

Official Norwegian Reports NOU 2017: 13 (Summary)

# New central bank act

The Act relating to Norges Bank and the Monetary System and the organisation of Norges Bank and the management of the Government Pension Fund Global

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Report from the Commission appointed by Royal Decree on 10 April 2015.  
Submitted to the Ministry of Finance on 23 June 2017.



# Contents

<b>1</b>	<b>Summary and recommendations</b> .....	5	1.3	Organisation of Norges Bank and the management of the GPFG .....	15
1.1	Recommendations of the Central Bank Law Commission .....	5	1.3.1	Introduction .....	15
1.1.1	Governance and organisation .....	5	1.3.2	Norges Bank's central banking functions .....	15
1.1.2	The central bank's purpose and responsibilities .....	8	1.3.3	An investment management entity separated from Norges Bank .....	17
1.2	More about the Commission's proposals .....	10	1.3.4	Norges Bank with the GPFG under the management of the Bank .....	18
1.2.1	Purpose and functions .....	10	1.3.5	The Commission's assessments and recommendations .....	19
1.2.2	Relationship between the central bank and government authorities	11	1.3.6	Some amendments to the Government Pension Fund Act ....	21
1.2.3	Monetary policy and financial stability .....	12			
1.2.4	The payment system .....	13	<b>2</b>	<b>Excerpts from the draft act on Norges Bank and the Monetary System, etc.</b> .....	22
1.2.5	Other functions .....	14			
1.2.6	Duty of confidentiality, administrative procedures etc. ....	14			



## Chapter 1

# Summary and recommendations

### 1.1 Recommendations of the Central Bank Law Commission

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The mandate of the Commission has been to propose a new Act relating to Norges Bank and the Monetary System and consider the organisation of Norges Bank and the management of the Government Pension Fund Global (GPFG), also referred to as the Fund.

#### 1.1.1 Governance and organisation

1. According to the mandate, the Commission is to consider whether the Fund should continue to be managed by Norges Bank and propose governance and organisational models where the Fund remains under the management of Norges Bank and where the Fund is separated from Norges Bank. The Commission was also requested to consider assigning functions to separate committees in Norges Bank.

The Commission notes that the Ministry of Finance is of the view that Norges Bank has managed the Fund and the central banking operations in a satisfactory manner. The Commission has sought to be forward-looking and has considered how Norges Bank and the Fund should be organised in the light of current insight into central banking and investment management.

*2. The Commission recommends, on the basis of an overall assessment, to separate the management of the Government Pension Fund Global from Norges Bank and to establish a separate statutory entity to manage the Fund (in the report referred to as Model A).*

The Commission has emphasised, among other things, the following:

The traditional functions of central banking have changed considerably since the 1990s. Monetary policy was for a long period geared towards a fixed or stable exchange rate. Inflation targeting requires a broader and more extensive decision-making basis. The 2008 financial crisis reminded us how vulnerable the economy is when

confidence in the financial system collapses. The sustained period of low interest rates following the financial crisis poses new challenges to the central bank in its conduct of monetary policy, its work on financial stability and with regard to the interaction between the two areas. A framework should be established to clarify and expand the central bank's responsibility for financial stability and macroprudential supervision. The central bank must have a leading role in Norway in the development of new forms of money and payment systems. The Commission is of the view that the work relating to the central bank's overall functions has become more demanding.

The management of the Fund has become more extensive than expected at the time this function was assigned to Norges Bank. The Fund's investment universe has been broadened to include emerging economies and real estate. The size of the Fund has increased substantially and hence the Fund has become of considerable importance for the Norwegian economy. The Fund is now of a size equivalent to around three times annual national income. The expected annual return is on a par with the gross product of Norway's manufacturing industry as a whole. Around every seventh Norwegian krone that is spent via public sector budgets in 2017 will be drawn from the expected return on the Fund.

The organisational structure must be designed to facilitate the further development of the Fund. Establishing an organisation and a board solely responsible for this function will strengthen the Fund.

Norges Bank and the new investment management entity will both be transparent organisations with a clear governance structure. They should be able to deliver results and meet goals. The governing bodies and management will be held accountable and liable for their actions. This is important in order to maintain the prevailing credibility and legitimacy of Norges Bank and the Fund. With two separate entities, the professional competence

and composition of the governing bodies can more easily be tailored to the task at hand.

If the Fund is to be managed by Norges Bank, the governance structure becomes complicated, and the Governor will face a substantial scope of tasks. Few persons will possess the experience and breadth of skills required to handle both functions. There will be a risk that a failure in investment management could undermine the credibility and reputation of central banking operations and the central bank's independent position.

