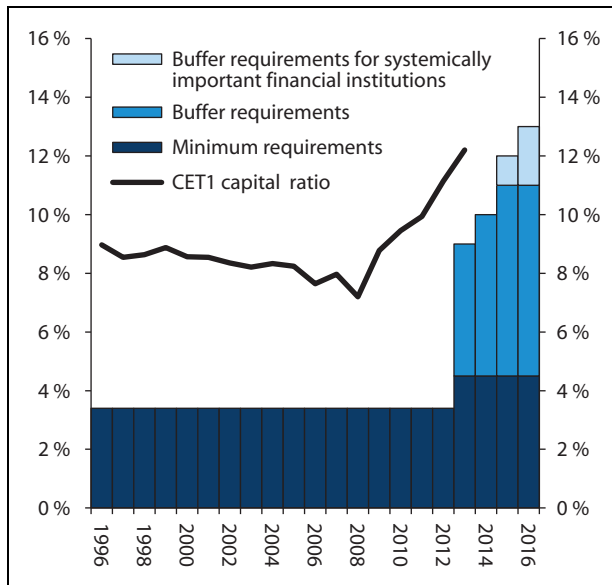


Figure 2.12 CET1 capital as a percentage of risk-weighted assets (CET1 capital ratio) for Norwegian banks and banking groups, as well as CET1 capital ratio minimum requirements and buffer requirements. Percent

Source: Finanstilsynet and the Ministry of Finance.

total CET1 capital requirement will be 11 pct., including a counter-cyclical capital buffer requirement of 1 pct., for banks that are not systemically important, whilst the overall requirement will be 13 pct. for systemically important banks.⁵

All Norwegian banks met the minimum requirement and buffer requirement applicable at yearend 2013. When weighted by bank size, the average CET1 capital ratio was 12.2 pct. at yearend 2013, which is an increase of 1.1 percentage points from the previous year, cf. Figure 2.12.

It is evident from the figure that Norwegian banks have improved their solvency significantly in recent years. For banks as a whole, the CET1 capital ratio has increased steadily by a total of 5 percentage points since 2008. However, if solvency improvement is measured differently, by CET1 capital as a portion of non-risk-weighted total assets, the increase has not been equally large. For banks as a whole, this measure of solvency has increased by about 1.5 percentage points over this five-year period, to a level of 6.5 pct. at yearend 2013. This is not high in a historical perspec-

tive. The difference between the CET1 capital ratio and the non-risk-weighted measure has been increasing for a number of years, and has never been higher than at yearend 2013. The increase in such difference may indicate higher growth in lending that is accorded less weight when calculating risk-weighted assets for capital requirements purposes, for example lending for residential purposes.

Differences between various measures of solvency are also large for many foreign banks. Figure 2.13 shows the robustness of the largest financial groups in the Nordic region based on three different measures of solvency. The difference between the CET1 capital ratio and CET1 capital as a portion of non-risk-weighted total assets is not large for the Norwegian bank DNB ASA when compared to the other groups.

Large financial institutions, including all large Nordic financial groups, often calculate risk weights using internal models (the so-called IRB approach). These models generally result in lower capital requirements for banks than would have applied if they had instead used the so-called standardised approach, under which the risk weights are stipulated in regulations, and this is likely to be part of the motivation for adopting the IRB approach. In order to prevent capital requirements from becoming very low, a transitional arrangement implies that institutions using internal models to calculate capital requirements need to keep above a certain limit as to the minimum risk weight they can attribute to their assets. This is referred to as the Basel I floor, since the lower limit is defined by reference to the former Basel I rules.

If one calculates the CET1 capital ratios of Nordic financial groups on the basis of their own models only, i.e. without the Basel I floor, the difference between the risk-weighted measure and the non-risk-weighted measure of solvency becomes very large as far as many banks are concerned, cf. Figure 2.13. The Swedish bank Handelsbanken, for example, looks very robust when considering that its CET1 capital ratio is 18 pct., but the CET1 capital of the bank represents no more than 4 pct. of its total assets. DNB ASA, on the other hand, may seem the least robust of the Nordic groups, since its CET1 capital ratio without the Basel I floor is the lowest in the sample, whilst DNB ASA has the highest CET1 capital relative to total assets. This topic is also discussed in Chapter 3.

⁵ The overall buffer capital requirement will increase to 5.5 pct. from 1 July 2014 and then to 6.5 pct. from 1 July 2015, including a counter-cyclical capital buffer requirement of 1 pct., cf. Chapter 3. On top of that is added a special capital buffer requirement for systemically important institutions of 1 pct. from 1 July 2015 and 2 pct. from 1 July 2016.

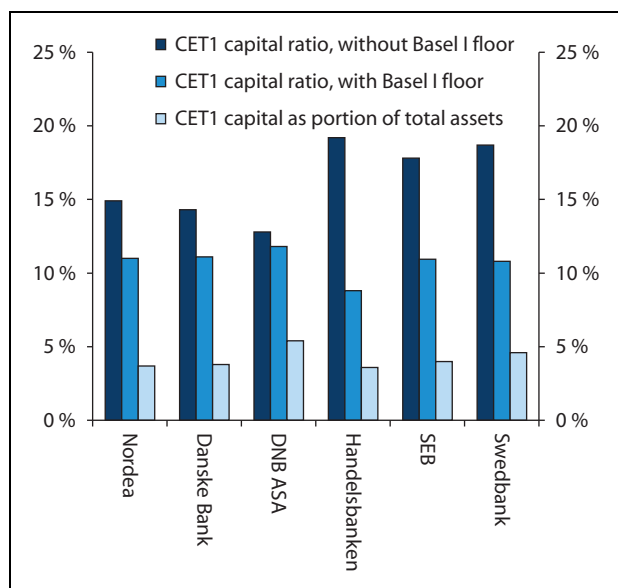


Figure 2.13 CET1 capital ratio with and without Basel I floor and CET1 capital as a portion of total assets (TA) at yearend 2013. Nordic financial groups. Percent

Source: Finanstilsynet.

Over the last five years, the CET1 capital ratios of the six largest banking groups in Norway have primarily been increased through retained profits and equity issues; cf. Figure 2.14. Some of the increase is also caused by a reduction in risk-weighted assets relative to CET1 capital, largely as the result of a reduction in average risk weights.

Norwegian banks registered total profits before tax in excess of NOK 45 billion in 2013; about NOK 8 billion more than the previous year. The improvement in earnings is primarily caused by an increase in net interest income, which is the main source of income for banks. There was a particular increase in the net interest income of banks and mortgage companies from residential mortgages in 2013.

Since banks are selling off lending portfolios to mortgage companies on a large scale, there has been a major increase in loans held by mortgage companies. All in all, about 56 pct. of all Norwegian residential mortgages are now held in residential mortgage companies that issue covered bonds.

In aggregate, the mortgage companies, excluding Eksportfinans ASA, registered significantly higher earnings in 2013 than the previous year, primarily because of higher net interest

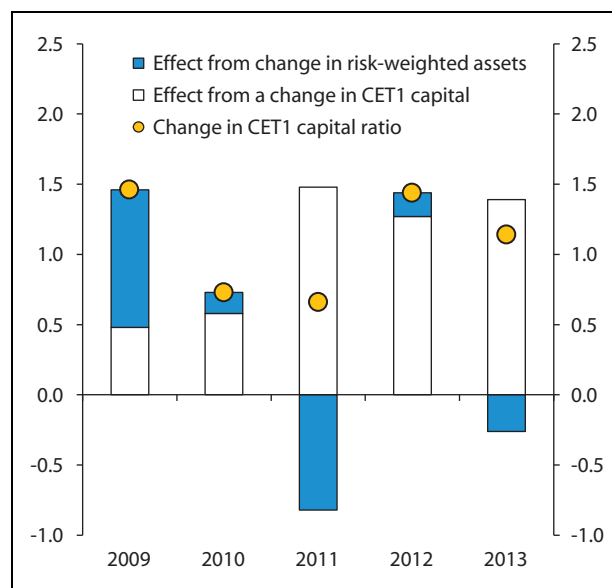


Figure 2.14 CET1 capital ratio changes (decomposed). Percentage points. Weighted average of the six largest banking groups. 2009–2013.

Source: Norges Bank.

income. Profits before tax increased by about NOK 3.5 billion, to NOK 7.3 billion. Most mortgage companies that issue covered bonds are wholly owned by a bank, thus implying that their earnings are included in the earnings of the banks. These mortgage companies increased their CET1 capital ratios from 12.7 pct. to 13.1 pct. in 2013. The remaining mortgage companies that issue covered bonds, which are partially owned by several banks, had a CET1 capital ratio of 10.6 pct. at yearend 2013, which is the same as the previous year.

Finance companies registered profits before tax of about NOK 2.6 billion in 2013. This is somewhat higher than in 2012, and the earnings improvement has to do with an increase in net interest income.

Future developments are subject to uncertainty, and high household debts represent a risk of imbalances. Banks and other credit institutions are now better prepared for turbulence than a few years ago. They have strengthened their solvency, and they have a less risky funding structure. It is important for the institutions to continue to strengthen their solvency and reduce their liquidity risk. Conditions are favourable for this now that earnings are good and markets are well-functioning.

2.5 Insurance and pensions

2.5.1 Risk factors

Life insurers promise insured persons a benefit when a specific event occurs, for example when the insured person becomes disabled or reaches the age at which he or she qualifies for retirement pension. The monetary value of these promises constitutes the most important liabilities of life insurers.

The *insurance risk* of life insurers is largely related to whether more people become disabled, or whether the insured persons live longer than expected on average. Moreover, such risk is related to what type of insurance customers have. With regard to defined-benefit pensions, as opposed to defined-contribution pensions, insurers have for example often undertaken to provide a life-long retirement pension. If customers live longer than assumed when premiums were paid, insurance companies have to cover the shortfall.

Life expectancy is increasing in Norway. The life expectancy assumptions (the mortality basis) applied in recent years; the so-called K2005 basis for group pension schemes, do not take changes in the life expectancy of insured persons into account. Finanstilsynet therefore adopted a new minimum mortality basis requirement one year ago; see the discussion in Chapter 3 and in the Financial Markets Report 2012. The new minimum requirement is intended to ensure that life insurers allocate sufficient capital to accommodate the higher life expectancy.

Transition to the new mortality basis will require insurance companies to increase retirement pension premiums in group pension schemes. The financial allocations for previously accrued retirement pensions will also have to be increased. Companies may use any excess returns from the management of customer funds (returns on the group portfolio in excess of the rate guaranteed to customers) to fund up to 80 pct. of this increase in allocations (reserve building); see section 3.3.4 for further details. Life insurance companies allocated about NOK 8 billion of their excess returns to reserve building in 2013. The remaining reserve building needs are about NOK 19 billion.

The Insurance Activities Act stipulates that customers with group pension products and defined benefits shall each year make prepayment for the management of the pension assets. Insurance companies carry a *market risk*, i.e. they may

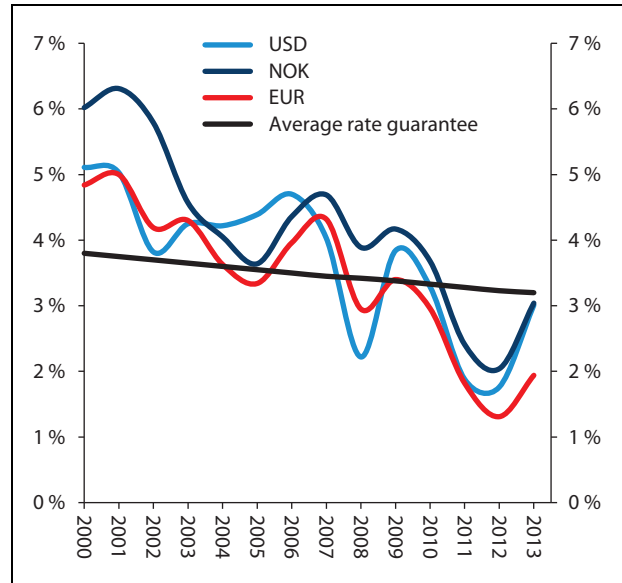


Figure 2.15 Developments in the average rate guaranteed by Norwegian life insurance companies and yields on 10-year government bonds in Norway (NOK), the US (USD) and the Euro zone (EUR).¹ Percent

¹ AAA-rated bonds.

Source: Finanstilsynet.

incur a loss when the market prices of assets change. This is because companies have offered customers a guaranteed rate, i.e. guaranteed them a return on their funds. It is important for companies to charge for this guaranteed rate, and for them to use the income from this to accumulate adequate net asset buffers for those years when customer portfolio returns are lower than the guaranteed rate.

Companies cannot charge a guaranteed rate premium for paid-up policies or individual insurance policies established before 2008. Instead, they earn their income by the company and the customer sharing any excess returns from asset management in those years when such returns exceed the guaranteed rate. This pricing based on the sharing of any excess returns means that life insurers are especially vulnerable if they have accumulated inadequate net asset buffers before a period of low returns on customer assets.

Market yields on low-risk fixed-income securities have declined in recent years. Market yields on government bonds are generally below the average guaranteed rate, despite interest rates having increased significantly in 2013, cf. Figure 2.15. A persistently low interest rate level will make it challenging for companies to ensure a sufficiently high return to match the guaranteed rate.

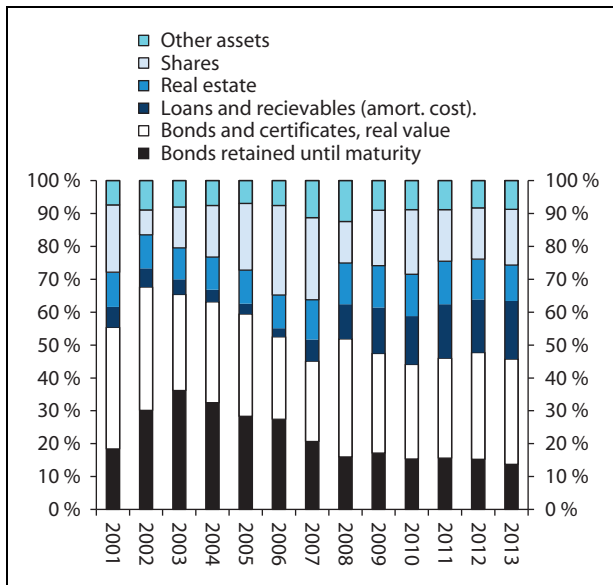


Figure 2.16 Life insurance company assets. Portion of total funding

Source: Finanstilsynet.

The market risk of life insurance companies has been closely linked to developments for bonds and certificates. Whilst the equity portion of asset portfolios has declined, the fixed-income portion has increased, cf. Figure 2.16.

2.5.2 Solvency and earnings

In 2013, life insurance companies earned profits before tax of NOK 6.9 billion. This represented a NOK 1.8 billion increase over profits in 2012. Value-adjusted profits before tax (taking account of unrealised capital gains) were NOK 16.4 billion in 2013.

The buffer capital expresses the ability of life insurance companies to absorb losses whilst maintaining compliance with the stipulated minimum capital requirements.⁶ The buffer capital of life insurance companies represented 6.1 pct. of total assets at yearend 2013, which is about 0.6 percentage points higher than in 2012, cf. Figure 2.17. This is primarily the result of an increase in the market price adjustment reserve, which reflects unrealised changes in the market value of group portfolio assets.

The capital adequacy ratio of companies as a whole was 16.8 pct. at yearend 2013. This is an

⁶ Buffer capital comprises equity, in the form of tier 1 capital in excess of the minimum requirement, and customer funds, in the form of supplementary provisions, up to one year's guaranteed return, market price adjustment reserve and risk equalisation reserve.

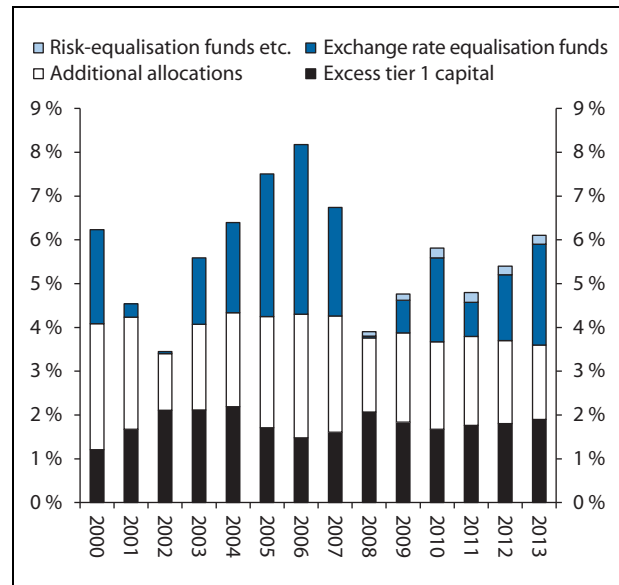


Figure 2.17 Buffer capital developments. Percent of total assets

Source: Finanstilsynet.

increase of 0.6 percentage points from 2012. The capital adequacy requirement applicable to life insurance companies is, like that applicable to credit institutions, 8 pct. of risk-weighted assets. All companies met this capital adequacy requirement.

Pension funds earned profits before tax of about NOK 2 billion in 2013.⁷ This is equivalent to about 1 pct. of their average total assets. A significant unrealised increase in asset values resulted in value-adjusted profits of NOK 14 billion in 2013.

The capital adequacy ratio of pension funds as a whole was 15.5 percent at yearend 2013, which is a decrease of about 1 percentage point from the previous year.

Life insurers are facing major challenges in relation to rising life expectancy and low interest rates. As the Ministry of Finance has emphasised in its financial markets reports for several years, it is very important for life insurers to ensure that risk and solvency are well matched, with a substantial margin of safety.

Non-life insurance companies earned profits before tax of NOK 6.8 billion in 2013,⁸ which is NOK 0.3 billion less than in 2012. Total insurance claim costs and other insurance-related operating

⁷ These pension fund figures are based on a sample representing about 93 pct. of total pension fund assets.

⁸ Not including captives, the marine insurance companies Gard and Skuld, or the Norwegian Shipowners' Mutual War Risks Insurance Association.

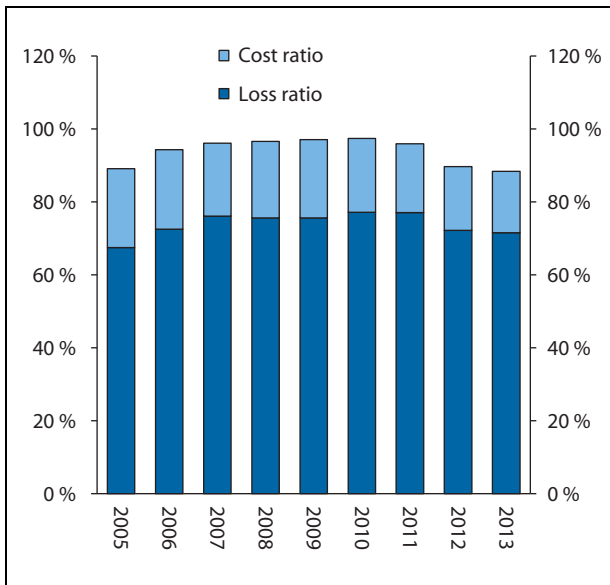


Figure 2.18 Developments in the cost and claims ratios of non-life insurance companies. Percent

Source: Finanstilsynet.

costs for own account, measured as a percentage of premium income for own account, are referred to as the *combined ratio*. It expresses the profitability of the actual insurance operations. A *combined ratio* in excess of 100 pct. means that the company needs other income than premium income to break even; for example financial income. In 2013, the *combined ratio* of non-life insurance companies was 88 pct. This was 1.5 percentage points lower than the previous year; cf. Figure 2.18. Both the claims ratio, i.e. claims payments as a percentage of premium income, and the cost ratio, i.e. operating expenses as a percentage of premium income, declined.

Overall, the solvency situation of Norwegian non-life insurance companies was fairly good in 2013. The capital adequacy ratio of non-life insurance companies was 43.3 pct.

2.6 Investment firms

Investment firms that are not integrated into banks registered operating income of NOK 6.5 billion in 2013, approximately NOK 1 billion more than in the previous year. The income increase was primarily generated within *corporate finance activities*, which is a core area for these firms. Operating profits were about NOK 1.2 billion, which is NOK 617 million more than in 2012. Investment firms that are integrated into banks and branches of foreign investment firms regis-

tered a decline in operating income of 21 and 18 pct., respectively, from 2012 to 2013.

2.7 Operational risk in financial undertakings

Operational risk is the risk of loss as the result of incomplete or inadequate internal processes, systems failure or human error. Operational risk includes, *inter alia*, legal risk and reputational risk. The causes may, for example, be inadequate procedures, defective information and communications technology systems (ICT systems), regulatory violations, fire, negative publicity or lack of trust. Delimitation against other types of risk is not precise, and losses classified under credit risk or market risk may be caused or multiplied by operational failure, for example weaknesses in credit evaluation processes.