3. *The Commission proposes the establishment of a separate statutory entity charged with managing the Fund, delinked from Norges Bank.* The new entity shall have a board appointed by the Government. The Ministry of Finance shall, as is the case today, define the mandate for investment management pursuant to the Government Pension Fund Act. The Commission assumes that the practice of parliamentary endorsement of important changes to the mandate is retained. The Ministry of Finance is responsible for the appointment of auditors, approval of the accounts and oversight of board decisions and mandate compliance. The entity reports to the Ministry of Finance, and the Ministry reports on Fund's activities to the Storting (Norwegian parliament).

The investment management unit at Norges Bank, Norges Bank Investment Management (NBIM), and its staff can be transferred to the new investment management entity.

The Commission has used the working title Norwegian Government Investment Management (NGIM) to designate the new entity.

4. The Commission finds that the main risk associated with such a separation is that the prevailing framework for the Government Pension Fund could be compromised. The Commission emphasises that a separation must not in any other respect affect the framework for the Fund. In order to safeguard the important role of the Fund in overall economic policy, the Commission proposes to *incorporate into the Government Pension Fund Act that the Fund is to be invested abroad, that the capital in the Fund is to reflect real government saving and a goal formulation that strengthens the emphasis on the Fund's function as a source of financing of the welfare state across generations.* The requirement of the highest possible return at an acceptable and carefully weighed risk level is thus of particular importance.

The Commission would caution against dividing the Fund into several entities, in the light of the additional costs and management challenges

this would entail. It is not meaningful in this case to create competition between government-controlled investment entities. The Commission would also caution against using the Fund as an instrument of foreign policy, business policy, regional policy or environmental policy. Public resources to promote these policies should be allocated via the central government budget subject to the criteria for prioritisation, realistic budgeting, transparency and the loss provisioning practices that follow thereof. The Fund must not, as emphasised in the legislative history, become a government budget number two for purposes that are not prioritised in the annual budget process.

A separation may have implications for the tax position of the Fund and immunity from lawsuits and seizure of assets in other countries. It is assumed that the Fund's tax positions in the main will be retained as the government will still be the beneficial owner, but the interpretation of both local law and of tax agreements may vary across countries. It would also appear that the Fund under the management of Norges Bank benefits from somewhat greater immunity in some countries. Any effects in respect of both taxation and immunity are uncertain, but the Commission judges that their size is such that they should not be given decisive weight.

A separation entails one-off costs and will require planning and resources. Relative to the benefits of establishing a solid organisation for the future, the costs are nonetheless assumed to be moderate. In order to dispel uncertainty about the organisation, it is important that the decision-making process and a separation process are carried out in an efficient manner.

5. *The Commission proposes the establishment of a five-member committee for monetary policy and financial stability at Norges Bank.* The Commission proposes that the committee be assigned responsibility for the use of monetary policy instruments and the work on promoting financial stability. The committee is chaired by the Governor of Norges Bank. Norges Bank should have one Deputy Governor and he/she should serve as vice chair. Two external members should serve in at least a half-time position, while one member, who is a full-time employee of Norges Bank, should be appointed by the Board on the proposal of the Governor. This provides a framework for a highly professional body, focused on central bank policy. External members can provide corrective feedback by providing new input from other professionals in their field, but as in most central banks, they should not have a major

rity of the seats in the committee. Part-time external members are useful in that the members can thereby be equally well prepared for the committee's deliberations. With external members serving part-time, the risk of conflict with other business or occupational roles is reduced.

The committee reports to the Ministry of Finance on its use of judgement and use of policy instruments. In addition to chairing the committee, the Governor is responsible for the daily management of Norges Bank and the Deputy Governor serves as his/her deputy.

6. *The Commission proposes the establishment of a board for Norges Bank with seven members.* When the responsibility for monetary policy instruments and the work on promoting financial stability are assigned to a committee, the board of Norges Bank should be independent of the daily management and administration of the Bank. The board should take over the functions currently assigned to the Executive Board of Norges Bank, with the exception of those assigned to the committee and the responsibility for managing the Fund, which in this model is separated from the Bank. The board shall establish plans, budgets and guidelines for the Bank's activities, instructions for the daily management of the Bank and oversee the operation of the Bank and the performance of the Governor in his capacity as general manager. In this work, the board shall be supported by an internal audit service. The board draws up an annual report and accounts, and reports to the Ministry of Finance, which approves the accounts. The functions will include, among others, establishing guidelines for the management of foreign exchange reserves and for the Bank's deposit and lending facilities, issuing notes and coins and the work on the payment systems. *The Governor's responsibility as general manager and external representative of the Bank shall be specified in the act. The Government shall appoint the Governor, Deputy Governor, the external members of the monetary policy and financial stability committee and the members of the board of Norges Bank.*