The Ministry of Finance promotes a systematic preventive effort to reduce the vulnerability of financial institutions and financial markets, as well as to ensure adequate preparedness for dealing with risk events. The Financial Infrastructure Crisis Preparedness Committee (BFI) was established to ensure the best possible coordination of financial infrastructure preparedness efforts. The Committee examines operational stability, risk and vulnerability in the financial infrastructure. In 2013, the Committee held three regular meetings and conducted one emergency preparedness exercise. Finanstilsynet is the secretariat of the BFI, and hence the activities of the Committee are also discussed in Chapter 6 on the activities of Finanstilsynet.

Banks' access to a joint payment infrastructure means that customers of one bank can readily and cost-effectively perform transactions with customers of other banks. Systems stability in the Norwegian financial infrastructure is quite good, and losses as the result of misuse and fraud are small. The infrastructure is nonetheless vulnerable to technical failure and external threats. The Ministry of Finance discussed vulnerability in the financial infrastructure in Chapter 5 of the Financial Markets Report 2012. Figure 2.19 shows that systems availability in the financial infrastructure was somewhat better in 2013 than in previous years.⁹ The majority of the adverse events and errors that occur are related to online banking problems.

An ever more relevant theme is the outsourcing by financial undertakings of ICT systems operations and development to other suppliers. Outsourcing of ICT activities can reduce costs,

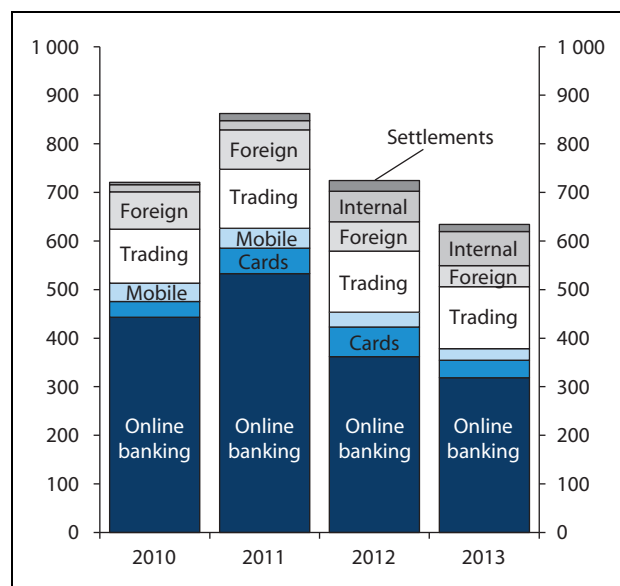


Figure 2.19 Impact-weighted adverse events and errors in Norwegian financial undertakings

The readings along the vertical axis represent a weighted and totalled assessment of the scale of the adverse impact of events within various services. The services are online banking (individuals and businesses), payment cards, mobile payments, stock trading, international payment, internal services, as well as clearing and settlement. The scale of the adverse impact is derived from the number of users affected, the duration of the event and a discretionary assessment of how serious the event was for users. The data in the figure can only be used to compare the scale of impacts across services and from year to year.

Source: Finanstilsynet

but may also make payment systems and other parts of the financial infrastructure more vulnerable to operational interruption. One may, for example, get reduced control over systems and more operational risk if a large part of ICT activities in the financial sector are outsourced, domestically or abroad. This may also increase the risk that unauthorised persons get access to (and steal) confidential financial information.

Finanstilsynet classifies ICT tasks as follows:

- a. ICT operations that require those responsible for such operations to have the rights of access necessary to ensure effective implementation and to intervene if problems arise, for example at night. The implications of errors and undesired events can be severe.

⁹ The data in the figure are obtained from the mandatory reporting of adverse events and errors to Finanstilsynet. Finanstilsynet has developed a database of information about such events, which base is used in its supervision. Thus far there are not much international statistics that can be used to compare the quality and availability of the Norwegian systems with circumstances in other countries. The reporting to Finanstilsynet only provides information about developments from year to year in Norway.

- b. Tasks that are linked to ICT operations, but do not directly form part of ongoing operations, are somewhat less sensitive. When such tasks are performed abroad, the output will typically be delivered to a coordination centre in Norway before being entered into the operating system. Such duties may be, for example, evaluation of new computer software, changes to existing computer software or pre-implementation testing of such changes. The coordination centre in Norway is responsible for quality assurance of the output received.
- c. Separate ICT development tasks performed under a supply arrangement with the coordination centre in Norway are also less sensitive. It is common practice for the coordination centre in Norway to acquire and ensure control over the developed solution, as well as to conduct its own testing and other quality assurance, prior to such solution being entered into use.

There is a long tradition in Norway for the outsourcing of ICT tasks in the financial sector. Most ICT suppliers are independent, and often stock exchange-listed, businesses with owners in Norway and abroad.

Until about 2000, all Norwegian banks had their ICT operations in Norway. A major part of the ICT operations of Norwegian banks and branches have now been relocated abroad in the wake of, *inter alia*, foreign acquisitions of Norwegian banks and outsourcing by remaining Norwegian-owned banks. Much of the securities-related ICT activities are also performed abroad.

Apart from those ICT operations of Norwegian financial undertakings that are performed in Sweden and Denmark, it is, in particular, separate ICT development tasks that are performed abroad for Norwegian financial undertakings. All major consulting firms, which are important suppliers for Norwegian financial undertakings, have their own subsidiaries in low-cost countries, especially in India. Besides, major Indian providers have gained contracts in the Norwegian market. Tasks relating to ICT operations are also being performed abroad to an increasing extent. Developments are driven by, *inter alia*, the cost-reduction needs of financial undertakings. Undertakings may, moreover, harbour expectations that well-known international operators will contribute to high quality in service production.

When services are delivered from countries located a long way from Norway, the choice of communications solutions may have a major impact on the risk associated with such deliveries.

The said deliveries may be vulnerable to communications interruptions, unless one has back-up solutions via independent channels. There have, for example, been serious interruptions to communications lines routed via cables on the seabed. Such cables constitute a key component of the global electronic infrastructure. Multiple independent communications solutions for each delivery need to be established as far as the delivery of key services in, *inter alia*, the financial sector is concerned. Whether or not this is possible depends on where in the world such deliveries are made from.

Finanstilsynet emphasises that the relocation of ICT tasks outside Norway generally requires sophisticated risk assessment and risk management on the part of each financial undertaking; see Finanstilsynet Circular 14/2010. This is an especially important consideration when relocating tasks to areas of high country risk, i.e. politically and/or economically unstable countries. Finanstilsynet has concluded that the ICT tasks performed in areas of high country risk are not critically important, and that interruptions to the delivery of the output in question will not threaten financial stability or otherwise represent any threat to the relevant financial undertakings in Norway. Thus far, the tasks performed from high-risk areas have been limited in scale and risk. However, this may change within a fairly short period of time, as it would appear that more activities are being relocated to such areas. This may not result in a material change in risk for any individual financial undertaking, but the increase in risk for the financial infrastructure as a whole may nonetheless be significant. It may also represent a threat to customers, in the form of an increased risk of unauthorised disclosure of personal data, etc. The authorities are developing new outsourcing provisions that will specify the extent to which outsourcing is permitted, as well as improve the scope of the authorities for intervention against new or modified outsourcing of activities; see section 3.8 for further details.

It is important for the relocation of ICT tasks to be dealt with properly, both for individual financial undertakings and for the financial system as a whole. The relevant regulatory framework and regulatory developments are discussed in Chapter 3.

Norges Bank and Finanstilsynet annually publish one financial infrastructure report each. The annual payment system report of Norges Bank discusses developments in customer-oriented payment transfer and internal bank systems, whilst

the risk and vulnerability analysis of Finanstilsynet addresses the use of information and communications technology in the financial sector.

2.8 Competition in the banking industry

2.8.1 Historical background

Competition may result in more cost-effective operation, lower prices, as well as improved allocation and use of labour and capital. Consequently, society and bank customers will benefit from competition between banks. High concentration, on the other hand, can impair both competition and the financial stability outlook.

The emphasis on competition to achieve a good allocation of capital has changed considerably over the last few decades. After World War II and until the late 1980s, interest rates and credit allocations for various parts of the economy were regulated and, in part, directly determined by the authorities. Regulations resulted in banks being able to select low-risk customers, as well as having the incentive to do so. Banks were characterised by stability, despite occasional exchange rate volatility, as well as mounting inflation and wage growth.

Direct credit regulation was abolished in the 1980s, and replaced by a system under which credit would be allocated in line with a market principle. Moreover, foreign banks and foreign finance companies were permitted to establish representative offices in Norway, for purposes of establishing contact between Norwegian customers and foreign creditors. All in all, such deregulation resulted in, *inter alia*, steep lending growth and high economic activity. Banks failed to adequately handle the transition to more liberal regulations, and credit institutions registered a significant increase in losses from 1987 onwards. By the following year, some banks were insolvent, and the situation thereafter swiftly deteriorated into an extensive banking crisis, as also experienced by many other countries when abolishing comprehensive credit regulations.

The banking crisis and the transition from credit regulation to more competition triggered a need for more robust solvency rules, improved supervision and structural changes within the banking sector. A number of bank mergers nonetheless resulted in increased concentration in the Norwegian banking market.

When Norway joined the EEA in 1994, the Norwegian financial market was opened to EEA

service providers via the establishment of subsidiaries or branches or via cross-border activities. The purpose was to create a common banking market in the EEA, thus enabling efficient banks to rapidly expand into countries in which margins and prices were higher than necessary. In theory, about 6,000 banks may now offer loans, accept deposits and provide other banking services in the Norwegian market. However, only a minor portion of these are actively involved in the Norwegian market, and a single banking market has yet to be established in the EEA. The EEA Agreement has nonetheless played a key role in shaping developments in the Norwegian banking market over the last two decades.

An important driver for change in banking markets for the last few decades has been new technological developments within data processing and communications. Exploitation of such new technology to develop new services and products has become a key priority for banks, and has reduced the need of banking service providers for a physical presence. Norway is one of the leading countries when it comes to making use of modern technology within payment transfers and information dissemination, and is in the global lead in terms of payment card use, online banking and e-Invoicing. See the Financial Markets Report 2012 and the Credit Report 2007 for further details on technological developments in the banking market.

2.8.1.1 Market concentration

The banking market in Norway is characterised by having a small number of major market participants and a large number of minor ones. There were 138 banks in Norway at yearend 2013, with most savings banks collaborating via various group constellations, such as the Eika group.

Concentration measures are frequently used to explain competitive conduct in the banking market.¹⁰ Empirical evidence suggests that concentration on the supply side of a market may result in high prices and high returns on equity for suppliers. Economic theory also suggests that concentration may give rise to such outcomes, but theory also shows that concentration interacts with other factors. These interactive effects can be altogether decisive in determining by how much concentration impairs competition. It is therefore important to recall, if using concentration measures to shed light on competition, that the rela-

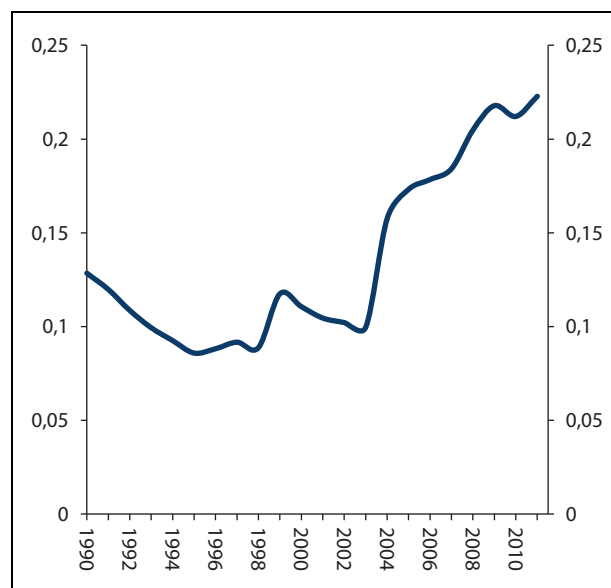


Figure 2.20 HHI developments, based on market shares as measured by total assets

Source: Finanstilsynet.

tionship between concentration and competition is complex.

It can also be difficult to define the relevant market. Moreover, there is reason to expect such definition to change over time, for example due to technological developments. Despite these problems, low concentration in a market can be an indicator of high competition, and high concentration can be an indicator of low competition.

Concentration can be measured in various ways, but the Herfindahl-Hirschmann Index (HHI) is a very commonly used measurement method for purposes of using concentration to shed light on competition in a market. HHI equals the sum of the squared market shares of the suppliers in the market, and covers a range from 0 to 1, with values close to zero meaning that there is low concentration in the market and a value of 1 meaning that there is only one supplier, i.e. a monopoly. The higher is the index value, the higher is concentration.

Figure 2.20 illustrates HHI developments from 1990 until now, by reference to the total assets of all banks in Norway, including total assets associated with the foreign activities of Norwegian banks. The figure shows that market concentration has increased since 2004, with the exception of a brief period in 2009. The steep HHI increase between 2002 and 2004 was caused by, *inter alia*, the merger between DnB and Gjensidige NOR.

Concentration in the Norwegian banking market is now relatively high compared to, *inter alia*,

¹⁰ OECD (2011). Bank Competition and Financial Stability.

Denmark, Sweden, Ireland, the UK and Germany, when measured by the Herfindahl Index. Concentration is somewhat lower in Norway than in Finland, Belgium and the Netherlands. Like in Norway, the Herfindahl Index has increased since 2005 in both the Netherlands and Finland. In Sweden and Denmark, for example, the Herfindahl Index has, on the other hand, remained fairly stable over the same period, whilst it has declined significantly in Belgium.

2.8.1.2 Margins

The interest rate margin; the difference between the average lending rate of banks and the average deposit rate of banks, is a key source of income for banks, and must, together with other income, be sufficiently large to cover the costs and expected losses of banks. It can be assumed that interest rate margins are influenced by, but not only by, competition between banks. Cost developments, expected loss developments, as well as the distribution between margin income and other income may also be important.

Risk premiums in the market may also influence margins. If risk premiums in the market increase, return on equity requirements applicable to banks may for example increase in line with the market as whole. One should therefore bear in mind, when interpreting the interest rate margin for recent years in Figure 2.21, that risk premiums

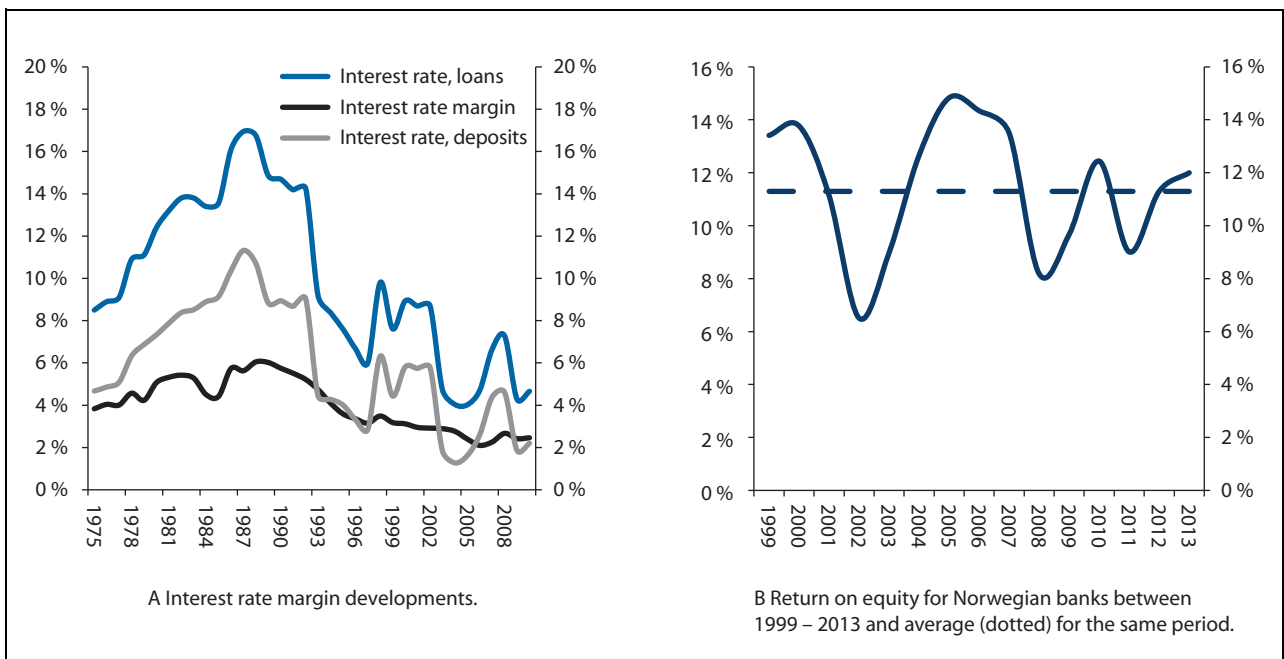


Figure 2.21 Interest rate margin developments for Norwegian banks. Percent

Source: Finanstilsynet.

for banks during the period prior to the outbreak of the international financial crisis were very low, and that premiums have declined significantly from their highest levels, whilst still remaining much higher than the levels registered prior to the outbreak of the international financial crisis.

Figure 2.22A shows that the interest rate margin of banks has declined from just over 5.5 pct. to



Figur 2.22 Interest rate margin (A) and return on equity developments (B) for Norwegian banks

Source: Statistics Norway and the Norwegian Banks' Guarantee Fund.

about 2 pct. since 1990. The interest rate margin has remained fairly steady at about 2 pct. from late 2006 until now, subject to some fluctuation at the time of the turbulence during the financial crisis in 2008.

Returns on equity in excess of normal levels, in aggregate or within various market segments, may be yet another indication of limited competition.¹¹ However, banking industry earnings are highly sensitive to cyclical fluctuations, and hence individual years of high or low earnings do not shed significant light on competition. If returns on equity in the banking industry are close to a normal equilibrium level over time, this may nonetheless indicate that the intensity of competition in the banking industry does not differ from that found in other industries.

Figure 2.22B indicates that the annual average return on equity over the period from 1999 to the 3rd quarter of 2013 fluctuated around a level of about 11.3 pct. The annualised return on equity at yearend 2013 was approximately 12 pct. This illustrates that the current return on equity is not unusually high compared to previous years. However, this comparison does not take account of the consideration that the return on equity requirement may be reduced as the equity ratio increases.

The return on equity of banks in the Norwegian market may be an indicator of competition between banks here and now, but may also have an important long-term impact on competition. If the return on equity is higher in Norway than in other banking markets, this may stimulate foreign banks to establish operations in Norway. If we look at profits before tax in proportion to total assets, the profitability of Norwegian banks is relatively high in an international context. The Nordic countries; Norway, Sweden and Finland, were characterised by high profitability, both before and during the crisis, compared to, *inter alia*, Germany, the Netherlands and Belgium. Admittedly, profitability in the US was somewhat higher before the financial crisis, but Norway, Sweden and Finland were the only countries in the sample addressed in a study by Ulltveit-Moe et.al with strictly positive earnings, in relation to total assets, throughout the financial crisis.¹² In 2011, it was again only in the US that the profitability of

banks, as measured in this way, was higher than in Norway.

In general, Nordic banks are also profitable in international terms when measured by returns on equity. From relatively similar levels in 1999, developments throughout the financial crisis have resulted in more pronounced inter-country variations in returns on equity in 2011. Whilst the UK and Denmark registered low bank profitability, Norwegian and Swedish banks delivered the highest returns on equity in 2011 in the sample of Ulltveit-Moe et.al.

2.8.1.3 Cost impact of regulatory changes

Banking regulations are currently undergoing change throughout the EEA. Regulatory changes may have an impact on the costs of banks. The degree of competition in the Norwegian market may be of considerable importance in determining the extent to which increased costs are passed on to customers, and the new regulations have triggered a competition debate in several countries.

It is hard to provide exact answers with regard to how a new regulation will influence the costs of Norwegian banks. Stricter capital requirements imply that banks need more equity per loan made than before. Generally speaking, equity is more expensive than debt.¹³ Consequently, stricter equity requirements may increase the total funding costs of banks. The overall effect on costs will depend on how much more expensive equity is than debt at the outset, and on how return on equity requirements and risk premiums change when banks get more equity and thus become more robust. The latter issue, in particular, has elicited considerable debate.

In the late 1950s, Franco Modigliani and Merton Miller developed a well-known theorem called the Modigliani-Miller Theorem.¹⁴ The theorem states that the value of a firm is, in equilibrium and under certain assumptions, unaffected by the ratio between equity and debt.¹⁵ The European

¹¹ Profits after tax, as a portion of book equity.

¹² Karen Helene Ulltveit-Moe, Bent Vale, Morten H. Grindaker and Erling Skancke (2013), Competitiveness and regulation of Norwegian Banks. *Norges Bank Staff Memo 18/2013*.

¹³ For a corporation, the return on equity requirement generally exceeds the interest rate on its debts. An important reason for this is that equity is exposed to more risk than debt. If the corporation reduces its equity, the risk of both owners and creditors is increased. In other words, a corporation with low equity must expect that both the return on equity requirement of its owners and the interest rate on its borrowing will be higher than those of a corresponding corporation with more equity.

¹⁴ Modigliani, F. and Miller, M. (1958), The cost of capital, corporation finance and the theory of investment, *American Economic Review* 48(3): 261–297.

Central Bank (ECB) has examined the extent to which the Modigliani-Miller Theorem actually holds true for banks.¹⁶ The ECB has used data for 54 banks from all over the world, including the large Nordic banks, for the period 1995–2011, and concluded that the Modigliani-Miller effect is likely to be in the region of 41 to 73 pct., depending on the specifics of the model. This would imply that between 41 and 73 pct. of the costs associated with a higher equity-to-assets ratio are recouped by way of a lower return on equity requirement. In addition, it would be reasonable to also expect the risk premium on debt to decline; cf. the above discussion. This further reduces overall funding costs, cf. the more detailed discussion of this issue in the Financial Markets Report 2011.

If we assume a difference of 10 percentage points between the return on equity and the interest rate on debt, and apply the above figures for the Modigliani-Miller effect, a 1 percentage-point increase in the CET1 capital ratio will increase funding costs by about 2 and 4 basis points.¹⁷ ¹⁸ Admittedly, these calculations are not definite. They are only intended to provide an indication of the potential effects of stricter capital requirements.

Residential mortgage guidelines may also have had an impact on interest rate margins. These guidelines imply that riskier customers do not obtain residential mortgages. Consequently, the lending portfolios of banks become less risky, which should contribute to both lowering residential mortgage funding costs and reducing the margins required on such mortgages.

Expectations of future regulatory changes may also have an impact on funding costs and lending margins. It is likely that this has been experienced during previous instances of extensive regulatory change. Expectations of a new sys-

tem for the winding-up of banks that enter into liquidation may, for example, already now be affecting the prices of long-term bank funding and result in banks changing their margins. This is discussed in more detail in Chapter 3.2.5. A structured arrangement for the winding-up of banks may reduce the implicit support expectation on the part of large banks. The value of such support expectations may be high. The Norwegian Financial Crisis Commission assumed, for example, that DNB enjoyed an implicit government guarantee valued at between NOK 1 and 4 billion annually.¹⁹ Moreover, expectations of new liquidity and stable funding requirements may also have an impact on bank margins. This is discussed in more detail in Chapter 3.2.2. It is difficult to quantify the overall effect of financial markets regulations and the expectations of banks and investors in relation to these.

More formalised models have been developed to link the degree of competition to corporate income. The Panzar-Rosse H-statistic is a frequently used model. It illustrates the income of a bank upon a change in the price of the factors of production. The thinking behind the model is that banks engaged in perfect competition will in the long run have to get their average costs covered, but no more. Higher values of the H-statistic are associated with more competition, and in a perfect competition scenario the H-statistic will be equal to 1, which represents a full cost impact. The Federal Reserve Bank of St. Louis has estimated the H-statistic for the Norwegian banking market based on data from the World Bank for 2010 and arrived at a figure of 0.3. This is fairly low and indicates, when taken in isolation, that competition amongst Norwegian banks is low.

The Panzar-Rosse H-statistic has a theoretical underpinning and may therefore offer advantages in comparison with analyses seeking to shed light on competition via structural measures such as, for example, concentration, or by the observation of profits and margins. However, it is not always the case that the assumptions on which the Panzar-Rosse statistic is premised are met in practice.

2.8.2 The retail customer market

If customers do not switch from expensive banks to cheaper banks, the competition between banks becomes ineffective. Low customer mobility may result from lock-in programmes, i.e. that a bank

¹⁵ These assumptions are unlikely to apply in full because, *inter alia*, tax implications and informational asymmetries may make it more expensive to obtain funding in the form of new share capital than in the form of debt.

¹⁶ European Central Bank (2011), Common equity capital, banks' riskiness and required return on equity, *Financial Stability Review December 2011*.

¹⁷ Bent Vale concludes, in the article «Effects of higher equity ratio on a bank's total funding costs and lending» (Staff memo 10/2011), that the return on equity of DNB was approximately 13.86 pct. over the period 2004–2010, whilst the borrowing rate, represented by 3-month NIBOR, over the same period was 3.48 pct. This chapter also supports a 10-pct. difference between return on equity and borrowing costs.

¹⁸ Under the assumption that risk-weighted assets represent about 2/3 of total assets

¹⁹ NOU 2011: 1 Green Paper

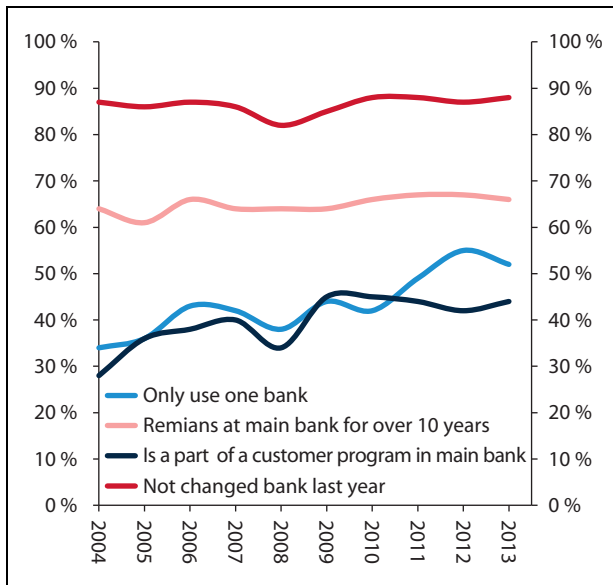


Figure 2.23 Switching between banks in the retail customer market. Percent

Source: Finance Norway.

offers a combination of salary account, insurance and loans, or from prices being difficult to compare, or from other circumstances that customers perceive as barriers to switching.

Figure 2.23 shows developments in various factors that shed light on the loyalty of Norwegian retail customers. The percentage of retail customers that did not switch or make use of a new bank over the last 12 months has remained stable at 88 for the last decade. More than 40 pct. participate in some form of customer programme offered by the bank, and this portion has increased gradually from about 28 pct. in 2004. In 2013, five percent of customers had switched their main bank over the last 12 months, whilst 6 pct. started to make use of a new bank, in most cases an additional bank. The same survey shows that only 7 pct. have ever checked the Finansportalen financial service comparison website.

Other data may nuance this. The Norwegian Consumer Council's switching survey for 2013 shows that one third of retail customers have renegotiated their residential mortgages or switched residential mortgage banks in the last two years. This may be an indication that consumers are price conscious and use market information to improve the terms offered by the banks of which they are already customers, but without switching banks. Such developments may have been boosted by technological progress within the industry and price comparison tools like Finansportalen.

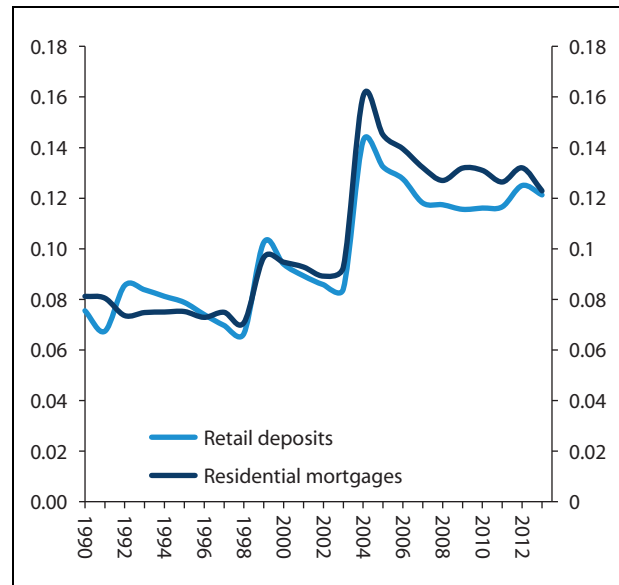


Figure 2.24 HHI for deposits from retail customers and residential mortgages

Source: Finanstilsynet.

Figure 2.24 shows concentration as measured by HHI for deposits from retail customers and residential mortgages to retail customers. These measures provide a better illustration of concentration in the retail customer market than the data presented in the introduction, which cover the market as whole. The figure shows that concentration in accepting deposits from, and lending to, retail customers is lower than for banks as a whole, and that concentration has declined in recent years. The upward shifts in concentration have to do with the merger between Postbanken BA and Den norske Bank ASA in 1999 and the merger between DNB NOR ASA and Gjensidige NOR Sparebank ASA in 2003.

The interest rate margin of banks does not reflect the fact that accepting deposits and granting loans are different activities. The lending margin of banks is the margin between the lending rate of banks and the money market rate. NIBOR is frequently used as a measure of the money market rate. NIBOR is a benchmark rate, and a very considerable number of financial market contractual relationships are linked to such rate. Figure 2.25 shows that there was a leap in the margin on lending to retail customers upon the outbreak of the financial crisis. As at yearend 2013, the lending margin in relation to private sector businesses and retail customers was the same, as measured by the NIBOR differential. This indicates higher profitability and less competition in the retail customer market than in the

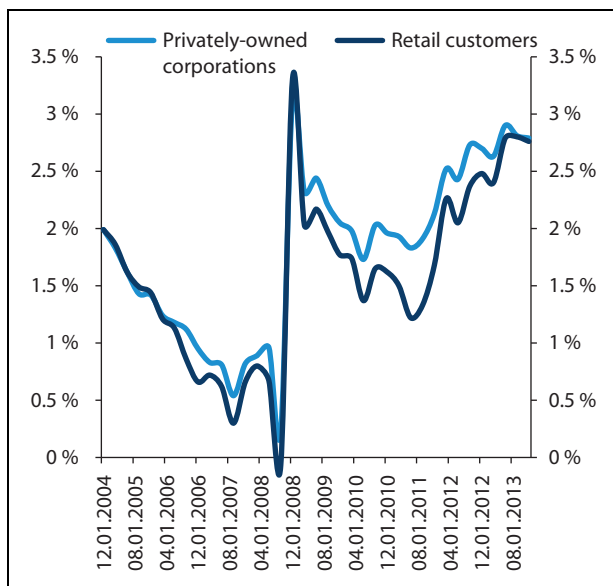


Figure 2.25 Difference between lending rates on various loan types and 3-month NIBOR. Percent

Source: Finanstilsynet.

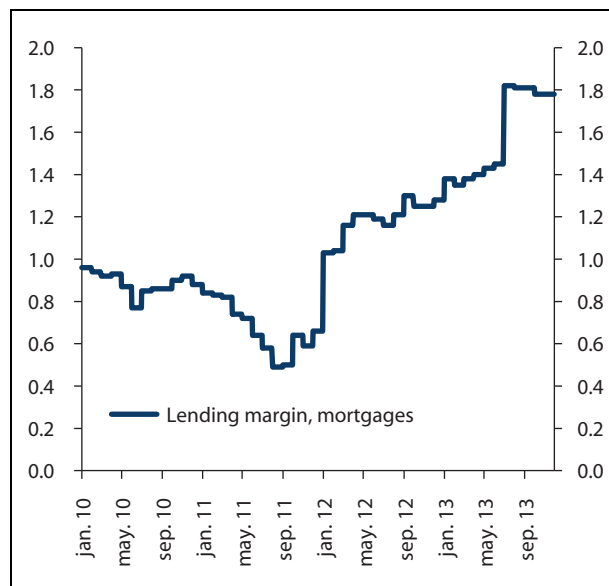


Figure 2.26 Residential mortgage lending margins based on average residential mortgage interest rates and estimated residential mortgage funding costs. Percentage points

Source: Norges Bank.

market for private sector businesses, since margins for private sector businesses are generally associated with higher risk.

NIBOR is an important benchmark rate in the derivatives market and for determining the lending rates of banks, although the lending margin as measured by NIBOR does not precisely express the lending margins of banks, because their costs of funding a loan may deviate from NIBOR. Norges Bank has therefore estimated the funding costs of banks for residential mortgages from 2010 until yearend 2013, as calculated on the basis of the weighted interest rate on the covered bond loan holdings and the weighted deposit rate. Figure 2.26 below shows that the lending margin on residential mortgages has, based on these data, increased significantly since 2012. At yearend 2013, the lending margin, defined as the interest rate on new residential mortgages less the estimated funding cost, was approximately 1.8 pct., an increase from about 0.5 pct. in August 2011. Besides, estimated funding costs have not declined in the same way as money market rates in recent years. Consequently, Figure 2.26 may indicate that competition between banks has weakened over the last couple of years as far as lending to retail customers is concerned. On the other hand, it is not evident that the lending margins from the autumn of 2011 were sufficiently high to cover the costs and risks of banks in relation to such lending.

2.8.3 The corporate market

Loans to corporations are less homogeneous than residential mortgages for retail customers. Loans to corporations are more diversified and, on average, associated with more risk, and banks often need to have detailed knowledge of the outlook

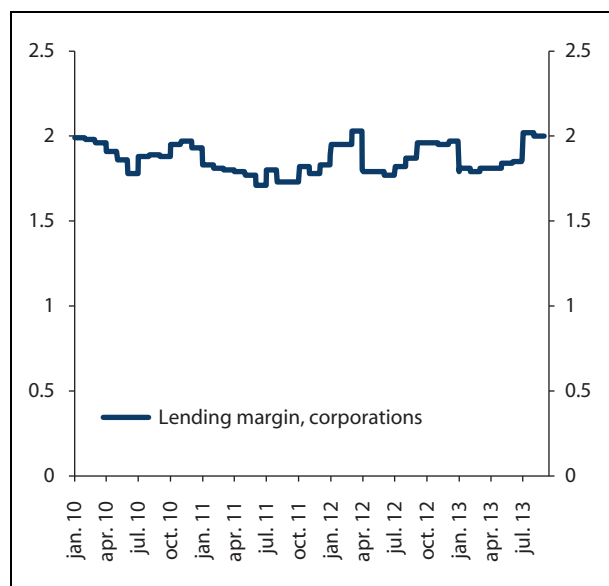


Figure 2.27 Corporate lending margins based on corporate lending rates and estimated corporate loan funding costs. Percentage points

Source: Finanstilsynet.

for the industries in which corporations are engaged.

The funding costs of banks are not closely linked to NIBOR as far as lending to corporations is concerned either. As with the retail customer market, Norges Bank has estimated a funding cost that is assumed to better reflect the actual funding cost. The funding cost for lending to corporations is estimated on the basis of the weighted interest rate on the senior bank bond holdings and the weighted deposit rate.

Figure 2.27 illustrates the lending margin in relation to corporations, based on the lending rate

for corporate loans less the estimated funding cost for corporate loans. The figure shows that the lending margin for private businesses has remained relatively stable in recent years. The estimated funding cost for corporate loans has not declined to the same extent as the money market rate since 2012. The lending margin in relation to corporations has remained stable at about 2 pct. in recent years, and was 2 pct. at yearend 2013. Corporate loans are associated with more risk, and hence one would expect the lending margin to be higher if competition was the same as in the retail customer.

3 Financial market regulatory developments

3.1 Introduction

In recent years, the Ministry has reported regularly on the key processes initiated to improve international and Norwegian financial market regulation following the financial crisis, which reporting has included the annual financial markets reports and national budget reports. Such processes and the development of new regulations may continue for a number of years. Consequently, the discussion in this chapter is in many respects based on, and represents an update of, information previously presented to the Storting by the Ministry.

Regulatory developments in Norway largely reflect the development of new regulations in the EU. The Norwegian authorities are committed to promoting solvency, liquidity and good conduct through government regulation and supervision of the financial sector. Primary responsibility for rules that promote financial stability lies with the national authorities, and the costs associated with financial imbalances are to a large extent imposed on the economy of the country in question. It is therefore important for each country to have at its disposal the policy tools needed to ensure stability in its financial markets. The Ministry will continue to emphasise the need to make use of the national freedom of action within international regulatory frameworks, thus enabling the Norwegian regulations to promote robust financial institutions. Robust financial institutions will also support the competitiveness of the Norwegian economy and that of its financial institutions.

3.2 Credit institutions

3.2.1 Capital requirements

3.2.1.1 *Capital requirements and international developments in general*

The capital adequacy rules are based on three so-called pillars. Pillar I concerns minimum capital requirements, whilst Pillars II and III concern cap-

ital needs assessments by institutions and information disclosure, respectively.

The capital requirements are expressed as minimum requirements in the form of a ratio. The denominator, called risk-weighted assets, is the value of all assets, with the addition of certain off-balance sheet items, weighted on the basis of the expected risk of loss associated with each asset or liability. The higher is the calculated risk of an asset, the larger is the denominator and, consequently, the higher is the capital requirement. Hence, the risk weights influence how much CET1 capital, tier 1 capital and total capital banks need to have behind each asset under the rules. For most institutions, the risk-weighted asset figure is much lower than total assets, i.e. the balance sheet value.

Banks either employ risk weights stipulated by the authorities (the standardised approach), or risk weights calculated by using internal risk models (often called the IRB approach), when setting the denominator used in calculating the capital adequacy ratio. The risk weights are different for different assets, but different banks may also use different risk weights for the same asset. The lower the risk weight, the higher the capital adequacy ratio for a given amount of total capital. The IRB approach is intended to align capital requirements more closely with the real risk of each bank. The IRB approach has often turned out to result in lower weights than would be implied by the standardised approach, for the same asset. Banks that employ internal models shall, under a transitional arrangement, maintain total capital corresponding to no less than 80 pct. of the minimum capital requirement under the Basel I rules. An important consideration is to prevent internal models from excessively reducing risk-weighted assets (the so-called Basel I floor). This is ensured by requiring the denominator used in calculating the capital adequacy ratios to be no lower than 80 pct. of what it would have been under the Basel I rules. Many EU and EEA countries have transitional Basel I floor provisions, but practical implementation differs.

The numerator used in calculating the capital adequacy ratio is total capital, which is the sum total of tier 1 capital (CET1 capital and other tier 1 capital) and Tier 2 capital. Total capital, and particularly tier 1 capital, absorbs losses incurred in the operations of institutions, thus serving as a buffer to prevent the losses of banks and other credit institutions from affecting their creditors and depositors.

The regulatory framework governing capital requirements has changed over time, and the recent financial crisis demonstrated that requirements had to be made stricter. The CRR/CRD IV regulatory framework, which was based on recommendations from the so-called Basel Committee for Banking Supervision, was adopted by the EU on 26 June 2013 and entered into force on 17 July 2013. The regulatory framework is referred to as CRR/CRD IV because the provisions are now separated into a directive; the *Capital Requirements Directive* (CRD IV), which is the fourth version of the EU Capital Requirements Directive, and a regulation; the *Capital Requirements Regulation* (CRR). Whilst a directive may often offer some scope for national adaptations, a regulation shall as a main rule apply directly in the member states. Nonetheless, CRR allows for some national choices in certain respects. The new provisions are to be introduced gradually, with full effect from 1 January 2019 at the latest.

Under CRR/CRD IV, the minimum capital requirement will remain that total capital shall represent 8 pct. of risk-weighted assets. CET1 capital shall represent no less than 4.5 pct. of risk-weighted assets, whilst tier 1 capital, which includes certain types of hybrid capital, shall represent no less than 6 pct.

Moreover, CRR/CRD IV includes a requirement for a so-called capital conservation buffer, which shall comprise CET1 capital and represent no less than 2.5 pct. of risk-weighted assets. The purpose of the capital conservation buffer is to ensure that institutions have a certain buffer for absorbing losses during periods of market turbulence and low economic activity.

Each member state may also introduce a requirement for a systemic risk buffer. The systemic risk buffer requirement may be stipulated as a percentage of risk-weighted assets for those financial institutions that are subjected to such a requirement. The systemic risk buffer shall serve to reduce non-cyclical systemic risk, which risk may have a significant negative impact on the financial system and the macro economy of individual member states. Such buffer requirements

may be imposed on individual institutions, groups of institutions or all institutions.

A financial institution may be so large, or perform tasks that are so important, that the said institution in itself has a particularly large impact on the financial system. Such institutions are also important for the economy as a whole. It has therefore been argued, in the international regulatory debate in the wake of the financial crisis, that systemically important institutions should be especially robust. CRR/CRD IV requires *globally systemically important institutions* to be subjected to an additional buffer requirement of between 1 and 3.5 pct. of risk-weighted assets as from 1 January 2016. The buffer requirement must be met with CET1 capital. The buffer is intended to reduce the incentives of such institutions to assume excessive risk, thus reducing the risk that taxpayers must absorb the cost of a potential crisis. In addition, member states may stipulate that *nationally systemically important institutions* shall also meet an additional buffer requirement of up to 2 pct. of risk-weighted assets.

Moreover, CRR/CRD IV requires a *counter-cyclical capital buffer*, which is to vary between 0 and 2.5 pct. of risk-weighted assets. The purpose of the counter-cyclical capital buffer is to make institutions stronger and more robust to loan losses in a future recession and to reduce the risk that banks will contribute to the worsening of a potential cyclical downturn by curbing their granting of credit. This counter-cyclical buffer requirement is to be applied during periods of especially high credit growth or other developments that increase cyclical systemic risk. This counter-cyclical buffer requirement may be lowered or removed if the economy cools down. Whilst an increased counter-cyclical buffer requirement shall normally be announced no less than 12 months before it takes effect, such requirement may be reduced with immediate effect. Nonetheless, a counter-cyclical capital buffer is not a tool that should be used to fine-tune the economy. In a letter of 4 December 2013 setting out advice on counter-cyclical capital buffers, Norges Bank states, *inter alia*, the following:

«Robustness considerations suggest that the capital buffer should not be reduced as a matter of course, despite indications of a tapering off in financial imbalances. Any future advice on reduction of the buffer will be based on an assessment of market turbulence, the bank loss outlook and the risk of a creditor-driven setback for the Norwegian economy.»