7. *The Commission finds that a board composed only of external members eliminates the need for Norges Bank's Supervisory Council.* The board of the Bank is to oversee daily management and activities, as do the boards of other government and private undertakings. The Ministry of Finance should take over the Supervisory Council's task of appointing an auditor, approving the Bank's accounts and overseeing the board's decisions, governance, control, etc. The Ministry of Finance shall

retain its function of evaluating the Bank's use of judgement and goal performance.

The Ministry of Finance reports to the Storting. The Office of the Auditor General of Norway oversees the use of powers by the Ministry of Finance. The Storting controls the Bank by means of its deliberations on the Ministry's white papers, reports by the Office of the Auditor General of Norway and hearings by the Standing Committee on Finance and Economic Affairs of the Minister of Finance, Norges Bank's senior management and members of the Bank's bodies.

The Commission is of the view that this provides further clarification regarding lines of responsibility. Each level in the governance chain oversees the level below. This makes it easier to assign accountability. The Bank's board and committee are accountable to the Ministry of Finance and the Government, and the Ministry of Finance and the Government are accountable to the Storting. In the event of a failure at the Bank, it will no longer be unclear whether it is the Minister of Finance or the Storting's own supervisory body that is to be held accountable to the Storting.

8. *The Commission also recognises that there are arguments in favour of keeping the Government Pension Fund Global under the management of Norges Bank. As owner, the Ministry of Finance's evaluation of the results thus far has been positive, and the Fund's incorporation into Norges Bank appears to have promoted a stable mandate for the Fund and for the governance and leadership of investment management. The Commission presents two alternative models should the Fund be kept under the Bank (in the report called model B and C).*

In model B a separate board is established for investment management in addition to the board for Norges Bank and the monetary policy and financial stability committee. Model C is more similar to the existing governance model with a board and a supervisory council, but in addition the model includes a monetary policy and financial stability committee and some changes to the Supervisory Council.

The Commission is of the view that both of these models are feasible and adequate, but that model B may be preferable.

In the first alternative (model B), Norges Bank has two boards, the board for Norges Bank and the board for investment management, both appointed by the Government. The board of Norges Bank is only composed of external members and oversees the board for investment management. The board of the Bank also decides on matters



that concern both boards and draws up the budget, accounts and annual report for the entire Bank.

The board for investment management is responsible for both the administrative and professional performance of investment management and it recruits the general manager for investment management. The Ministry of Finance issues a mandate for investment management directly to this board and the board reports on performance to the Ministry of Finance. The Commission is of the view that the Governor must chair this board and with the Deputy Governor as vice chair. The Fund's link to the Bank would otherwise be too weak, and it would be problematic if the Bank's senior management had no influence whatsoever over such a large part of the Bank's activities.

The lines of responsibility in this model are by and large clear between the different levels in the Bank, but could nevertheless be perceived as not entirely straightforward (see Section 1.3.4). The lines of responsibility are also somewhat blurred by the fact that it will be the board for Norges Bank that oversees the board for investment management, even though the latter operates under a mandate issued by the Ministry of Finance. Two boards, with a separate board for investment management in the Bank, could provide more time for the members of the respective boards to deal with matters in their areas with better suited professional competence, but the Governor will still be faced with a substantial scope of tasks.

In the other model (model C), the board of the central bank retains the responsibility for the management of the Fund. The Governor retains a dual role as chair of the board and general manager of central banking operations. In addition, he/she chairs the monetary policy and financial stability committee with functions that are currently the responsibility of the Executive Board of Norges Bank. The scope of tasks and responsibilities for the board and the Governor would remain substantial. Nor is this model straightforward. The division of responsibility between the Ministry of Finance, as the owner, and the Supervisory Council in overseeing the Fund will still be unclear. Most of the functions of the Supervisory Council are retained in this model, but the number of members should be reduced and its duties and responsibilities should be further defined and clarified.

### 1.1.2 The central bank's purpose and responsibilities

9. Under the terms of the mandate, the Commission is tasked with assessing other aspects of the Act relating to Norges Bank and the Monetary System in addition to the organisation of the Bank, including the Bank's purpose and its relationship to government authorities.