CRR/CRD IV also allows for the introduction of a new minimum tier 1 capital requirement based on non-risk-weighted assets (a leverage ratio requirement), in addition to the new risk-weighted capital requirements. Such a leverage ratio requirement is intended to limit how much debt an institution can have relative to its balance sheet value. A binding leverage ratio requirement may be introduced from 1 January 2018 if thus agreed by the Council and the European Parliament, based on a report to be submitted by the Commission by yearend 2016. Institutions shall nonetheless report their leverage ratios from 1 January 2015.

In addition to provisions on the activities of banks and investment firms, as well as capital requirement for institutions, CRR/CRD IV includes, *inter alia*, a revision of the provisions on salaries and bonuses for bank and investment firm employees, as well as bank asset liquidity and funding requirements.

3.2.1.2 Capital requirements in Norway

Introduction

The initial part of the incorporation of the CRR/CRD IV provisions into Norwegian law entered into effect on 1 July 2013, cf. Act of 14 June 2013 No. 34 relating to amendments to the Financial Institutions Act and the Securities Trading Act based on proposals made by the Ministry of Finance in Legislative Proposition No. 96 (2012–2013) to the Storting. Draft regulations on the incorporation into Norwegian law of remaining parts of CRR/CRD IV are currently circulated for consultation.

In Norway, the minimum CET1 capital requirement will be 4.5 pct. of risk-weighted assets from 1 July 2013. Tier 1 capital shall account for 6 pct. of risk-weighted assets, whilst total capital shall represent no less than 8 pct. of risk-weighted assets. Furthermore, a capital conservation buffer comprised of CET1 capital, which shall represent no less than 2.5 pct. of risk-weighted assets, and a systemic risk buffer comprised of CET1 capital, which shall represent no less than 2 pct. of risk-weighted assets, will be required. The systemic risk buffer requirement will be increased from 2 to 3 pct. on 1 July 2014.

The Ministry is of the opinion that stricter capital requirements for banks, and particularly stricter CET1 capital requirements, benefit society as a whole. Individual banks may perceive this differently. Rate of return requirements in the capital market reflect risk. Consequently, banks must

offer shareholders a higher expected return than they offer creditors. However, risk is reduced for both owners and creditors when the equity-to-assets ratio is increased. Hence, economic theory postulates that more equity will be accompanied by lower rate of return requirements for both equity and debt. This may nonetheless be a slow process, without any immediate adjustment. Whilst adjustments are taking place, this may in practice give rise to cost of capital differences for banks with the same underlying solvency. The market may also differ in its assessments of the trade-off between risks and returns, both over time and between investors.

It is advantageous for stricter capital adequacy requirements for banks to be introduced when the economy is performing well, thus enabling the capital to serve as a buffer for leaner times. This is why new Norwegian capital requirements are introduced somewhat earlier than required under the EU incorporation deadline. Some other countries whose economies are performing above the European average, including Sweden and Switzerland, are introducing such requirements now. The said countries have a larger banking sector, as measured by the ratio between total banking sector assets and GDP, than Norway. On the other hand, large banks in these countries are likely to have better access to equity markets than have Norwegian banks. What Norway, Sweden and Switzerland have in common is that they have their own and relatively minor international currencies, as well as domestic capital markets of moderate size.

CET1 capital buffer requirements

As mentioned, the EU framework regulates the buffer requirements in a directive. In Norway, it is intended for all buffer requirements to be calculated on the same basis as other capital requirements. The Ministry has recently completed a consultative process on draft regulations concerning the basis for calculating new buffer requirements and implications if buffer requirements are not met. Buffer requirements are discussed in more detail in section 3.2.1.1 above.

The Ministry is of the view that it is appropriate to stipulate special requirements for nationally systemically important financial institutions in Norway, and one reason for this is that the Norwegian financial market is characterised by a small number of banks having large market shares, and by the largest banks being a source of funding for the smaller banks. At the same time,

Norway has a fairly large number of independent banks relative to its population. The Storting has resolved to introduce a special buffer requirement for systemically important institutions, which will be 1 pct. from 1 July 2015 and 2 pct. from 1 July 2016. The Ministry may, in the form of regulations, stipulate, *inter alia*, criteria for determining which institutions shall be characterised as systemically important, as well as special operating provisions and solvency requirements for such institutions, including a stipulation that the special buffer requirement shall be higher or lower than 2 pct.

On 11 November 2013, the Ministry circulated draft provisions on systemically important institutions for consultation. The draft was prepared by Finanstilsynet in consultation with Norges Bank. Finanstilsynet proposed that systemically important financial institutions be identified on an annual basis, and that institutions conforming to one or more of the criteria outlined in the consultation memorandum shall as a main rule be defined as systemically important. The draft proposes that institutions shall be considered systemically important if conforming to one or more of the following criteria:

- a. total assets representing no less than 10 pct. of mainland Norway GDP or aggregate total assets in the Norwegian banking industry;
- b. a market share of no less than 5 pct. of the Norwegian retail lending market;
- c. a market share of no less than 10 pct. of the corporate lending market in one or more regions; or
- d. a critical role in the financial infrastructure

In addition, the draft authorises the Ministry of Finance to include or exclude institutions from the group of systemically important institutions on the basis of qualitative assessments. Finanstilsynet proposes that DNB Bank, Nordea Bank, Sparebank 1 Nord-Norge, Sparebank 1 SR-Bank, Sparebank 1 SMN, Sparebanken Vest, Sparebanken Sør and Sparebanken Pluss¹ be classified as nationally systemically important and subjected to, *inter alia*, an additional capital buffer requirement of 2 pct. Sparebanken Vest is the only one of these not to exceed the above threshold values, whilst Kommunalbanken is not included in the group despite exceeding the threshold values under criterions a and b.

¹ Sparebanken Sør and Sparebanken Pluss have subsequently merged.

The Norwegian capital requirements regulations authorise the Ministry of Finance to stipulate further provisions on counter-cyclical capital buffer requirements. Regulations on how to determine this buffer requirement were laid down on 4 October 2013. Norges Bank shall four times a year, and by the end of each quarter at the latest, prepare the underlying documentation (including a buffer guide). Norges Bank and Finanstilsynet shall exchange relevant information and assessments. Norges Bank will give advice to the Ministry concerning the level of the counter-cyclical capital buffer. Finanstilsynet may also express its views. The level shall for the time being be determined by the Ministry of Finance. Norges Bank recommended, in its Monetary Policy Report with financial stability assessments from December 2013, that the counter-cyclical capital buffer should be 1 pct. of risk-weighted assets with effect from 1 January 2015. Finanstilsynet endorsed this advice. On 12 December 2013, the Ministry of Finance stipulated that banks shall meet a counter-cyclical capital buffer requirement equivalent to 1 pct. of risk-weighted assets. The Ministry of Finance chose to grant banks somewhat more time to comply with the requirement. The counter-cyclical capital buffer requirement will therefore enter into effect from 30 June 2015.

The counter-cyclical capital buffer is a new policy tool. Norges Bank and the Ministry of Finance will assess the impact of the buffer requirement on the Norwegian economy on a regular basis, and are monitoring developments in the determination and implantation of this buffer requirement in other countries.

As from 1 July 2013, the CET1 capital requirement is 9 pct. (including buffer requirements) and the aggregate total capital requirement is 12.5 pct. for all banks. As from 1 July 2014, the CET1 capital requirement will be 10 pct. and the aggregate total capital requirement will be 13.5 pct. As from 1 July 2015, the aggregate total capital requirement, including a systemic risk buffer of 3 pct., a buffer for systemically important institutions of 1 pct. and a counter-cyclical capital buffer of 1 pct., will be 15.5 pct. of risk-weighted assets for systemically important banks and 14.5 pct. for other banks. Out of the minimum total capital requirement of 8 pct., 4.5 percentage points shall be in the form of CET1 capital. The remainder may be in the form of additional tier 1 capital and subordinated loans. All buffer requirements shall be met with CET1 capital. Any capital requirements imposed by Finanstilsynet on each of the institu-

tions via the so-called Pillar II process will be additional to these requirements.

Internal models for the calculation of capital requirements

As mentioned, banks may use either the standardised approach or the IRB approach to calculate risk weights for their assets. It has turned out that use of the IRB approach may result in significantly lower risk weights than use of the standardised approach for the same loans. The risks of comparable portfolios are often assessed differently by different banks. The internal models used by banks in their risk weight calculations are based on, *inter alia*, the magnitude of previous losses incurred by them on similar assets. These models may provide a lot of useful information, but one disadvantage is that they often reflect structural changes that only influence risk after they occur. Since the purpose of capital requirements is to enable banks to cover future losses, this is a distinct weakness, which means that the model estimates need to be examined critically.

Residential mortgages have only entailed very minor losses for banks over the last twenty years. This period has largely been characterised by economic growth, rising housing prices and steep increases in household debts. Norwegian housing prices and debts are now very high relative to Norwegian household incomes, whilst the interest rate level is low. This implies that risk has increased, although the change in risk is not visible in the loss figures of banks. In addition, residential mortgages make up a significant portion of the balance sheets of banks. It is therefore necessary to examine the models used by banks to calculate capital requirements for residential mortgages, to ensure that capital requirements are adequately reflecting the risk. On 13 October 2013, the Ministry adopted amendments to the Capital Requirements Regulations, which increased the minimum residential mortgage «loss given default» (LGD) estimates of banks from 10 pct. to 20 pct. as from 1 January 2014. This amendment will have less of an impact on banks using the IRB approach, since the Basel I floor continues to apply.

The IRB models of banks need to be approved by Finanstilsynet before being used to calculate the capital requirement. Finanstilsynet is currently reviewing the models of banks with a view to, *inter alia*, making the requirements more stringent. It is likely that such review will result in somewhat higher and less disparate residential

mortgage weights for Norwegian IRB banks. The Basel I floor will continue to be an effective threshold for most banks. It is important not to abolish the Basel I floor until a satisfactory level of risk-weighted assets has been established for banks, i.e. no less than the level currently implied by the floor. The provisions laid down by the EU require the Basel I floor to be applied until 31 December 2017, with scope for extension. An increase in the model-based risk weights will also reduce the effect of any future abolition of the floor. The floor may be of major importance to the banking subsidiaries of foreign banks, as foreign authorities evaluate the IRB model used by the group and thus, *inter alia*, the estimated probability of default.

The capital requirements should be forward looking. If capital requirements are not increased until the risk is reflected in higher losses, there is a danger that banks will find it very difficult to increase their capital adequacy ratios. Because the Norwegian economy is still performing reasonably well, Norwegian banks have registered favourable earnings and been in a position to prepare for stricter capital requirements. Banks have to some extent already taken the opportunity to do so, and if earnings remain at the same level ahead it will be fairly straightforward for banks to comply with these future requirements.

The use of IRB models as a basis for determining capital adequacy requirements is quite a recent regulatory development, and was introduced into the regulatory framework during the previous international collaboration process on capital adequacy requirements; Basel II. International developments demonstrated that banks used, during the run-up to the implementation of these regulations, the changeover and transition to internal modelling to expand their balance sheets with a smaller proportion of equity funding. This tendency was also in evidence in the Nordic region. Upon the introduction of new regulations relating to the Basel III process, it has also been noted that some banks have registered a significant reduction in risk-weighted assets when using IRB modelling. Since one of the purposes of the Basel III reform is to increase the overall solvency and equity of banks as a whole, this has in some cases had unfortunate implications. This has given rise to a debate as to how appropriate it is to link capital adequacy requirements to the individual risk models of banks, as well as to higher expectations for liquidity requirements and the use of individual non-weighted capital requirements. The regulations are therefore still

in development by, *inter alia*, the Basel Committee and the EU.

However, the use of IRB models shall primarily serve as an internal management tool for each individual bank that makes use of models. The models shall contribute to more efficient use of capital and provide banks with tools for improved control of the return and risk of their commitments. This effect, which has organisational implications, is independent of whether or not such modelling serves as a basis for capital requirements stipulated by the authorities. The authorities, on their part, need to be aware that the introduction of IRB modelling may result in risk being shifted from banks that have introduced IRB modelling to banks that have not done so. However, the fact that a bank has not introduced IRB modelling does not mean that its risk management is inadequate. The size of the bank and the composition of the balance sheet of the bank are important factors in determining whether it can make use of sophisticated modelling tools, but also in determining whether to do so is at all necessary.

Links between banks and mortgage companies that can issue covered bonds

Banks have over time transferred well-secured residential mortgages to mortgage companies that can issue covered bonds. In order to prevent this from resulting in increased risk in the banking system, the Ministry intends to examine whether the links between mortgage companies that can issue covered bonds and banks are appropriate. This also has competition implications, as discussed in more detail in Chapter 3.5.

3.2.2 Liquidity coverage and funding structure requirements

Banks convert liquid, short-term deposits into long-term lending. This maturity transformation imposes a liquidity risk on banks. There may for various reasons be a discrepancy between the liquidity risk a bank deems to be beneficial and the liquidity risk it is beneficial for society for such bank to assume.

Moreover, since banks and mortgage companies borrow large sums from each other, liquidity failure in one institution may cause liquidity problems in other institutions. During the international financial crisis it was, for example, evident that banks in a situation of uncertainty became very reluctant to lend to each other, preferring to deposit surplus liquidity with the central bank. In

a worst case scenario, domino effects may result in the stability of the entire financial system being threatened by a liquidity problem in only one or a small number of institutions.

CRR/CRD IV lays down new requirements with regard to the liquidity coverage and funding structure of banks. Section 2-17 of the Financial Institutions Act authorises the Ministry of Finance to stipulate detailed liquidity coverage and funding structure requirements for the institutions falling within the scope of the Act.

The *liquidity coverage requirement* (LCR) is a minimum requirement as to the volume of liquid assets a bank needs to hold to withstand periods of funding markets failure. The European Commission shall provide a final LCR definition by the end of June 2014. The Basel Committee completed its examination of the indicator in January 2014. The proposal from the Basel Committee implies that a bank shall always retain a holding of «high quality liquid assets» (HQLA) that exceeds its net cash outflow over 30 calendar days in a stress scenario. In order for an asset to be defined as HQLA, it must be readily and immediately convertible into cash with, at most, only a minor loss in value. Corporate and municipal bonds may, for example, be included if markets for these are sufficiently deep and liquid, provided that such bonds also have a high credit rating. Norway has a small market for securities that meet the original HQLA definition. The problem of illiquid securities is shared by a number of small countries. CRR/CRD proposes that institutions subject to the LCR must meet 60 pct. of the requirement from 2015. The requirement shall be stepped up gradually, until it is applied 100 pct. from 1 January 2018. Finanstilsynet has proposed that the LCR be introduced with full effect for the systemically important financial institutions from 1 July 2015. The Ministry will examine the time schedule. Norwegian authorities have accorded priority to early phase-in of the new capital requirements.

The LCR has been somewhat revised since the first proposal from the Basel Committee. The Basel Committee proposed amendments to the requirement in January 2014. The proposal calls for more assets to be classified as HQLA, as well as for certain changes to the stress scenario. If this LCR version is applied, it will become easier for banks to comply with the LCR.

In order to further reduce the liquidity risk of banks, the Basel Committee has proposed a *net stable funding ratio* (NSFR) requirement. This ratio expresses a requirement as to what portion of the funding of banks needs to be “stable”. The

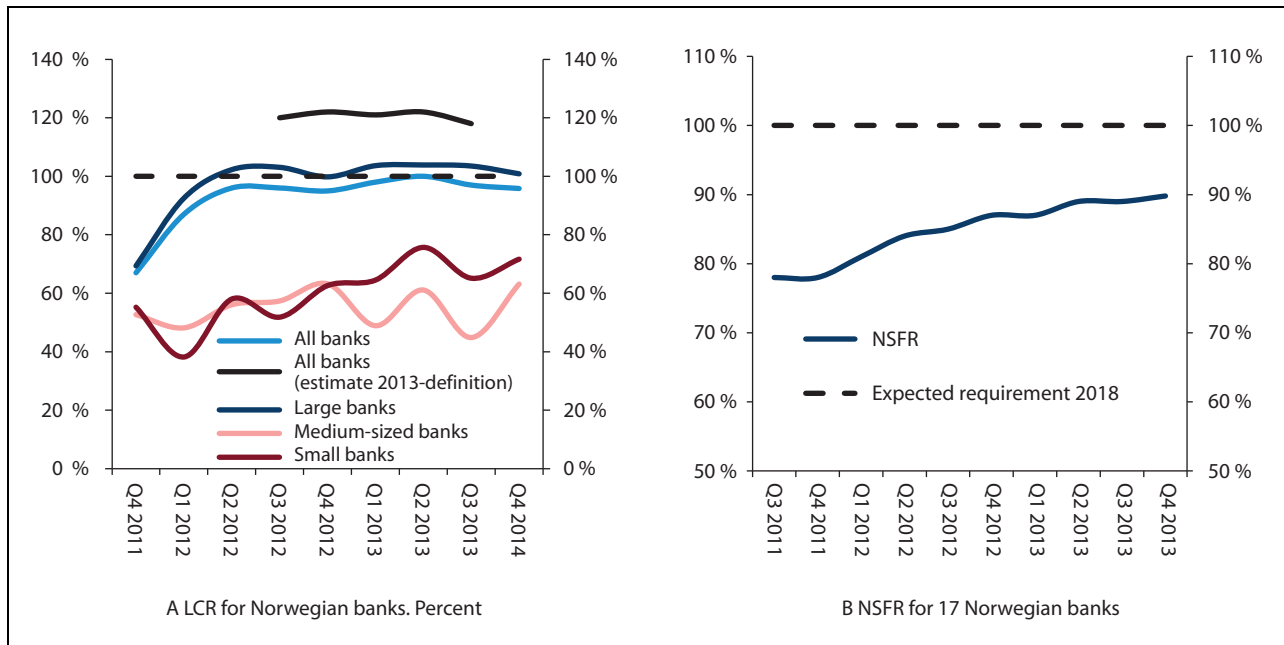


Figure 3.1 LCR for Norwegian banks (A) and NSFR for 17 Norwegian banks (B)

Source: Finanstilsynet.

NSFR proposal of the Basel Committee has recently been circulated for consultation. The NSFR process lags somewhat behind the LCR process, and completion is expected in 2018 at the earliest.

Norwegian banks report quarterly to Finanstilsynet on the extent to which they meet the anticipated liquidity and funding requirements, cf. Figure 3.1. All banks report on the extent to which they comply with a version of the LCR, whilst 17 banks report on compliance with the NSFR requirement.

3.2.3 Nordic cooperation

Nordic financial markets have become more integrated over time. In recent years, the Nordic financial market supply side has seen a trend towards the largest groups establishing operations in several Nordic countries. Competition from such banks is important in the Norwegian market, because it increases domestic competition between banks and results in more choice for customers. Although there are many banks in Norway, most of these are limited in their geographical scope. The strict regulatory requirements applicable to banking also give rise to special barriers to entry in this industry.

The large Nordic banks make extensive use of internal models for calculating capital requirements and risk. Hence, such requirements may be

lower than the capital requirements applicable to banks that use the standardised approach, and may be more difficult to compare between banks and between countries. If banking solvency requirements in Norway become more uniform, it will create a more level playing field in the market. The Government is cooperating with other Nordic authorities to promote more harmonised regulations for all undertakings with operations in any of the Nordic countries (host country regulation). Important considerations for Norwegian authorities include mutual recognition of the risk weights for residential mortgages and counter-cyclical capital buffers.

Cross-border harmonisation of solvency requirements is advantageous, but this consideration cannot be accorded so much priority as to impair the solvency of Norwegian banks, or capital requirements caused by differences between the Norwegian economy and another economies. Primary responsibility for financial stability lies with the authorities in each country, and experience from past crises shows that problems and costs must in most cases be handled at the national level. Banking market competition may be effective despite certain differences in regulatory requirements between different market participants.

Norwegian authorities are cooperating closely with the other Nordic countries on a common approach to capital and liquidity requirements for

banks and financial institutions. In 2012, a Nordic working group comprising representatives from the Nordic ministries of finance was appointed to look into such an approach. Specific Nordic adaptations based on the recommendations of the Nordic working group are currently being pursued at the supervisory authority level. Finanstilsynet has, *inter alia*, received written confirmation from the financial supervisory authorities in Denmark and Sweden that they are interested in following up on the Norwegian initiative on Norwegian residential mortgage weights for every entity engaged in banking operations in Norway. Such cooperation is also discussed in the meetings of the Nordic Council of Ministers for Finance.

Nordic banks are not only competing for loan and deposit customers; they are also competitors in the international market for the funding of their own activities by debt and equity. Major national differences in the structure of regulatory frameworks governing, *inter alia*, capital adequacy may, even if the overall requirements are fairly similar, create an impression of differences in solvency and total capital between banks. If the capital market fails to recognise the reality behind apparent differences, it may result in different funding terms for banks with the same or similar risk. Such comparisons are difficult, because no two banks are perfectly identical. Both banks and authorities can contribute to shedding light on real solvency similarities and differences.