The Commission emphasises that the Bank should have democratic legitimacy, which should be combined with transparency, predictability and a long-term approach in its use of instruments and the performance of its tasks.

The Commission proposes that the Storting should define the Bank's purpose and – as under the current Act – delegate important tasks and instruments to the Bank. The Government is given the authority to set objectives, such as the monetary policy mandate.

It will thus be clear under the Act that the Storting and the government define the Bank's purpose and specifies its objectives. Experience, supported by theory, indicates that central bank instrument independence from the central government authorities promotes transparency, predictability and a long-term approach. The Commission proposes that Norges Bank should be given somewhat greater independence than today by, for example, raising the threshold for when government instructions can be issued to the Bank.

The Bank's bodies and management must at the same time be held accountable for their use of judgement. The Bank's goal performance must be thoroughly evaluated. The Commission holds the view that the government and the Storting could strengthen their work in this area. The Commission is also in favour of regular evaluations of the Bank's objectives, as expressed for example in the monetary policy mandate.

10. *The Commission proposes that Norges Bank's purpose should be to maintain monetary stability. Norges Bank should be the executive and advisory authority for monetary policy.* The functions and responsibilities of central banks have changed considerably over time. A central bank's traditional responsibility has been to issue banknotes and coins and contribute to a smoothly functioning payment and credit system. But the payment system only functions smoothly when the public has trust in the value of money. Preserving the value of the currency has therefore always been important for central banks. It is equally important to prevent prices from falling as it is to pre-

vent high and variable inflation. A stable value of money enhances the soundness of saving and investments. With low and stable inflation, markets are more efficient. It is easier for market participants to determine whether a higher price for a product reflects a shortage of that particular good. Central banks can normally contribute to stable price developments by means of the instruments at their disposal.

*Norges Bank's purpose should also include promoting the stability of the financial system and an efficient and secure payment system. Norges Bank has executive and advisory authority in the work to promote financial stability.* Finanstilsynet (Financial Supervisory Authority of Norway), with the Ministry of Finance as the supreme authority, also has important functions in the same area.

Unstable banks and financial markets can lead to economic decline. Central banks are generally responsible for ensuring that interbank payment and settlement systems are efficient and stable. In addition, Norges Bank also works to promote financial stability in a broader sense. This is particularly evident in the management of crises when the Bank supplies substantial liquidity both to influence market rates and to stabilise the financial system. *The Commission also proposes that the government should confer responsibility on Norges Bank for setting the countercyclical capital buffer for banks and should also consider providing Norges Bank with the authority to issue regulations for new residential mortgage loans.*

Both under the standing lending facility and in the management of crises, Norges Bank requires collateral for loans provided to banks and other financial undertakings. Under the Norwegian system of government, Norges Bank may not provide solvency support. If the need to provide extensive liquidity support to banks over an extended period should arise again, the government should assume this responsibility, as it did under the 2008 crisis.

One of the main objectives of economic policy is to achieve stable and solid economic growth with high employment and low unemployment. The level of employment is primarily determined by structural conditions. The quality of education, gender equality, the tax system, the social security system and the pension system, the adaptability of business and labour and wage and income formation are of essential importance. The most important contribution the central bank can make to a high and sustainable path for activity is to safeguard financial stability and price stability. When inflation is expected to be low and stable, mone-

tary policy can give more weight to stabilising output and employment. Even if the Bank cannot compensate for structural and incentive shortcomings, the Bank's response to an economic downturn or financial crises will influence activity and employment for a long time. Therefore, the Commission is of the view that *the central bank should otherwise contribute to high and stable output and employment.*

11. The purpose of Norges Bank proposed by the Commission is in the form of a general statement. *The government should therefore, as necessary, further specify Norges Bank's objectives under the act.* One of these objectives will be expressed in a mandate specifying the operational target of monetary policy, but mandates can also be laid down for other areas. The objectives will also serve as a reference in the evaluation of the Bank's use of instruments and should, in the view of the Commission, be assessed at regular intervals, for example every five years. The government should establish these objectives in a transparent manner. The Bank must have the opportunity to express its opinion before a decision is made, and the matter should be submitted to the Storting shortly after the decision is made. This is in line with the formal requirements for the instruction of the central bank today.