In addition, Nordic authorities are also collaborating on plans for handling a potential crisis in the Nordea Group, which is identified by the Financial Stability Board (FSB) as one of 29 globally systemically important banks. The parent company of Nordea is domiciled in Sweden, and it has large banking subsidiaries in Norway, Denmark, Finland, the Baltic countries and Poland. The purpose of such collaboration is to seek agreement between countries as to the handling of potential problems in the Nordea Group, thus ensuring that the authorities are well prepared in the event of problems. It is intended to establish a cooperation agreement, as well as a plan for government handling of a potential crisis in the Nordea Group. Corresponding processes are underway for each of the 29 globally systemically important banks, but none of these have been completed. The crisis management framework in all countries where Nordea has banking operations will change significantly upon the implementation of the planned EU Crisis Management Directive in the EU/EEA. After the Crisis Management Directive has entered into effect, crisis

management should be in conformity with the system defined by that directive.

3.2.4 The deposit guarantee scheme

Deposit guarantee schemes serve an important consumer protection purpose and help to ensure that retail deposits constitute a good and stable source of funding for banks. Consequently, such schemes boost confidence in the banking system and promote financial stability. The Norwegian scheme functioned well during the financial crisis. Norway was the only EU/EEA country in the OECD area that did not introduce extraordinary government guarantee measures during the crisis of 2008. In 2009, the EU adopted amendments to the Deposit Guarantee Schemes Directive; Directive 94/19/EC, which introduced, *inter alia*, full harmonisation of coverage levels, at EUR 100,000 for national deposit guarantee schemes from 1 January 2011. This directive is not implemented in Norway. There has been an understanding between the European Commission and Norway that this matter shall be decided in connection with the deliberation of the directive proposal published by the Commission in July 2010. When the European Commission put forward, in July 2010, a proposal for a new, comprehensive directive on deposit guarantee schemes to replace the current directive, the Commission retained such full harmonisation and also proposed, *inter alia*, pre-funding of the schemes, a risk premium payment requirement for banks and a maximum reimbursement period for depositors of seven days. The EU ministers of finance and the European Parliament reached agreement on the directive on 17 December 2013. The Council of the European Union passed a formal resolution on 3 March, and the directive is expected to be adopted by the European Parliament between 14 and 17 April.

While full harmonisation of the coverage level at EUR 100,000 constitutes a major improvement on the schemes of most EU member states, incorporation of such full harmonisation in Norwegian law would reduce the coverage level in Norway by about 60 pct.

The Ministry has, on a regular basis, kept the Storting informed of developments in the EU regulation of deposit guarantee schemes and the extensive efforts of the Government and the Ministry to maintain the current coverage level from 1996, of NOK 2 million per depositor per bank. The Ministry of Finance stated the following in the supplementary proposition on the National Budget for 2014:

Box 3.1 Systemic importance and structural measures in the banking sector

Structural reforms of the financial sector, especially the banking sector, are under discussion in various international forums. One major issue is whether the size or scope of the activities of banks should be limited in order to promote financial stability. Norwegian authorities are not currently contemplating such measures.

In February 2012, an expert group chaired by the Governor of the Bank of Finland; Erkki Liikanen, was appointed to examine whether financial sector structural reforms can promote financial stability, efficient markets and consumer protection. The group was asked to propose specific measures. On 2 October 2012, the group submitted a report to the European Commission. On 29 January 2014, the Commission published a proposed regulation following up on some of the proposals from the Liikanen report. The purpose of the proposal is to prevent the largest and most complex banks from engaging in risky proprietary trading. The proposal is comprised of two main propositions:

1. Banks to be prohibited from trading in financial instruments and commodities for the sole purpose of generating profits for banks. The proposal is based on the premise that such activities entail risk without offering commensurate benefits to bank customers or the economy as a whole.

2. The supervisory authorities may require banks to separate so-called high-risk activities and ordinary banking into separate legal entities. Banks may avoid such separation if they can demonstrate to the supervisory authorities that the risk is managed otherwise.

The Commission also states that measures are needed to make the shadow banking market more transparent to prevent circumvention of the proposed rules.

The proposal pertains to very large banks, especially those with significant trading portfolios, because a liquidation of such banks will have a major impact on the financial system and the economy as a whole. The Commission proposes that the regulation shall apply to banks that are identified as being of global systemic importance, or that exceed all of the following thresholds for three consecutive years:

- (1) Total assets in excess of EUR 30 billion
- (2) Total trading assets and liabilities exceed EUR 70 billion or 10 pct. of total assets.

The Commission estimates that about 30 banks holding approximately 65 pct. of aggregate total assets in the EU banking sector will fall within the scope of the proposal.

«The Storting has on numerous occasions been informed of the efforts pursued by Norwegian authorities in relation to the directive proposal on deposit guarantee schemes currently under consideration in the EU, and unanimously supported the efforts of the authorities to retain the Norwegian regulatory framework and its NOK 2 million deposit guarantee per depositor per bank. The EU has in its proposed directive suggested a continuation of the full harmonisation of a cover level of EUR 100,000, or about NOK 800,000. The so-called EU trilogue negotiations on the directive have now been resumed. The Ministry of Finance will continue to accord high priority to this matter.»

This matter has been pursued very actively by both the previous and the present Government,

thus ensuring that the Norwegian position and arguments are well known to the EU. This has been unanimously endorsed by the Storting. The directive, in the form it is currently expected to be adopted, stipulates a five-year transition period, until yearend 2018, for countries with cover in excess of EUR 100,000 euro. In other important areas, like the payment period and the accumulation of guarantee funds, the directive proposes a transition period of up to ten years. It is only after the said ten years that the regulatory framework will be harmonised in the EU. The matter will now be submitted for technical review by the EU, and formal adoption by the Council and the European Parliament. Norway will subsequently negotiate on how to incorporate the directive into the EEA Agreement. The Norwegian deposit guarantee provisions will under no circumstance be amended until this has been done.

The Government will now continue to pursue this matter in connection with the coming negotiations on incorporation of the directive into the EEA Agreement. The Ministry will keep the Storting informed of developments in the matter.

3.2.5 Crisis management

In June 2012, the European Commission published a proposal for a directive on the recovery and resolution of credit institutions and investment firms in crisis (the Crisis Management Directive). EU political agreement concerning such directive was reached in December 2013. The directive is assumed to be EEA relevant. It is proposed that it be entered into effect in 2015. Provisions on internal recapitalisation, so-called *bail-in*, cf. below, shall apply from 2016 at the latest. The proposed directive distinguishes between various tools:

1. Preventive measures, for example enhanced supervision, requirements for all institutions to prepare recovery and resolution plans; so-called testaments, as well as scope for group entities to conclude agreements on the provision of intra-group support, on certain terms, if any entity is in financial difficulties;
2. measures that enable the authorities to intervene early when problems are impending; and
3. powers and tools for restructuring, separating or liquidating institutions when a crisis has materialised.

The objective is to be able to liquidate both small and large institutions without creating financial instability, and without burdening public budgets. In order to shield public budgets, the Commission is of the view that it is necessary to establish emergency funds/funding arrangements that are pre-funded by the institutions in each EU country.

The proposed directive introduces new tools for use in situations of crisis. One of four liquidation tools that may be used by national liquidation authorities is *bail-in*. What is meant by *bail-in* in the directive is reducing the liabilities of an institution and converting these into equity. There is a pre-defined order for using the amounts outstanding to creditors in a bail-in. Exemptions are also specified in terms of liability types that cannot be converted into equity. It is proposed that, *inter alia*, deposits covered by a deposit guarantee scheme and secured debts, including covered bonds and other instruments secured in similar ways, shall not be subject to conversion into equity. The three other tools are sale of the busi-

ness, establishment of a bridge institution, i.e. a provisional transfer of the «healthy» assets of an institution to a government-controlled institution, and separation of assets, i.e. a transfer of the «bad» assets of an institution to a separate entity.

An overarching principle for the use of liquidation tools is that the shareholders of an undertaking shall incur losses before the creditors of such undertaking. A creditor of a bank shall, as a main rule, not incur a larger loss than such creditor would have incurred in the event of ordinary liquidation, and creditors with the same priority shall be treated equally. The authorities must have concluded, in order to be able to make use of the liquidation tools, that the institution is about to fail or likely to fail. The authorities shall reach such a conclusion if the institution is (or is likely in the near future to be) in violation of the conditions for engaging in licensed activities, without net assets (liabilities exceed assets), illiquid (unable to discharge liabilities as and when these fall due) or dependent on extraordinary government support measures. Nor can there be any prospect of alternative private sector measures – including measures from so-called «institutional protection schemes» and supervisory measures, including the tools for early intervention and reduction or conversion of additional tier 1 capital and tier 2 capital – preventing, within a reasonable time horizon, the institution from failing.

Finally, the crisis resolution must be necessary to realise, and be reasonably commensurate with, five crisis resolution objectives, including a requirement that liquidation of the institution by ordinary insolvency proceedings will not to the same extent serve to realise the objectives. The five crisis resolution objectives are:

- to ensure the continuity of the critical functions of the institution;
- to avoid significant adverse effects on financial stability;
- to protect public funds by minimising reliance on public financial support;
- to protect depositors and investors covered by deposit guarantee and compensation schemes;
- to protect client funds

The Norwegian system for dealing with financial institutions that encounter financial difficulties is laid down in the Guarantee Schemes Act. The Act authorises the implementation of a number of different measures, depending on how far the crisis in the financial institution has evolved and what can be done to remedy the situation. If need be, the Norwegian Banks' Guarantee Fund may, *inter*

alia, grant loans, furnish guarantees and provide equity to ensure sound and structured continuation or liquidation of institutions in crisis. These statutory provisions are additional to provisions enabling Finanstilsynet to intervene early in institutions in difficulties. The Ministry requested, in a letter of 26 June 2009, the Banking Law Commission to examine potential revision of the current Guarantee Schemes Act, including appurtenant regulations. This shall be adapted to any amendments to relevant EU directives.

3.2.6 EU banking union

There is agreement in the EU on the creation of a single supervisory authority for banks in the Euro zone; the so-called «single supervisory mechanism» (SSM). The decision to create such a supervisory authority was made in October 2013. The decision implies that the European Central Bank (ECB) assumes the role of overarching supervisory authority for all banks (credit institutions) in the Euro zone. The ECB will supervise about 150 of the most important banks in the Euro zone, i.e. banks with total assets in excess of EUR 30 billion or representing in excess of 20 pct. of GDP of their country of domicile, as well as banks believed by the ECB to be of special importance for other reasons. Supervision of the approximately 6,000 other banks in the Euro zone will continue to be the responsibility of national supervisory authorities, although the ECB may intervene in such banking supervision if the ECB deems such intervention to be called for.

The European Parliament and the Council recently agreed a joint EU crisis resolution mechanism, the «single resolution mechanism» (SRM), based on a proposal from the Commission. The purpose is to centralise expertise and resources for dealing with crises in banks in the Euro zone and any other member states that may join the banking union.

EU member states outside the Euro zone may join the banking union of their own volition. The banking union is not open to Norway and the other EEA/EFTA states.

3.2.7 Guidelines for prudent lending practices

Finanstilsynet issued guidelines for prudent residential mortgage lending practices in March 2010. Their purpose was to curtail the volume of loans that are high relative to both income and residential property value, in order to make

households and banks better prepared for potential economic downturns. The guidelines were tightened in December 2011 by requiring, *inter alia*, loans to not normally exceed 85 pct. of the value of the residential property, cf. Box 3.2.

The guidelines laid down by Finanstilsynet stipulate requirements for banks' own internal residential mortgage guidelines. These include, *inter alia*, requirements for institutions to obtain accurate information concerning the income and overall debt of the borrower, and for institutions to be able to calculate the ability of customers to service the loan based on their income, expenses, including interest and instalments, overall debt, as well as the implications of a 5 percentage-point interest rate increase. Finanstilsynet has embedded some degree of flexibility in the guidelines. Banks may, for example, deviate from the norm of an 85 pct. loan-to-value ratio if additional collateral is furnished or if the bank has concluded, based on a specific assessment, that it would be prudent to derogate from the guidelines.

In a letter of 25 October 2013, the Ministry of Finance requested Finanstilsynet to examine how the residential mortgage guidelines are implemented by banks, and what effect such measure may have had on households, banks and the housing market. The Ministry also requested an assessment as to whether the norms laid down in the guidelines should in future be issued in the form of a circular (guidelines) or whether a different legal format (regulations) might be more appropriate.

Finanstilsynet submitted its review of the guidelines to the Ministry on 28 January 2014.

The review indicates that the guidelines have served to curb the accumulation of risk in the Norwegian economy, and that banks are making use of the flexibility embedded in the guidelines. Finanstilsynet is noting, *inter alia*, that the residential mortgage survey for the autumn of 2013 showed that 23 pct. of new residential mortgages were granted to borrowers with less than 15 pct. of own funds. This portion was 35 pct. for borrowers under the age of 35 years. 91 pct. of the loans granted to borrowers with less than 15 pct. of own funds were granted to customers estimated to have surplus liquidity, i.e. positive disposable income after the deduction of subsistence costs and all debt-servicing expenses, and approximately 60 pct. were granted to borrowers that furnished additional collateral. Finanstilsynet also stated that it is not proposing amendments to the guidelines or codification of bank lending practices in the form of regulations, although it may

Box 3.2 Guidelines for prudent lending practices

Finanstilsynet issued guidelines for prudent residential mortgage lending practices in March 2010. The guidelines apply to all Norwegian financial institutions under the supervision of Finanstilsynet, as well as to Norwegian branches of foreign financial institutions. The contents of the guidelines, subsequent to their tightening in December 2011, may be summarised as follows:

- (1) Accurate information should be obtained concerning the income and overall debt of the borrower, and concerning the residential property to be mortgaged by the borrower.
- (2) The bank should calculate the capacity of the customer for servicing the loan, based on income, all expenses, overall debt and the implications of a certain interest rate increase. If the borrower would end up with a so-called liquidity deficit after a potential interest rate increase, the loan should as a main rule not be granted, and the bank should dissuade the customer from obtaining the loan.
- (3) The loan, including any other loans secured on the residential property, may not normally exceed 85 pct. of the residential property value.
- (4) In the event of deviations from the norms, either additional formal collateral (other properties, surety/guarantees) must be furnished, or the bank must have conducted a specific prudential assessment as to whether it is appropriate to derogate from the guidelines. Criteria for such prudential assessments should be established by the board of directors of the relevant bank.
- (5) Loans exceeding 70 pct. of the residential property value should normally be established with payment of instalments from the first due date.
- (6) Banks must clarify which customer groups may be granted a home equity credit line. Account should be taken of the fact that the ability to pay may be significantly impaired during the credit term due to income reduction.
- (7) The granting of home equity credit lines by a bank must be based on a prudential assessment. Home equity credit lines should not normally exceed 70 pct. of the market value of the residential property.
- (8) The bank must, when assessing the ability to pay, make allowance for an interest rate increase of at least 5 percentage points. It is important to make the borrower clearly aware of this. The bank should, when rendering its advice, always make clear the implications of choosing between a fixed and a variable interest rate.
- (9) Any decision by the bank to deviate from its internal guidelines shall be made at a higher level than that normally authorised to grant residential mortgages.
- (10) A report on the bank's follow-up of the guidelines shall be submitted to the board of directors or, as far as foreign branches are concerned, the management team of the bank, in respect of each quarter. Any deviations from the guidelines shall be identified and reported.

Finanstilsynet is following up on the guidelines via reporting in connection with the annual residential mortgage surveys, supervision of Norwegian institutions and meetings with branches. If institutions are in violation of the guidelines, Finanstilsynet may order an increase in their capital adequacy ratio pursuant to the capital adequacy rules. If necessary, Finanstilsynet will first contact the supervisory authorities in the home country.

become necessary to consider new measures depending on financial developments.

On 6 February 2014, the Ministry of Finance sent a reply letter to Finanstilsynet concerning the guidelines. The Ministry stated that a good debt-servicing capacity and a documented ability and willingness to save may compensate for a some-

what higher leverage ratio, as also evidenced by practices observed under the guidelines. The Ministry also stated the following:

«It is important for the discretionary assessments of banks to pay heed to the ability of the customer to discharge his or her liabilities,

based on his or her further loan-servicing capacity. Clause 2 of the guidelines would, when taken in isolation, appear to be somewhat static with regard to this factor. Future ability to service loans must be a permissible consideration when banks perform their specific prudential assessments, cf. Clause 4 of the guidelines.»

The Ministry made it clear that it may be justifiable to grant residential mortgages to borrowers with own funds down to 10 pct. if, for example, borrowers have a satisfactory debt-servicing capacity, have a demonstrated ability to accumulate savings and protect against interest rate increases by binding the interest rate.

The Ministry noted, in its letter of 6 February 2014, that it is important for Finanstilsynet to consider the contents and implementation of the guidelines, as well as the need for codification in the form of regulations, in view of future financial developments. In particular, the Ministry requested an assessment as to how appropriate it is to use a fixed nominal premium of 5 percentage points as a test for how well loan applicants will cope with an interest rate increase. The Ministry is of the understanding that banks will, generally speaking, take the selection of any fixed interest rate option into account for purposes of calculating the interest rate sensitivity of loan applicants.

In addition, the Ministry noted that it is necessary, in order for banks to have flexible guidelines, for the board of directors of each bank to adopt criteria to be used in assessing whether it would be prudent to grant a loan. Such criteria shall be reviewed by Finanstilsynet. Finanstilsynet should ensure that banks do not compete through differences in their practices under the guidelines.

3.3 Insurance and pensions

3.3.1 New solvency rules (Solvency II and Omnibus II)

In April 2009, the European Parliament adopted new solvency rules for insurance companies. The Solvency II Directive (Directive 2009/138/EC) incorporates, *inter alia*, the Consolidated Life Assurance Directive and the three «generations» of non-life insurance directives. One of the objectives of the new directive is to ensure that insurance companies are subjected to allocation and solvency requirements that better reflect the risks of such companies than do the current EU regulations. Unlike previous EU insurance directives,

the Solvency II Directive is predominantly a full harmonisation directive. In other words, member states can neither impose stricter, nor less strict, requirements on companies than those implied by the directive.

Solvency II is organised into three pillars that have much in common with the three pillars of the CRD rules for banks. Pillar I comprises quantitative solvency requirements, including technical provision requirements, solvency capital requirements (SCR) and minimum capital requirements (MCR). In the event of non-compliance with the solvency capital requirements, the supervisory authorities shall require the company to take measures to remedy its solvency status. The licence of the company may be revoked if the company fails to comply with the minimum capital requirement and compliance with such requirement in the near future seems unlikely. Pillar II comprises, *inter alia*, supervision and monitoring provisions. Pillar II also authorises the introduction of a capital requirement tailored to the risk of each insurance company, as well as the imposition of risk management and internal control requirements on companies. Pillar III comprises provisions intended to improve the scope for disciplining insurance companies, including, *inter alia*, provisions on the disclosure obligations of insurance companies.

Inception and implementation of the Solvency II Directive have been postponed repeatedly. It has been necessary to amend the directive in several important respects to, *inter alia*, adapt the rules to the new EU supervision structure, but also because impact studies have demonstrated that a large portion of insurance companies would have found it problematic to meet the requirements laid down in the original directive. The need for new rules on long-term guarantees was particularly evident. An impact study in the spring of 2013 showed that about 60 pct. of EU life insurance companies would not meet the requirements as stipulated at the time. The EU has therefore introduced considerably less strict requirements than originally anticipated. There are, like in the banking sector, major historical, structural and financial differences between insurance companies and insurance markets within the EU.

In the EU, the amendments to the Solvency II rules were made by adoption of the so-called Omnibus II Directive. On 13 November 2013, the Council and the European Parliament agreed, in trilogue negotiations with the Commission, the wording of the Omnibus II Directive. The directive was formally adopted by the European Parliament on 11 March 2014.

It is expected that national authorities will be given a deadline of 31 March 2015 for establishing national rules in accordance with the Solvency II Directive, including the amendments resulting from the Omnibus II Directive. The rules are scheduled to enter into effect on 1 January 2016. However, a clear distinction needs to be made between when the rules are to be implemented and enter into effect, and at what speed they will be applied, i.e. phase-in of the rules over time. It is anticipated that national authorities will, *inter alia*, be permitted to issue extensive transitional provisions with the effect that the new requirements will not be applied to companies until later, and not be applied in full until after 16 years. It is expected that countries will take the financial situation of the country itself, the solvency situation of its national insurance companies, as well as international competition conditions, into consideration for such purposes.

On 1 March 2012, the Storting approved incorporation of the Solvency II Directive into the EEA Agreement, cf. Recommendation No. 192 (2011–2012) to the Storting and Proposition No. 54 (2011–2012) to the Storting. The Ministry is planning the inclusion of general provisions on a new solvency framework for insurance companies in the new Act on Financial Undertakings and Financial Groups, based on the draft submitted by the Banking Law Commission in the NOU 2011: 8 Green Paper.

The current solvency provisions for insurance companies in Norway are based on, *inter alia*, the Solvency I Directive, which is focused on the liabilities side of the balance sheet of the companies. In order to ensure more comprehensive regulation, Norwegian insurance companies are also subject to capital adequacy requirements that take the risk on the asset side of the balance sheet into consideration. Fundamentally, it is favourable for insurance companies internationally to also be subjected to solvency rules that take risks of both sides of the balance sheet into account.

The new solvency provisions under Solvency II imply, *inter alia*, that assets and liabilities shall be valued at so-called fair value, or market value. Future liabilities shall therefore be discounted by using a market yield curve. The yield curve is determined by using observed market rates and by extrapolation to a long-term equilibrium rate, or *ultimate forward rate*. For Norwegian life insurance companies, which currently discount liabilities by using a fixed discount rate, these amendments may result in the value of liabilities becoming higher or lower than under the current rules, depending on the interest rate level at the time of

transition. The amendment also implies that the value of liabilities will fluctuate in future.

The challenges posed by fluctuations in the value of insurance liabilities as the result of discount rate changes have represented one of the main difficulties in the completion of the Solvency II rules within the EU. It has been agreed, in the said trilogue negotiations on the Omnibus II Directive, that national authorities may permit a 16-year phase-in period for the valuation of insurance liabilities, either by phasing in the change in the value of the provisions from Solvency I principles to Solvency II principles, or by phasing in the use of market rates to discount liabilities.

The way ahead in Norway depends on the process in the EU. After Omnibus II has been adopted, supplementary EU rules are to be stipulated at several levels. It is expected that the European Commission will adopt implementation provisions in the form of a regulation. Such regulation will have direct binding legal force in member states and is intended to enter into effect simultaneously with the Solvency II Directive.

Finanstilsynet is charged with preparing draft Norwegian regulations, but must await the final EU rules. The Ministry of Finance intends to circulate such regulations for consultation in the ordinary manner.

3.3.2 Private occupational pension schemes

Ever-increasing life expectancy poses a challenge to all aspects of the pension system. If one wishes to maintain the same level of the annual retirement pension, one will need to either save more per year of work or work for more years, thus retiring at a higher age. The alternative is lower retirement benefits per year. The low interest rate level also poses challenges to the private pension system. Pension providers must each year deliver a guaranteed return on major parts of the assets they manage on behalf of customers. Low interest rates make it challenging to deliver returns in excess of the guaranteed amount without assuming more risk.

The national insurance scheme has undergone a major reform to ensure the financial sustainability of the public pension system and to provide individuals with an incentive to continue working for longer.

Private sector corporations are required to provide their employees with a retirement pension scheme. Retirement pension schemes provided in compliance with such requirement receive preferential tax treatment, compared to other pension savings. From 1 January 2014, a

third alternative for such retirement pension schemes was put at the disposal of corporations, in addition to the traditional defined-contribution and defined-benefit schemes. The new product framework combines features from both defined-contribution and defined-benefit schemes. The product framework was adopted on the basis of a proposal from the Ministry of Finance, submitted in Legislative Proposition No. 199 (2012–2013) to the Storting, which was again based on the recommendations of the Banking Law Commission in the NOU 2012: 13 Green Paper and a consultation memorandum dated 7 January 2013 from Finanstilsynet. In connection with the deliberation of the legislative proposal by the Storting, the Standing Committee on Finance and Economic Affairs requested, in Legislative Recommendation No. 35 (2013–2014) to the Storting, the Ministry to examine whether it would be appropriate to propose amendments to the provisions of the Defined-Contribution Pensions Act and the Mandatory Occupational Pensions Act concerning the minimum pension benefit payment period and the pension saving contributions of employees, and to revert, if appropriate, with a legislative proposal covering these issues. The Ministry intends to initially request Finanstilsynet to examine these issues, before reverting to the Storting.

The Banking Law Commission is currently examining whether it would be desirable and practicable to establish a form of defined-benefit retirement pension scheme tailored to the new national insurance scheme, cf. the mandate of 21 March 2013 from the Ministry of Finance to the Banking Law Commission.

Self-employed persons and others that do not meet the minimum requirement as to the number of employees necessary to establish a group defined-contribution pension scheme, may save up to 4 pct. of their income between 1 and 12 times the national insurance base amount (G) in a tax-favoured pension scheme. The Government will examine the various types of pension schemes in context and has, *inter alia*, signalled in the Sundvolden platform that it will strengthen the individual pension savings (IPS) scheme. The scope of self-employed persons, etc., for making tax-favoured pension savings should be examined in the context of, *inter alia*, IPS.

3.3.3 Paid-up policies with an investment option

When an employee resigns from a corporation with a defined-benefit retirement pension scheme,

he or she is issued with a paid-up policy evidencing his or her accrued pension entitlements. Paid-up policies will also be issued to employees if a corporation terminates its defined-benefit pension scheme.

Under defined-benefit schemes, the pension provider promises a certain return on the pension assets. The authorities stipulate a cap on the guaranteed return. Any return in excess of the guaranteed amount will in normal circumstances be allotted to the policies as profits. For as long as the scheme remains active, i.e. for as long as pension entitlements continue to accrue, pension providers may collect an annual premium to cover the return risk. Once paid-up policies are issued, the scope for collecting annual premiums is replaced by an arrangement under which the pension provider may retain up to 20 pct. of any excess return.

In Legislative Proposition No. 11 (2012–2013) to the Storting, the Ministry of Finance proposed that paid-up policyholders be permitted to waive the return guarantee in exchange for a right to decide for themselves how the pension assets linked to their paid-up policies shall be managed. This is referred to as the investment option arrangement. Requirements are proposed with regard to the information to be disclosed by pension providers in circumstances where such conversion to an investment option is a possibility. The Storting adopted the proposal submitted by the Ministry of Finance, but the rules have yet to enter into effect. One of the reasons for this is a need for clarifying how to deal with paid-up policies when the pension assets linked to these are insufficient to fund the guaranteed pension benefit, cf. the below discussion of step-up plans. On 25 November 2013, the Ministry circulated a proposal from Finanstilsynet for consultation, under which proposal paid-up policies would have to be fully provisioned prior to any conversion to the investment option. The deadline for submitting consultative comments was 17 January 2014, and these comments are currently being examined by the Ministry.

3.3.4 Step-up to new mortality rate schedules

Finanstilsynet has stipulated new minimum requirements as to the assumptions underpinning life expectancy development calculations; so-called mortality rate schedules, in order for these to better reflect the changes in life expectancy. The new requirements will apply from 2014. The new schedules are dynamic, i.e. expected life

expectancy developments in coming years are embedded in the schedules.

When life expectancy increases, the retirement pension premiums and provisions need to be increased. The new mortality rate schedules make it clear that life insurers have for a number of years made insufficient provisions for funding the liabilities they have assumed. Companies will be granted a step-up period to accumulate the reserves required to comply with the new requirements. Moreover, Finanstilsynet intends to consent to pension undertakings using customer returns for reserve building, subject, however, to a minimum of 20 percent of annual reserve building taking place by using the assets of the pension undertaking itself. It has been discussed whether pension providers should be permitted to use excess returns on one policy to accumulate reserves on another policy. The Ministry of Finance stated the following in a letter of 27 March 2014 to Finanstilsynet:

«The Ministry of Finance agrees with Finanstilsynet that considerations relating to the balanced apportionment of the costs of step-up to C2013 suggest that consent should not be granted to excess returns on one policy being used to boost the provisions for other policies, and that the minimum contribution of pension undertakings, of 20 percent of the reserve building need, shall be attributed at the policy level. [...]

Generally speaking, the reserve building contributions of pension undertakings will, within a given step-up period, be higher if customer returns are allotted to individual policies than if customer returns are allotted across policies («cross subsidisation»). If no change is to be made to the contribution of the pension undertaking, the duration of the step-up period will have to be extended. It has previously been assumed, as mentioned above, that the duration of the step-up plans should not exceed five years. The Ministry of Finance expects Finanstilsynet to adopt step-up plans for each pension undertaking based on using customer returns as specified above (no «cross subsidisation»), with a reasonable reserve building contribution from pension undertakings, cf. the assumption of an equity contribution of no less than 20 pct. outlined by Finanstilsynet in its letter of 8 March 2013.»

This was followed by a letter of 2 April 2014 from Finanstilsynet to all pension undertakings on

guidelines for reserve building and the use of returns to cover increased group pension insurance provisions.

Employers with defined-benefit pension schemes for their employees, persons with paid-up policies from group schemes and persons who receive pension benefits from defined-benefit schemes during the step-up period will not receive excess returns until the reserve building has been completed for their policy. However, the guaranteed pensions of employees – their contractual benefits – will not be reduced.

3.4 Securities markets

3.4.1 Benchmark rates

Benchmark rates are used, *inter alia*, to determine prices and payments under various types of financial contracts. The most frequently used benchmark rates are intended to reflect the interest rates on unsecured loans between banks for different maturities. There is, generally speaking, very limited activity in the markets for such loans, so the benchmark rates are typically determined by way of a panel of banks reporting, on a daily basis, their estimates as to what would have been the price of such loans if the transactions had taken place.

Manipulation or suspected manipulation of such important benchmark rates may have a serious impact on market integrity, and may cause major loss for consumers and investors or disturb the real economy. On 4 February 2014, the European Parliament approved a proposal from the European Commission on new provisions to counter market abuse, which rules include a clear prohibition against the manipulation of benchmark rates, including LIBOR and EURIBOR, and made such manipulation a criminal act by way of including criminal sanctions in the proposal.

NIBOR («Norwegian Interbank Offered Rate») is the corresponding Norwegian benchmark rate. The rules for determining NIBOR are, as with many other «IBOR» benchmark rates internationally, laid down by the financial industry (Finance Norway, as far as Norway is concerned).

Investigations in several countries in the wake of the financial crisis have identified weaknesses in the frameworks for determining benchmark rates, in the form of, *inter alia*, unclear definitions and procedures, inadequate controls and conflicts of interest, as well as an absence of market anchoring, disclosure and verifiability. Some of the weaknesses are also of relevance to Norway.

Much has been done to remedy this over the last year, principally by improvements in self regulation within the industry.

Although significant improvements have been made recently, there is room for additional measures both internationally and in Norway. In August 2013, the Ministry of Finance requested Finanstilsynet to monitor developments in best international practice within this field and to prepare draft public rules on benchmark rate determination by the end of March 2014. The Ministry also requested a report on which types of benchmark rates are needed in the Norwegian market. On 18 September 2013, the European Commission proposed a new regulation on «benchmarking», which will include, *inter alia*, requirements for determining benchmark rates and other pricing benchmarks for financial instruments and financial contracts. It is assumed that a future regulation will be EEA relevant.

3.4.2 Savings and investment products

Different types of investment products are currently regulated in different ways, depending on, for example, how the products are designed, or which sector provides them. The EU is developing a regulatory framework pertaining to advice on, and distribution of, various savings and investment products; so-called *packaged retail investment products* (PRIIPs). The objective is to bring about harmonised rules for information on, and sales of, savings and investment products. It is intended that these new rules will largely be premised on the principles and provisions of the existing regulatory framework, such as the Insurance Mediation Directive and the so-called *Markets in Financial Instruments Directive* (MiFID) with regard to good business practice requirements, and the EU securities fund provisions (the UCITS Directive) with regard to disclosure requirements.

The Ministry of Finance is considering amendments to the financial legislation to expand the disclosure obligation of investment firms, banks and insurance companies in relation to advice on, and sales of, alternative savings products and the introduction of a requirement for audio recording of such advice and sales. Alternative savings products are products perceived to be similar to, or meeting consumer needs similar to those met by, financial instruments. Such alternative savings products include defined-contribution products and life insurance with an investment option. Draft amendments to the applicable provisions were cir-

culated for consultation in October 2013. The draft circulated for consultation calls for advice on, and sales of, alternative savings product to be subjected to the same disclosure requirements as currently apply to advice on, and sales of, financial instruments.

3.5 Measures to enhance financial market competition

The economy needs robust financial institutions that compete for customers. Effective competition promotes efficient operations, good resource utilisation and economically profitable capital allocation, as well as prices reflecting the costs and benefits of using and creating financial products and services. Effective competition will also benefit consumers via, for example, lower prices, better products, better information and scope for opting out of using suppliers that fail to meet their personal needs.

The Ministry is committed to facilitating effective competition in the financial market and will also continue to develop financial market regulations with this objective in mind. An important general prerequisite for effective market competition is transparent market places. It should be easy for purchasers of financial services to get an overview of the products offered by different service providers, as well as the applicable prices and other terms. It should be correspondingly easy for sellers to disseminate information about their own products, as well as the applicable prices and other terms, to potential purchasers, without thereby sharing information about future conduct with competitors. The Finansportalen financial service comparison website is a useful tool for creating transparent markets for consumers in their choice of financial service providers.

Disclosure of nominal and effective interest rate details is required when loans are marketed, in order to ensure that information on, for example, loan offers includes relevant details. Detailed rules have been laid down on the calculation of effective interest rates in order to prevent individual service providers from calculating such interest rates as they deem fit. Marketing information needs to be fairly general and brief. Financial institutions are also required to disclose, *inter alia*, the effective interest rate, which includes fees and other costs, in addition to the nominal interest rate, prior to concluding any agreement for the granting of a loan. The disclosure obligation is then stricter than in a more general marketing

context. The Ministry will take an initiative for reviewing the disclosure requirements with a view to making the information even more readily accessible and understandable for consumers. The Ministry will, *inter alia*, examine how it can be ensured that financial institutions include links to Finansportalen on their websites. Such a link will make it easier for customers to compare prices and other terms.

Technological developments may improve the competition situation in the market. More readily available information may for example make the demand for financial services less dependent on geographical considerations. Finansportalen facilitates comparison of the current prices and other terms of different financial service providers. Information on current prices may be of limited value in choosing service providers, especially for financial services whose prices may change rapidly, for example variable interest rate loans. Information on the prices offered by different service providers over a period of time may be of use to, for example, a customer who is not envisaging frequent changing of service providers in response to ongoing interest rate changes. Finansportalen is currently testing a solution in which historical residential mortgage prices are made available to the public. The Ministry is of the view that such a tool may be well suited for stimulating competition for, *inter alia*, variable interest rate loans.

It should be simple and inexpensive to change banks, in order to stimulate competition. The Ministry will examine to scope for facilitating easier switching between banks. This will necessitate assessment of new technological solutions and developments in other countries. Relevant measures may include, *inter alia*, facilitating so-called bank giro number portability, i.e. that a corporation can have one bank giro number for use by its customers to pay for its goods and services, irrespective of what account and bank such corporation chooses to link to the said bank giro number.

For corporations, the bond market represents an alternative to bank loans. Current law implies that issuers and investors do not have access to information about the identity of bondholders. It has been asked whether this strengthens the position of brokers with good access to information through their own systems, and impairs competition. The Norwegian Fund and Asset Management Association and Nordic Trustee have proposed the establishment of Nordic Bond Pricing. The intention is to improve public information on bond market pricing. Moreover, the Ministry is examining a suggestion from the Oslo Stock

Exchange, under which the issuer would be able to stipulate a contractual right of access to information about the identity of bondholders, including the potential effect of this on market liquidity and competition.

The supply side of the financial market has changed considerably over time. One such change is that credit undertakings issuing covered bonds have taken over a large part of the residential mortgage market from banks. The intention behind admitting mortgage companies that can issue covered bonds was more efficient and cheaper funding of such lending. Lower costs may benefit loan customers in the form of lower interest rates.

The scope for establishing credit undertakings that issue covered bonds may have affected competition in the residential mortgage market. This results, *inter alia*, in a larger number of entities in the market that can fund residential mortgages for Norwegian households, but mortgage companies that can issue covered bonds do not market loan offers. Contact with the loan customers of the mortgage companies that can issue covered bonds is handled by the banks that originally granted such loans. The Ministry also intends to examine the links between banks and mortgage companies that issue covered bonds, with a view to establishing the competition implications of such links.

The authorities have a number of tools at their disposal for preventing financial institutions from collaborating in ways that impede competition. The Competition Authority has various powers enabling it to intervene against arrangements that limit market competition. Sector-specific regulation also confers competition-related powers on the Ministry of Finance. Collaboration agreements between financial institutions that do not form part of the same group shall, for example, require the approval of the Ministry of Finance, subject to certain exemptions, cf. Section 2-7 of the Financial Institutions Act. Some types of collaboration may promote enhanced market competition. This will depend on specific assessments in each individual case. Collaboration may, for example, be important for small banks by keeping costs down and adding knowhow, and scope for collaboration may serve to bring more competitors into the market. The Ministry will initiate an evaluation of the regulation of competition matters in the Financial Institutions Act, as well as the principles to which weight has been accorded, to ensure that effective market competition is facilitated to a sufficient extent.

Contact between authorities may strengthen the quality of the initiatives pursued by various authorities to improve competition. Finanstilsynet holds annual meetings with both the Competition Authority and the consumer protection authorities, in addition to contacts whenever needed in specific matters. The Ministry has examined whether it may be appropriate to establish a specific forum for coordinating and exchanging information about the financial market competition situation. The Ministry is of the view that further expansion of such cooperation in the form of a competition policy forum between the said bodies may result in more effective promotion of competition and contribute to good contact and exchange of information between public bodies with potentially overlapping responsibilities.

3.6 Consumer protection

3.6.1 Consumer considerations in financial market regulation

Consumers need stronger legal protection in the financial market than do professional customers. The activities of Finanstilsynet, which supervises financial undertakings, are organised to promote statutory and regulatory compliance. Finanstilsynet is required to focus on consumer rights and consumer interests in its supervision. Supervision can be complex because, *inter alia*, new products and multiple products are marketed to consumers, and because marketing is often more personal and «tailored» to each consumer or group of consumers.

Norwegian authorities have attached considerable weight to consumer considerations in drafting financial markets regulations. One important task for the authorities in protecting consumer interests is to ensure the robustness of financial undertakings. This is important for the economy as a whole, but also out of consideration for consumers who hold claims in the financial market, whether in the form of bank deposits, insurance claims, pension savings, fund units or other securities investments.

Consumer protection is reflected in, *inter alia*, the Financial Contracts Act, which confers rights on consumers that cannot be contracted out of to the detriment of the consumer. The Financial Contracts Act contains a number of detailed provisions on contracts for various financial services, and regulates various issues. The Act includes provisions on, *inter alia*, what information the financial institution shall disclose to its customer,

the right of the customer to terminate contracts, limitations in the right of the financial institution to terminate contracts, the obligation of the financial institution to notify the customer of any changes before these enter into effect, the obligation of the financial institution to advise the customer against conclusion of certain contracts, and limitations in the right of the financial institution to refuse to conclude contracts.

There is a clear legal distinction between the statutory provisions governing the relationship between a financial institution and a customer, which are found in the Financial Contracts Act, and the statutory provisions governing the activities and organisation of financial institutions in general. Although the latter statutory provisions are not designed to give consumers specific rights, such provisions are of major importance to consumers. It is, for example, in the interest of consumers for the legal framework to prevent banks and insurance companies from exposing the funds of their customers to risks that are not wanted by such customers, as well as from organising their activities in such a way that their own financial interests are in conflict with the interests of their customers. In order for consumer interests to be attended to in a good manner, it is necessary to take such interests into consideration when the authorities, for example, introduce measures to prevent financial instability, define capital requirements for financial undertakings, and establish bank deposit guarantee schemes.

3.6.2 Access to information

Finansportalen is a public, web-based information solution that gathers and compares financial service information for consumers, created at the initiative of the Ministry of Children, Equality and Social Inclusion and the Ministry of Finance. The portal provides an overview of banking, investment and insurance services. The portal enables consumers to monitor the market and to compare prices and services. Finansportalen also provides a simple system for changing banks and a solution that makes it easy to compare offers from different non-life insurance providers. Finansportalen can therefore serve as an effective tool for consumers in choosing a financial service provider. Increased awareness and use of Finansportalen on the part of consumers may have a positive impact on competition between banks.

Consumers may, as an alternative to contacting banks and other financial institutions themselves, get assistance with obtaining and evaluat-

ing offers for the provision of financial services from, for example, credit intermediaries or financial advisers. Credit intermediaries and financial advisers are not governed by the same regulatory framework. Credit intermediation is classified as a financial activity and is governed by the Financial Institutions Act. A credit intermediary shall serve as an impartial intermediary between the financial institution and the customer, and attend to the interests of both parties. He or she may also, on certain conditions, be remunerated by both parties. A financial adviser assists the customer in his or her dealings with the financial institution, and can only accept payment from the customer, not from the financial institution. Financial advisers are governed by the Financial Contracts Act.

The Financial Contracts Act also includes provisions on financial agents. A financial agent acts on behalf of the financial institution, and is its assistant. The financial agent shall make the customer aware of this. A financial agent cannot receive remuneration for its services from the customer; only from the financial institution with which he or she has an agency agreement.

Upon the conclusion of loan agreements, a financial institution shall comply with the obligations laid down in the Financial Institutions Act, the Financial Contracts Act, the Anti-Money Laundering Act, etc. These include, *inter alia*, providing the customer with information about the agreement and the obligations assumed by the customer. Special disclosure obligations apply in relation to consumers. Banks will, in addition to their statutory obligations, make a commercial assessment as to which agreements they wish to conclude, and banks will not normally be under any obligation to conclude agreements. It is important to be aware that persons or corporations that assist with obtaining and evaluating offers for the provision of financial services, such as credit intermediaries and financial advisers, need to be paid for the services they provide. Hence, there is a cost to them acting as intermediaries between the customer and the financial institution, and the customer must weigh the benefits involved against such cost.