The central government administration is chiefly organised in a line structure from the ministry to subordinate agencies. The governance of Norges Bank currently deviates to some extent from this system and does so under the proposal presented here. Instruments are delegated directly to the Bank by the Storting through the Norges Bank Act, while the government issues the mandate specifying the objective of monetary policy and for other areas where necessary. *The Commission proposes that Norges Bank should not in any other way be subject to instruction as to its activities except in extraordinary circumstances.* This gives Norges Bank a high degree of autonomy in its use of monetary policy instruments and its work on financial stability. The threshold for instruction only applies to the conduct of monetary policy and work on financial stability, and otherwise areas where the central bank derives its authority from the Norges Bank Act, as is the case today. In cases where Norges Bank's authority has been delegated under common administrative law, a general power of instruction will apply, as it does today. The Commission nonetheless proposes that the same protection against instruction that applies to monetary policy and the work on financial stability should also apply if the autho-

riety to set the countercyclical capital buffer and any other macroprudential instruments are delegated to Norges Bank as proposed by the Commission.

12. The Commission proposes that Norges Bank's duty to submit matters of particular importance to the Ministry of Finance before a decision is made, should no longer apply. *The Bank should inform the Ministry of Finance about matters of importance.* The Commission presumes that it would be useful for the Minister of Finance and the Governor to continue to meet on a regular basis.

*The Bank should also inform the public about the basis of the decisions made by the Bank to fulfil its objectives.* Providing information on the Bank's considerations facilitates evaluation of the Bank's decisions. Transparency also promotes trust in the central bank and predictability with regard to the Bank's response pattern. A committee composed of external members serving on a part-time basis would provide more channels of communication than currently used by the Executive Board. Committee members other than the Governor and the Deputy Governor could express their opinion in oral and written public statements and testify before the Storting's Standing Committee on Financial and Economic Affairs. More detailed minutes including members' individual assessments could also be published. The Commission does not specify in the proposed act how Norges Bank should inform the public about its activities. The assessment and development of this task should primarily be entrusted to the Bank.

13. Technological innovation has led to substantial changes in the monetary and payment systems. The definition of money and legal tender is likely to change in the years ahead. Norges Bank must take on a leading role in this area. The solutions that may be forthcoming are not within the scope of the Commission's mandate. In time, developments will likely require changes in legislation, including the central bank act.

There is a need for a form of legal tender backed by the central bank to underpin trust in money and enable it to fulfil its role in the economy. Today, banknotes and coins are defined as legal tender in Norway and other countries. Until we know more about further developments, *banknote and coins should continue to be legal tender in Norway. Norges Bank should have the sole right to issue banknotes and coins.* In the proposal on the new central bank act, Norges Bank is required to oversee the payment system and other ele-

ments of the financial infrastructure, including contributing to contingency solutions. Norges Bank is also given the authority to require the banks to distribute cash for contingency purposes.

14. Like many other central banks, Norges Bank has budgetary autonomy, which is uncommon in other parts of public administration. *The Commission proposes, on the basis of an overall assessment, that Norges Bank should continue to have budgetary autonomy.* Such autonomy may be perceived as important to the Bank's freedom of manoeuvre in monetary policy and in its work on financial stability. In view of the Bank's financial position, such freedom of manoeuvre requires strict budgetary discipline on the part of the Bank and close monitoring by the Ministry of Finance.

*Norges Bank's profit should accrue to the government according to rules laid down by the Government.* In the proposal on the new central bank act, the Government should ensure that the Bank has adequate equity to achieve its objectives. The Bank decides on the level of foreign exchange reserves and other assets necessary for the fulfilment of the Bank's monetary policy objectives and its work on financial stability.

15. The Commission proposes including a provision in the act allowing the Government to delegate the performance of financial services for the government, as previously, to Norges Bank. The services currently performed by the Bank include the administration of the government's consolidated account and government debt. According to the proposal, Norges Bank may still not extend credit directly to the government. The Bank administers the rights and fulfils the obligations ensuing from Norway's membership of the International Monetary Fund (IMF). *To fulfil its purposes, Norges Bank may also under the Commission's proposal become a party to international agreements, as long as collateral is required for any central bank credit provided.*

## 1.2 More about the Commission's proposals

### 1.2.1 Purpose and functions

The Commission proposes that a clearer distinction be made in the new central bank act between Norges Bank's purpose and the tasks the bank is required to perform to achieve its objectives than in the current Act (Section 1). The Bank's purpose must also be consistent with the instruments at its disposal.

The Commission proposes that in Section 1-2, Norges Bank's purpose should be to maintain monetary stability, promote financial stability and otherwise contribute to high and stable output and employment (see discussion in 1.1.2). The central bank has a particular responsibility for the payment system in that it issues payment instruments and has a direct responsibility for the central settlement system for interbank payments. The Commission therefore proposes that this task be specifically mentioned in the purpose section.