3.6.3 New EU provisions on payment services

The EU is in the process of revising the Payment Services Directive, based on a directive proposal of 24 July 2013 from the European Commission. The purpose of the new Payment Services Directive is to modernise the regulatory framework in

line with market developments, encourage innovation and promote more secure technical payment solutions. Other objectives are expanding consumer choice and reducing the costs of using payment services. The directive addresses a number of important issues. Key issues that merit mention are the regulation of third party payment service providers («TPPs»), the reach of provisions governing telecom operators that process payment transactions, the scope of payees for charging payors for the use of various payment instruments («surcharging»), and the scope of national authorities for limiting the liability of consumers for card misuse in case of gross negligence.

The main rule with regard to card misuse, under both the current directive and the directive proposal, is that the customer is liable for any loss, without limitation, if the customer has acted fraudulently or with gross negligence. However, the current directive includes an exemption authorising national authorities to limit the liability of customers, even in cases of gross negligence on the part of the customer. The Norwegian regulatory framework makes use of such exemption, with the liability for loss being limited to NOK 12,000. The said exemption is not included in the directive proposal, on the grounds that the Commission is aiming for further harmonisation of the EU payment services market. The current exemption was originally included in the Payment Services Directive at the behest of Norway and the member states Sweden and Denmark, with the support of Germany and the UK.

The European Commission proposal for a new Payment Services Directive has been circulated for consultation in Norway, and the Ministry of Finance is following up on this. On 14 January this year, the Minister of Finance sent a letter to the European Parliament in which she called for the continuation of the current exemption, which authorises capping of the liability of consumers for card misuse.

Norway has also taken the initiative for a joint statement from the EFTA member states to relevant EU bodies, raising key issues relating to the Payment Services Directive and outlining the positions of the EFTA member states on these.

3.6.4 The Norwegian Financial Services Complaints Board and dispute resolution

The Norwegian Financial Services Complaints Board is a non-judicial dispute resolution body, which was established in 2010 by the Norwegian

Consumer Council, the Confederation of Norwegian Enterprise, Finance Norway, the Association of Norwegian Finance Houses and the Norwegian Fund and Asset Management Association. The Norwegian Financial Services Complaints Board was created by combining the former Insurance Complaints Bureau (Insurance Complaints Board) and Banking Complaints Board. The Norwegian Financial Services Complaints Board organises four professional boards to hear disputes between financial undertakings and their customers.

Against the background of a request from the Storting to the Government in 2012, cf. the discussion in Chapter 4 of Report No. 30 (2012–2013) to the Storting; the Financial Markets Report 2012, amendments have been made to the contractual framework governing the activities of the Norwegian Financial Services Complaints Board:

- Firstly, the governing documents of the Norwegian Financial Services Complaints Board now stipulate that the chair and deputy chair of each professional board shall be highly qualified lawyers who are neutral in relation to the contracting parties and the industries and interest groups represented by the contracting parties. The professional boards are being expanded. Previously, each professional board comprised five members: one independent chair, two members from the customer side and two members who represented financial undertakings. Following the amendments, each professional board comprises seven members, since the deputy chair shall attend all hearings alongside the chair, and since each professional board shall include one ordinary, independent member who is a qualified lawyer, and who meets the same independence requirements as the chair and the deputy chair. The three independent members shall be appointed by a unanimous resolution of the executive committee of the Norwegian Financial Services Complaints Board.
- Secondly, it becomes easier to submit well-structured complaints to the Norwegian Financial Services Complaints Board. The Norwegian Financial Services Complaints Board shall implement measures to achieve this, and intends to, *inter alia*, provide thorough guidance on the Internet as to how a complaint should be submitted, whilst also facilitating the use of appropriate electronic solutions for the submission of complaints. The complainant will still receive guidance from the secretariat of the Norwegian Financial Services Com-

plaints Board as to the structuring of a complaint.

- Thirdly, financial undertakings shall ensure that a clear distinction is made between internal complaints procedures and a neutral complaints body like the Norwegian Financial Services Complaints Board when financial undertakings communicate with their customers. Financial undertakings should provide clear information about the Norwegian Financial Services Complaints Board, and should forward complaints to the Board if these are of such a nature as to merit deliberation by an independent body.

The Ministry of Justice and Public Security has recently, in a letter of 14 March 2014 to the Norwegian Financial Services Complaints Board, approved the overall contractual framework governing the Norwegian Financial Services Complaints Board under the Financial Contracts Act and the Insurance Contracts Act. The approval confers certain rights on customers of undertakings affiliated with the Board: The customer is entitled to have disputes heard by one of the professional boards, the case cannot be brought before the courts of justice as long as it is pending before a professional board, and a case that has been heard on its merits by a professional board can be brought directly before the District Court without first having been deliberated by the Conciliation Court. The Ministry of Justice and Public Security has previously evaluated and approved the contractual frameworks governing the Banking Complaints Board and the Insurance Complaints Board.

The Norwegian Financial Services Complaints Board has long been a well-functioning and effective dispute resolution body, but there has nonetheless been scope for improvement. The amendments now made will enhance the integrity and expertise of the Norwegian Financial Services Complaints Board, contribute to improving the processing of cases and make it easier to submit complaints. This serves to strengthen the position of consumers in the financial market.

The Storting has adopted new statutory provisions on the board hearing of disputes between financial undertakings and their customers, cf. Legislative Recommendation No. 116 (2013–2014) to the Storting and Legislative Proposition No. 188 (2012–2013) to the Storting. Firstly, the new statutory provisions authorise the King to lay down regulations requiring financial undertakings to be affiliated with a complaints board governed

by a contractual framework approved pursuant to the Financial Contracts Act or the Insurance Contracts Act, for example the Norwegian Financial Services Complaints Board. Secondly, financial undertakings shall, if they fail to comply with the conclusions of a complaints board in a dispute with a consumer, cover any necessary legal costs incurred by both themselves and the opposite party in judicial proceedings before the court of first instance in the same dispute between the same parties. This will apply correspondingly to proceedings before the court above if the financial undertaking is the appellant. The new provisions eliminate the financial risk to consumers when instituting legal proceedings if financial undertakings fail to comply with board conclusions that are in favour of the customer, and have a disciplining effect on financial undertakings. This makes the resolution of disputes with financial undertakings even more secure and simple for consumers. The provisions are based on drafts and initiatives from the Banking Law Commission and the Norwegian Financial Crisis Commission, cf. the NOU 2011: 8 and NOU 2011: 1 Green Papers, respectively.

The Ministry of Children, Equality and Social Inclusion is preparing new provisions on consumer disputes in general. A government-appointed commission has, in the NOU 2010: 11 Green Paper on the Board Hearing of Consumer Disputes, proposed changes to non-judicial dispute resolution arrangements in Norway. The proposal calls for boards to qualify for government approval if they meet certain requirements, including, *inter alia*, requirements as to the organisation of the board, requirements as to its composition, and formal requirements as to its chair. Moreover, the commission has proposed authorisation for decisions made by government-approved boards to be accorded legal effect and enforceability, provided, however, that the contracting parties behind each board shall decide whether to accord legal effect and enforceability. The commission has proposed procedural provisions for such boards, including, *inter alia*, provisions on adversarial proceedings (i.e. a right for the parties to argue their case and to be informed of the arguments invoked by the opposite party), on neutrality and on the structuring and publication of board decisions. The follow-up of the NOU 2010: 11 Green Paper will largely run in parallel with an ongoing process relating to new EU provisions. Under new EU provisions; Directive 2013/11/EU on Alternative Dispute Resolution for Consumer Disputes and Regulation No. 524/2013 on Online Dispute Resolution for Consumer Dis-

putes, all EU member states shall offer non-judicial dispute resolution in all types of consumer cases, and the members of the dispute resolution bodies shall meet requirements with regard to expertise and integrity. A supervisory body shall supervise the dispute resolution bodies, and the dispute resolution bodies shall report to the supervisory body on, *inter alia*, the number of complaints, processing times, outcomes and efficiency. The supervisory body shall, based on the reported details, assess whether the dispute resolution bodies meet the requirements under the directive and request any outstanding matters to be remedied. If such matters have not been remedied by the stipulated deadline, the approval of the relevant dispute resolution body shall be revoked. If new EU provisions are incorporated into the EEA Agreement, amendments to Norwegian law will be required. Such amendments include, *inter alia*, the requirement for a supervisory body to supervise the dispute resolution bodies.

3.6.5 Investment advice

Investment advice is a personal recommendation to a customer, at the initiative of the customer or the investment firm, concerning one or more transactions in certain financial instruments. Investment advice is a service requiring a licence, and is subject to extensive requirements laid down in the Securities Trading Act and the Securities Trading Regulations. One important requirement is that any investment firm providing investment advice shall organise its activities in such a way that the risk of conflicts of interest between the firm and its customers is minimised. This implies, *inter alia*, that the salaries of investment advisers shall not be directly linked to what product the customer invests in, or to whether or not the customer chooses to invest. Moreover, the investment firm can only accept remuneration from other parties than the customer (for example product providers) if such remuneration serves to improve the quality of the investment advice and does not detract from the obligation of the firm to attend to the interests of the customer in the best possible manner. Finanstilsynet may revoke the licence to provide investment advice in case of serious regulatory violations.

3.7 Ownership limits

Government consent is required for individual persons or corporations to acquire so-called signif-

ificant ownership stakes of financial institutions. In this context, a significant ownership stake is an ownership stake representing 10 percent or more of the assets or votes of the relevant financial institution, or otherwise offering scope for exerting considerable influence over the management and activities of such institution.

It is established and entrenched practice that no single natural or legal person is permitted to hold more than 25 percent of the shares of a bank. This limit is introduced to, *inter alia*, ensure the independence of the institution and to prevent private banker activities. There are special exceptions premised on special circumstances, for example a group context, the owner being a body of a cooperative nature, or the licensed activities in question being very narrow in scope. In the legislative history of the Financial Institutions Act, the reasoning behind the regulatory framework is explained, *inter alia*, as follows (Proposition No. 50 (2002–2003) to the Odelsting, p. 16):

«[The Ministry is of the view] that the regulatory framework should safeguard the independence of financial institutions in relation to other businesses and owners that might conceivably use their influence to favour themselves, their business associates or their private associates through underpriced loans, guarantees, etc. Control of, for example, a major financial group provides considerable influence over other businesses. Consequently, one should still seek to prevent non-financial owners from exerting undue influence over other businesses through major ownership stakes in Norwegian financial institutions, since such stakes may pave the way for arrangements motivated by extraneous considerations. Furthermore, one must still seek to prevent non-financial owners from using their positions to obtain favours (for example cheap credit, including credit that would otherwise not have been granted because of excessive risk) for themselves, their business associates or their private associates. Such conflicts of interest also provide incentives for imposing especially strict conditions on customers that are, for example, engaged in competition with such major owner's own business. Attaching weight to non-commercial considerations may also impair the position of other customers of the relevant financial institution, as well as the profitability of such financial institution, and hence also the other owners. In a worst case scenario, others will have to contribute funding

to the financial institution in a rescue operation. Moreover, economic loss may be incurred if capital is not allocated to the most viable projects.»

There has been a broad consensus on this in the Storting, and the Ministry will maintain the practice under which individual persons are not permitted to hold more than 25 percent of the shares of a bank.

3.8 Outsourcing

There is an increasing tendency within the financial industry for financial institutions to use contractors to perform tasks and functions that were previously performed by financial institutions themselves; so-called business outsourcing. The use of contractors varies considerably between financial institutions. Tasks that are commonly outsourced include those relating to personnel and administrative functions, accounting and asset management, actuarial services, etc., whilst for example small pension funds may in many cases outsource the predominant part of their activities – apart from overall coordination – to third parties. Conversely, specialised tasks may also be outsourced, for example if a bank or other financial institution contracts a debt-collection agency to perform the enforcement of overdue or defaulted loans. The outsourcing of tasks by financial institutions has not previously been subject to general statutory regulation in Norway, although rules have been introduced in certain areas, for example the provisions in Section 2-9 of the Financial Institutions Act and special rules on the outsourcing of activities by investment firms. Limitations on the outsourcing of tasks will normally also be laid down in the licence issued for the various activities engaged in by financial institutions. The main rule is that core tasks, i.e. tasks that form a necessary and integrated part of the activities for which the institution has been granted a licence shall not be outsourced. Outsourcing raises a number of key issues relating to, *inter alia*, the supervision of outsourced activities, the protection of personal data, the safeguarding of ICT systems and other financial infrastructure, emergency preparedness, as well as the secure and appropriate handling of incidents. New outsourcing provisions have been considered by, *inter alia*, the Banking Law Commission in the NOU 2011: 8 Green Paper. The Ministry is currently drafting a

proposal for new outsourcing provisions in the Financial Institutions Act and the Financial Supervision Act. The proposed statutory provisions will include rules on what tasks can be outsourced by financial institutions and how, as well as rules specifically authorising Finanstilsynet to monitor outsourcing and to take measures against financial institutions that are outsourcing in a manner deemed inappropriate or unlawful by Finanstilsynet.

3.9 Financial reporting

3.9.1 Accounting

A new consolidated Accounting Directive, replacing the previous accounting directives, was adopted by the EU on 26 June 2013. The main purposes of the new directive are:

1. simplification and reduction of administrative burdens, especially for small companies;
2. clearer and more comparable financial statements, especially for companies in respect of which such considerations are of key importance as the result of developments towards ever-increasing cross-border activities and a larger number of external stakeholders;
3. protection of important user needs via dissemination of necessary accounting details to users; as well as
4. transparent payments to governments from companies with activities in the extractive industry or the logging of primary forests; so-called country-by-country reporting.

The directive requires companies governed by the Accounting Directive that are classified as «large» under the threshold values of such directive, and that have activities in the extractive industry and/or within forestry in primary forests, to prepare a separate report on payments to governments. The same obligation applies to listed companies that are engaged in such activities. The country-by-country reporting provisions of the directive have already been enacted in Norway with individual national adaptations; see Item 4.1.5 below.

It is intended for the new directive to be incorporated into national legislation no later than July 2015. The Ministry intends to appoint a legislative committee to examine potential amendments to the Accounting Act, including any amendments necessary to incorporate the Accounting Directive into Norwegian law.

3.9.2 Auditing

On 30 November 2011, the European Commission proposed amendments to the Statutory Audit Directive and a new regulation on the statutory audit of public-interest entities (including, *inter alia*, banks, insurance companies and listed companies). On 17 December 2013, the Council and the European Parliament reached political agreement on new EU provisions. It is expected that final EU provisions will be formally adopted in the spring of 2014. The main purposes of the amendments to the directive and the introduction of the new regulation are:

1. to increase audit quality;
2. to strengthen competition between audit firms by, *inter alia*, removing barriers to entry for small and medium-sized audit firms;
3. to introduce clearer and stricter independence requirements for auditors;
4. to strengthen the supervision of auditors and audit firms;
5. to ensure that audit services can increasingly be provided on a cross-border basis within the EU through, *inter alia*, the emergence of truly pan-European audit firms;
6. to reduce burdens for small and medium-sized companies.

The proposal is EEA relevant. The Ministry intends to appoint a legislative committee to examine potential amendments to the Auditing Act, including any amendments necessary to incorporate the Statutory Audit Directive into Norwegian law.

3.10 The new EU supervisory system

On 1 January 2011, the EU established a new supervisory system intended to strengthen supervision of the entire European financial sector and to improve the basis for financial stability. The new supervisory system adopts a two-track approach. Macro-prudential supervision is left to a European Systemic Risk Board (ESRB) with responsibility for monitoring systemic risk in the European financial market as a whole, whilst micro-prudential supervision is conducted by three supervisory authorities, for the banking sector (EBA), the insurance and pensions sector (EIOPA) and the securities sector (ESMA), respectively.

The micro-prudential supervisory authorities are to advise the Commission and national supervisory authorities, draft proposals for supplementary regulatory provisions in their sectors, promote harmonised supervisory practices within the EU/EEA and, to some extent, supervise individual institutions. The micro-prudential supervisory authorities have decision-making powers in certain situations: 1) in case of violation of relevant EU provisions; 2) in emergencies; and 3) in case of dispute between national supervisory authorities. Such decisions may be binding on national supervisory authorities or apply directly to private parties in the EU member states. Moreover, the micro-prudential supervisory authorities have in separate legislative acts been granted direct supervisory powers in relation to certain types of undertakings.

The inclusion in the EEA Agreement of legislative acts granting decision-making powers to an EU body represents a challenge in terms of both the two-pillar structure of the EEA Agreement and the stipulations in the Norwegian Constitution on the prerequisites for the transfer of executive powers. Norwegian authorities are currently involved in discussions, alongside Iceland and Liechten-

stein, with the EU on potential models for inclusion of the supervision provisions in the EEA Agreement, taking into consideration, *inter alia*, the Norwegian Constitution and the two-pillar structure of the EEA Agreement. Until a solution is found in this regard, new legislative acts within the financial market area that grant such powers to micro-prudential supervisory authorities in the EU are not included in the EEA Agreement. The EEA/EFTA states and the EU agree that quickly finding a solution is now a matter of pressing importance.

Unlike the micro-prudential supervisory authorities, the ESRB cannot make binding decisions, although it may make recommendations to member states. Consequently, inclusion in the EEA Agreement of the regulation establishing ESRB does not pose the same challenge in terms of the Norwegian Constitution and the two-pillar approach.

Pending a formal affiliation via the EEA Agreement, Finanstilsynet participates as an observer in the micro-prudential supervisory authorities on an informal basis. Norges Bank and Finanstilsynet also participate on an informal basis as observers in the ESRB «Technical Advisory Committee».

4 Regulatory amendments and licences in major financial market matters

4.1 Regulatory developments

Sections 4.1.1 to 4.1.6 of this chapter provide an overview of the main financial market regulatory amendments in 2013. Section 4.1.7 provides a brief overview of regulations laid down in 2013. Section 4.2 lists key licences granted that same year, with a brief discussion of each case.

The overarching objective of regulatory amendments within the financial markets area in 2013 was to promote financial stability and well-functioning markets.

4.1.1 Banking

On 10 June 2013, the Storting adopted amendments to the Financial Institutions Act and the Securities Trading Act. The legislative amendments are discussed in Legislative Proposition No. 96 (2012–2013) to the Storting, Amendments to the Financial Institutions Act and the Securities Trading Act (new capital requirements, etc.). The legislative amendments entered into effect on 1 July 2013.

The legislative amendments constitute a first step in the adaptation to CRD IV, the EU regulatory framework based on the recommendation of the Basel Committee on new capital and liquidity standards adopted in December 2010. The statutory capital adequacy requirements are 4.5 percent CET1 capital ratio, 6 percent tier 1 capital ratio and 8 percent capital adequacy ratio. In addition to the minimum requirements, institutions shall have CET1 capital buffers. A 2.5 percent capital conservation buffer is required from 1 July 2013. The systemic risk buffer is introduced gradually, with a 2 percent systemic risk buffer being required from 1 July 2013, increasing to 3 percent from 1 July 2014. The level of the said buffer may be adjusted upwards or downwards. The buffer for systemically important institutions shall be 1 percent from 1 July 2015 and 2 percent from 1 July 2016. The 9 percent CET1 capital ratio requirement remains in effect until 1 July 2014. The requirement will then be increased to 10 percent,

and again to 11 percent from 1 July 2015. The Ministry of Finance proposes, in the preparatory works of the legislative amendments, that the capital conservation buffer, counter-cyclical buffer and systemic risk buffer requirements shall not, for the time being, apply to investment firms.

On 4 October 2013, the King in the Council of State laid down regulations on counter-cyclical capital buffers. The regulations establish the system of counter-cyclical capital buffers. The counter-cyclical capital buffer requirement shall apply to banks, credit undertakings and parent companies of banking groups. The purpose of the counter-cyclical capital buffer is to make institutions stronger and more robust to loan losses in a future recession and reduce the risk that banks contribute to deepening a recession by curtailing their granting of credit. The regulations stipulate that Norges Bank shall prepare a basis for decision making and advise the Ministry of Finance as to the level of the counter-cyclical capital buffer four times a year. In preparing such basis for decision making, Norges Bank shall exchange relevant information and assessments with Finanstilsynet.

On 12 December 2013, the Ministry of Finance laid down regulations on the level of the counter-cyclical capital buffer. The regulations stipulate that the counter-cyclical capital buffer shall be 1 percent of risk-weighted assets as from 30 June 2015.

Amendments to the Capital Requirements Regulations were adopted on 13 October 2013, with the lower limit on Loss Given Default (LGD) when using internal risk models for residential mortgages being increased from 10 to 20 percent for all loans secured on residential property in Norway. The amendments entered into effect on 1 January 2014.

On 27 September 2013, the Ministry of Finance adopted amendments to Regulations of 18 December 2009 No. 1726 relating to the Committee for the Monitoring of Anti-Money Laundering Measures. The amendments were predominantly of a technical nature, but also introduced supple-

mentary requirements on the dealings of the Monitoring Committee. The amendments entered into effect on 1 July 2014.

On 22 March 2013, the Ministry of Finance adopted regulations on computer system requirements and reporting to the Norwegian Banks' Guarantee Fund, in replacement of Regulations of 19 May 2010 No. 706. The new regulations stipulate system requirements, as well as requirements concerning the format and contents of the reports to be submitted to the Norwegian Banks' Guarantee Fund when a decision has been made to place a bank under public administration. The regulations entered into effect on 1 July 2013.

Finanstilsynet has, at the request of the Ministry of Finance and in consultation with Norges Bank, performed an assessment of the system for determining the so-called *Norwegian Interbank Offered Rate* (NIBOR) and measures to strengthen the financial system. In 2013, Finanstilsynet conducted inspections of the six panel banks: DNB Bank ASA, Nordea Bank Norge ASA, Handelsbanken, Danske Bank, Skandinaviska Enskilda Banken AB and Swedbank Norge.

4.1.2 Insurance and pensions

On 13 December 2013, the Storting adopted the Act relating to Occupational Pensions (the Occupational Pensions Act). The Act entered into effect on 1 January 2014 and enables businesses to choose a new tax-favoured group occupational pension product for their employees. The new occupational pension product will represent an alternative to the existing mandatory occupational pension schemes and defined-contribution pension schemes. The amendments form part of the process of adapting the private sector pension legislation to the new retirement pension provisions under the national insurance scheme.

On 13 December 2013, the Ministry of Finance adopted amendments to Regulations of 22 December 2000 No. 1413 relating to Act of 24 November 2000 No. 81 relating to Occupational Defined-Contribution Pensions (the Defined-Contribution Pensions Act), which imply that the maximum contribution rates for defined-contribution pension schemes are increased to the same level as the contribution rates for the new occupational pension product, and that the so-called levelling-off point is increased from 6 to 7.1 times the national insurance base amount (G). The amendments shall apply from 1 January 2014.

In a letter of 8 March 2013 to all life insurers, Finanstilsynet stipulated new minimum require-

ments for group life insurance mortality rate assumptions.

4.1.3 Securities trading and securities funds

On 14 May 2013, the Ministry of Finance adopted amendments to Chapter 7 of Regulations of 29 June 2007 No. 876 relating to the Securities Trading Act (the Securities Trading Regulations), in order to implement the EEA provisions corresponding to Regulation (EU) No. 311/2012, Regulation (EU) No. 486/2012 and Regulation (EU) No. 862/2012 on prospectus contents. The amendment entered into effect on 1 July 2013.

On 4 July 2013, the Ministry of Finance adopted amendments to Section 36 of Regulations of 29 June 2007 No. 875 (the Securities Exchange Regulations), providing for the members of the Stock Exchange Appeals Committee to be appointed for a term of up to four years. The background to the amendment is a need for more systematic appointment timings.

On 18 December 2013, the Ministry of Finance repealed Regulations of 20 December 1996 No. 1247 relating to Issue Price and Obligation to Report the Issuance of Bearer Bonds, etc. The repeal implies that there are no restrictions on the issuance of bonds at a price below the redemption price («at a discount»). The repeal also implies the abolition of the obligation to report bond issuances to Norges Bank under the said regulations. The repeal entered into effect on 1 January 2014.

4.1.4 Estate agency

On 21 June 2013, the Ministry of Finance adopted amendments to Regulations of 23 November 2007 No. 1318 relating to Estate Agency. The amendments imply that bidding rounds organised through an estate agent shall be documented. The estate agent shall only process bids, acceptances and rejections made in writing. Any information from the estate agent to the bidders and the seller during the bidding round shall also be in writing. SMS and e-mail messages qualify as being "in writing". In addition, all bidders need to document their identity before submitting any bids. The purpose of the amendments is to make it safer for consumers to make residential property purchases, by making it simple to establish, after the bidding round, what has been communicated to and from the participants during such round. The amendments entered into effect on 1 January 2014.

4.1.5 Accounting, auditing and bookkeeping

In Act of 19 April 2013 No. 15, the Storting enacted amendments to the Accounting Act and certain other acts. The amendments imply that accounting entities qualifying as large enterprises for purposes of the Accounting Act shall, in their annual reports or other documents, present their policy on the integration of considerations relating to human rights, employee rights, social matters, the external environment and corruption prevention in their business strategy, in their daily operations and in their stakeholder relations. In addition, they shall specify how they go about turning such policy into action, and provide an assessment of what has been achieved and expected future achievements.

The said Act of 19 April 2013 No. 15 also enacted an amendment to the Auditing and Auditors Act, authorising Finanstilsynet to grant individual exemptions from the requirement for audit firms to have a permanent establishment in Norway if documents pertaining to clients in Norway are stored at a location in this country in a sound and secure manner. Moreover, a statutory provision was added to the effect that the auditor shall assess information disclosed in connection the corporate social responsibility presentations pursuant to the Accounting Act, which are included in annual reports or other documents. Likewise, the auditor shall in the auditor's report comment on such presentations and the statements made in annual reports or other documents with regard to corporate social responsibility. Royal Decree of 19 April 2013 No. 395 stipulates that the amendments shall apply with effect from financial years commencing after 31 December 2012.

In Act of 22 December 2013 No. 116, the Storting enacted amendments to the Accounting Act on so-called country-by-country reporting (CCR). The amendments imply that accounting entities engaged in the extractive industry and/or forestry in primary forests and classified as «large» for purposes of the new Accounting Directive, shall prepare and publish an annual report on such activities. The report shall, *inter alia*, disclose payments to governments, at the country and project level. Corresponding amendments were made to the Securities Trading Act, thus implying that the same obligation applies to corporations that are issuers of securities and engaged in activities of the abovementioned type. The legislative proposal was published in Legislative Proposition No. 1 (2013–2014) to the Storting. The Ministry of Finance laid down regulations

with supplementary provisions on 20 December 2013. These amendments to statutes and regulations entered into effect on 1 January 2014, with effect for financial years commenced on 1 January 2014 or later.

In Act of 22 December 2013 No. 121, the Storting enacted amendments to the Bookkeeping Act. The amendments imply that the storage period for so-called primary documentation is reduced from 10 to 5 year. At the same time, the Ministry was authorised to adopt regulations requiring a longer storage period for certain types of primary documentation if necessary for mandatory financial reporting purposes or for tax audit purposes. It was announced, in connection with the legislative amendment, that it would be necessary to adjust the adjoining regulatory framework in response to this, and that one would also review those areas where the need for older documentation tends to be most pronounced, to examine whether remedial measures are needed. The legislative amendment entered into effect on 1 February 2014. At the same time, the Ministry of Finance adopted regulations setting out transitional provisions, and instructed the Directorate of Taxes to examine whether a longer storage period is necessary for certain types of documentation needed for tax audit purposes, as well as for combating white-collar crime.

On 17 January 2013, the Ministry of Finance adopted amendments to the Annual Financial Statement Regulations for banks and mortgage companies. These amendments relate to note information. Investments in Norwegian companies require the enterprise registration numbers of such companies to be included in notes, and the note requirements with regard to capital adequacy have been amended in conformity with applicable capital adequacy rules.

On 19 December 2013, the Ministry of Finance amended Regulations of 16 December 1998 No. 1240 relating to the Annual Financial Statements, etc., of Banks, Financial Undertakings and their Parent Companies. The amendments imply that banks and financial undertakings that have not issued listed securities shall also recognise and measure pension liabilities in conformity with IFRS (IAS 19) as from the 2015 financial year. Moreover, a requirement was introduced to the effect that such institutions shall publish their annual financial statements, annual reports and auditor's reports on their websites.

On 19 December 2013, the Ministry of Finance amended Regulations of 16 December 1998 No. 1241 relating to the Annual Financial

Statements, etc., of Insurance Companies. The amendments imply that insurance companies that have not issued listed securities shall also recognise and measure pension liabilities in conformity with IFRS (IAS 19) as from 2015. In addition, certain adjustments were made to the regulations as the result of amendments to IFRS, principally with effect from 2014. Besides, a requirement was introduced to the effect that such institutions shall publish their annual financial statements, annual reports and auditor's reports on their websites, with effect from the 2013 financial year onwards.

On 19 December 2013, the Ministry of Finance amended Regulations of 20 December 2011 No. 1457 relating to the Annual Financial Statements of Pension Undertakings. The amendments imply that pension undertakings will be required to recognise and measure pension liabilities in conformity with IFRS (IAS 19) from 2015. In addition, certain adjustments were made as the result of amendments to IFRS, principally with effect from 2014. Besides, a requirement was introduced to the effect that such institutions shall publish their annual financial statements, annual reports and auditor's reports on their websites, with effect from the 2013 financial year onwards.

On 28 June 2013, the Ministry of Finance amended Regulations of 1 December 2004 No. 1558 relating to Bookkeeping. The amendments are based on, *inter alia*, the proposals in sub-reports number 2 and 3 from the Norwegian Bookkeeping Standards Board, which reviewed experience with the existing regulations. The amendments may reduce the administrative costs of businesses by up to NOK 300 million per year. The amendments entered into effect on 1 January 2014.

4.1.6 Miscellaneous

For each coming six-month period, the Ministry of Finance stipulates a late payment interest rate pursuant to Section 3 of Act of 17 December 1976 No. 100 relating to Late Payment Interest, etc. (the Late Payment Interest Act). The rate was equivalent to the Norges Bank key policy rate, with a surcharge of no less than 7 percentage points until 1 July 2013, and with a surcharge of no less than 8 percentage points after that date. On 26 June 2013, the late payment interest rate was fixed at 9.50 percent p.a., cf. Regulations of 26 June 2013 No. 755 relating to Late Payment Interest. At the same time, the Ministry of Finance stipulated a standard debt collection cost compensation amount of NOK 300. On 20 December 2013,

the late payment interest rate was fixed at 9.50 percent p.a., cf. Regulations of 20 December 2013 No. 1586. At the same time, the Ministry of Finance stipulated a standard debt collection cost compensation amount of NOK 320.

4.1.7 Enacted regulations

The Ministry of Finance enacted 22 sets of financial market regulations in 2013:

- Regulations of 8 January 2013 No. 15 relating to amendment of Regulations of 21 December 2011 No. 1467 supplementing the Securities Fund Act (the Securities Fund Regulations)
- Regulations of 11 January 2013 No. 32 relating to amendment of Regulations of 17 December 2004 No. 1852 relating to the Implementation of the EEA Provisions on Adopted International Financial Reporting Standards
- Regulations of 17 January 2013 No. 44 relating to amendment of Regulations of 16 December 1998 No. 1240 relating to the Annual Financial Statements, etc., of Banks, Financial Undertakings and their Parent Companies
- Regulations of 20 February 2013 No. 215 relating to amendment of Regulations of 29 June 2007 No. 876 supplementing the Securities Trading Act (the Securities Trading Regulations)
- Regulations of 22 March 2013 No. 330 relating to Computer Software Requirements and Reporting to the Norwegian Banks' Guarantee Fund.
- Regulations of 13 May 2013 No. 473 relating to amendment of Regulations of 29 June 2007 No. 876 supplementing the Securities Trading Act (the Securities Trading Regulations)
- Regulations of 14 May 2013 No. 474 relating to amendment of Regulations of 29 June 2007 No. 876 supplementing the Securities Trading Act (the Securities Trading Regulations)
- Regulations of 3 June 2013 No. 568 relating to transitional provisions supplementing Act of 9 April 2013 No. 15 relating to amendment of the Accounting Act and certain other statutes
- Regulations of 21 June 2013 No. 722 relating to amendment of Regulations of 23 November 2007 No. 1318 relating to Estate Agency (documentation of bidding rounds)
- Regulations of 26 June 2013 No. 755 relating to Late Payment Interest and Debt Collection Cost Compensation
- Regulations of 28 June 2013 No. 805 relating to amendment of Regulations of 1 December 2004 No. 1558 relating to Bookkeeping

- Regulations of 1 July 2013 No. 816 relating to amendment of Regulations of 14 December 2006 No. 1506 relating to Capital Requirements for Commercial Banks, Savings Banks, Financial Undertakings, Financial Group Holding Companies, Investment Firms and Securities Fund Management Companies, etc. (the Capital Requirements Regulations)
- Regulations of 4 July 2013 No. 859 relating to amendment of Regulations of 29 June 2007 No. 875 relating to Regulated Markets (the Securities Exchange Regulations)
- Regulations of 27 September 2013 No. 1134 relating to amendment of Regulations of 13 March 2009 No. 303 relating to the Committee for the Monitoring of Anti-Money Laundering Measures.
- Regulations of 4 October 2013 No. 1170 relating to Counter-Cyclical Capital Buffers
- Regulations of 13 October 2013 No. 1301 relating to amendment of Regulations of 14 December 2006 No. 1506 relating to Capital Requirements for Commercial Banks, Savings Banks, Financial Undertakings, Financial Group Holding Companies, Investment Firms and Securities Fund Management Companies, etc. (the Capital Requirements Regulations)
- Regulations of 12 December 2013 No. 1440 relating to the Level of Counter-Cyclical Capital Buffers
- Regulations of 18 December 2013 relating to repeal of Regulations of 20 December 1996 No. 1247 relating to Issue Price and Obligation to Report the Issuance of Bearer Bonds, etc.
- Regulations of 19 December 2013 No. 1680 relating to amendment of Regulations of 16 December 1998 No. 1241 relating to the Annual Financial Statements, etc., of Insurance Companies, Regulations of 20 December 2011 No. 1457 relating to the Annual Financial Statements of Pension Undertakings and Regulations of 16 December 1998 No. 1240 relating to the Annual Financial Statements, etc., of Banks, Financial Undertakings and their Parent Companies
- Regulations of 20 December 2013 No. 1586 relating to Late Payment Interest and Debt Collection Cost Compensation
- Regulations of 20 December 2013 No. 1682 relating to Country-by-Country Reporting
- Regulations of 20 December 2013 No. 1668 relating to amendment of Regulations of 17 December 2004 No. 1852 relating to the Implementation of the EEA Provisions on Adopted International Financial Reporting Standards

4.2 Administrative licences

On 5 March 2013, Gjensidige Arbejdsskade-forsikring AS and Gjensidige Forsikring ASA were granted a merger licence, with Gjensidige Forsikring ASA as the acquiring company. The licence is subject to conditions.

On 22 March 2013, Vestbo Finans AS was granted a licence to engage in financial activities pursuant to Section 3-3 of the Financial Institutions Act. At the same time, Vestlandske Housing Association was granted a licence to hold 100 per cent of the shares of Vestbo Finans AS. The licence is subject to conditions.

On 18 April 2013, Sparebank 1 Kredittkort AS was granted a licence to engage in financial activities pursuant to Section 3-3 of the Financial Institutions Act. The licence is subject to conditions.

On 26 April 2013, Sparebanken Hedmark was granted a licence to expand its ownership stake of Sparebank 1 Oslo Akershus AS from 12 per cent to 40.5 per cent. The licence is subject to conditions.

On 26 April 2013, the Norwegian Confederation of Trade Unions (LO) was granted a licence to expand its ownership stake of Sparebank 1 Oslo Akershus AS from 5.9 per cent to 19 per cent. At the same time, LO and Affiliated Unions (Norwegian United Federation of Trade Unions, Norwegian Union of Industry and Energy Workers, Norwegian Civil Service Union, Norwegian Food and Allied Workers' Union, Norwegian Seafarers' Union, Norwegian Transport Workers' Union, Norwegian Engineers' and Managers' Association, as well as the Norwegian Union of Postal and Communication Workers) were granted a licence to expand their aggregate ownership stake of Sparebank 1 Oslo Akershus AS from 8.6 per cent to 28.4 per cent.

On 30 April 2013, the Ministry of Finance approved the merger of Oslo Børs ASA and its Swedish subsidiary Burgundy AB; a Swedish regulated market licensed to operate a multilateral trading facility. At the same time, Oslo Børs ASA was granted a licence to engage in activities in Sweden via a branch. Finanstilsynet granted Oslo Børs ASA a licence to operate a multilateral trading facility, thus enabling Oslo Børs ASA to continue the operations of Burgundy AB following the merger.

On 2 May 2013, Bø Sparebank and Seljord Sparebank were granted a merger licence. Bø Sparebank acquired the savings bank activities of Seljord Sparebank, with the latter being closed down. Two savings bank foundations were established, which foundations hold equity capital cer-

tificates of the merged bank. The licence is subject to conditions.

On 8 May 2013, Sunndal Sparebank was granted a licence to issue transferable equity capital certificates. The licence is subject to conditions.

On 8 May 2013, Aasen Sparebank was granted a licence to issue transferable equity capital certificates. The licence is subject to conditions.

On 21 May 2013, OBOSBanken AS was granted a licence to engage in banking activities. OBOS Finans Holding AS, which is the owner of OBOS, was approved as 100 percent owner of OBOSBanken AS. The licence is subject to conditions.

On 10 June 2013, Hypo Næringskreditt was granted a licence to engage in credit activities. The licence was granted pursuant to Section 3-3 of the Financial Institutions Act. The licence is subject to conditions.

On 28 June 2013, Safe Deposit Bank of Norway AS was granted a licence to engage in commercial bank activities. The licence was granted pursuant to Section 8 of the Commercial Banks Act. At the same time, the Ministry of Finance approved the establishment of Safe Deposit Holding ASA as the parent company of a financial group, with Safe Deposit Bank of Norway AS as its wholly-owned subsidiary.

On 12 July 2013, Ria Financial Services Norway was granted a licence to engage in financial activities pursuant to Section 3-3 of the Financial Institutions Act. The licence is subject to conditions, and is restricted to currency exchange activities.

On 18 September 2013, Time sparebank was granted a licence to issue 1 million equity capital certificates with a nominal value of NOK 100 by conversion of its primary capital into equity capital. At the same time, a licence was granted for the establishment of Sparebankstiftelsen Time og Hå. The licence is subject to conditions.

On 2 October 2013, Nes Prestegjelds Sparebank and Hol Sparebank were granted a merger licence, with Nes Prestegjelds Sparebank as the acquiring bank. Two savings bank foundations were established, which foundations hold equity capital certificates of the merged bank. The bank has been named Nes Prestegjelds Sparebank. The licence is subject to conditions.

On 7 October, OBOS Factoring AS was granted a licence to engage in financial activities. The licence was granted pursuant to Section 3-3 of the Financial Institutions Act.

On 15 November 2013, Sparebanken Sør and Sparebanken Pluss were granted a licence to

merge by the transfer of the assets and liabilities (operations) of Sparebanken Sør to Sparebanken Pluss, cf. Section 2c-2 of the Financial Institutions Act. It is intended for the operations of the merged bank to be continued under the name of Sparebanken Sør. A licence was granted, in connection with the said transfer, to issue equity capital certificates to Sparebankstiftelsen Sør in consideration for the equity capital of Sparebanken Sør. The licence also included the acquisition of significant ownership stakes in Sør Boligkreditt AS and Brage Finans AS, cf. Section 2-2, Sub-section 2, of the Financial Institutions Act, and the establishment and modification of a group structure, cf. Section 2a-3, Sub-section 2, and Section 2a-7, Sub-section 2, of the Financial Institutions Act. The licence is subject to conditions.

On 15 November 2013, Sparebank 1 NordVest was granted a licence to issue transferable equity capital certificates. The licence is subject to conditions, laid down pursuant to Section 2b of the Financial Institutions Act.

On 15 November 2013, Harstad sparebank was granted a licence to issue 1,500,000 equity capital certificates with a nominal value of NOK 100 by conversion of NOK 150 million of its primary capital into equity capital. At the same time, a licence was granted for the establishment of Sparebankstiftelsen Harstad Sparebank. The licence is subject to conditions.

On 25 November 2013, Helse Sør Øst RHF was granted a licence to establish a pension fund for health trusts in the capital region; Pensjonskassen for helseforetakene i hovedstadsområdet. The pension fund shall engage in group pension insurance activities classified as life insurance activities under Section 7-3 of the Insurance Activities Act of 10 June 2005. The licence is subject to conditions.

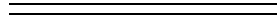
On 28 November 2013, Ly forsikring was granted a licence to engage in non-life insurance activities. The licence was granted subject to conditions. On 30 August 2013, Finanstilsynet confirmed that the conditions for activating the licence had been met, and that the licence could be activated.

On 20 December 2013, Komplet Bank ASA was granted a licence to engage in commercial bank activities. The licence was granted pursuant to Section 8 of the Commercial Banks Act. At the same time, Komplet AS was granted a licence to hold up to 20 percent of the shares of the bank. The licence is subject to conditions.

In 2013 Finanstilsynet received 19 applications for a licence to engage in payment activities. 16 of

these licence applications were limited to money transfers. Two of the undertakings that submitted applications were granted a licence to provide money transfers, whilst two applications were withdrawn and twelve applications were rejected. Three of the applications remain under consideration. At the same time, Finanstilsynet received 11 applications for the renewal of limited licences

granted in 2011. Three of these were granted, one was rejected and seven remain under consideration. In 2013, one licence to engage in payment activities was revoked due to inadequate reporting to Finanstilsynet, as well as the corporation failing to comply with its auditor appointment obligation.



Published by:
Norwegian Ministry of Finance

Internet address:
www.government.no

Cover: Area between two time-series showing, respectively, the difference between the average loan rate and estimated funding costs for loans to corporations and for mortgages. Credit institutions operating in Norway.

Printed by:
Norwegian Government Security and Service
Organisation 06/2014