The purpose section should be supplemented by an additional section describing the central bank's areas of responsibility and instruments (see Section 1-3 in the proposed central bank act). This will in turn provide the basis for more detailed rules concerning the Bank's responsibilities and instruments in a later section of the act. Section 1-3 should establish Norges Bank as the executive and advisory authority for monetary policy. Norges Bank should also have executive and advisory authority for the work on financial stability. The Bank should organise the central settlement system, oversee the payment system as a whole and have the sole right to issue banknotes and coins. Norges Bank is the bankers' bank and the government's bank, and it shall ensure that asset management is conducted in an appropriate and efficient manner. Even if the Bank is relieved of the responsibility of managing the Fund, it has an important responsibility for the management of foreign exchange reserves. In addition, the Commission proposes that the general clause in the current Act stating that the Bank may implement any measures customarily or ordinarily taken by a central bank should be retained. This provision safeguards the need for some degree of flexibility for Norges Bank in adapting to changes in the tasks the Bank is to and must be able to perform in support of its objectives.

The Commission proposes that the current provision concerning the monetary unit and its international value should be largely retained in a new central bank Act, cf the proposed Section 1-9. The choice of exchange rate regime must at the same time be considered in the context of the monetary policy framework. The Norwegian krone has been allowed to float freely since 2001. The exchange rate regime is an important part of our economic system. The authority to choose the exchange rate regime should lie with the government and it should not be possible, as it is now, to delegate this authority to the Ministry of Finance. This also means that the exchange rate regime

will be adopted by the same authority that adopts the monetary policy mandate.

### **1.2.2 Relationship between the central bank and government authorities**

The Commission has discussed the relationship between Norges Bank and the Storting, the government and the Ministry of Finance. The current Sections 2 and 3 of the Act regulates the Bank's duty to present submissions, and concerning instruction and the Bank's reporting, advisory role and duty to provide information.

The Commission proposes that a provision should be included in Section 1-4, first paragraph, of the new central bank act permitting the Government to make decisions regarding the Bank's objectives (see 1.1.2). As mentioned, Norges Bank will be given the opportunity to express an opinion before the decision is made and the matter should be submitted to the Storting shortly thereafter. These objectives could typically include the current monetary policy regulation, but objectives could also be set for other areas. The objectives must be based on the purpose of the Bank's operations as stated in the Act (cf proposed Section 1-2).

The Commission's proposal to prohibit the government from issuing instructions to Norges Bank except under extraordinary circumstances has been included in Section 1-4, second paragraph (see 1.1.2). The Commission proposes that this provision should have the same scope as the current power of instruction and include the same formal requirements. The power of instruction over the central bank currently available to the Government has never been used in individual matters or in the case of disagreement with the Bank. Nonetheless, there is a possibility that situations could arise where Norges Bank's contribution must be viewed in a broader context and where other considerations will have to be given weight than those that can be anticipated when the Bank's purpose is formulated.

The proposal reflects the Commission's opinion that the threshold for instruction should be high. The Commission argues that with this addition, the degree of autonomy conferred on Norges Bank will be approximately on a par with central banks in other open economies. This will give the Bank a framework that is familiar in an international context. With a high threshold for instruction, the Ministry of Finance and the government have somewhat more leeway to evaluate the Bank's use of judgement.

The Commission also proposes that Norges Bank's duty to advise the government on economic policy should be retained under the new act (cf proposed new Section 1-5). As is the case today, this duty applies in particular to the areas of economic policy that affect Norges Bank's objectives of price stability and financial stability when the Bank finds that the instruments available to it are not adequate. Norges Bank's duty to notify the Ministry of Finance about matters of importance should be included in Section 1-6 of the proposed new central bank act and the Bank's duty to inform the public in Section 1-7.

The Commission proposes that the current prohibition on extending credit to the government in Section 18 be retained in Section 3-8 of the new Act. An important reason for the independence of central banks is to prevent the government from being able to fund its activities by printing money. This prohibition will not prevent the Bank from trading in government securities in the secondary market as part of the conduct of monetary policy.

### 1.2.3 Monetary policy and financial stability

The central bank's role as bankers' bank is set out in Sections 19-22 of the current Norges Bank Act. This role is important in enabling Norges Bank to perform its tasks in the area of monetary policy and financial stability. Banks' holdings of deposits in accounts at Norges Bank are today the most important channel for the conduct of monetary policy, particularly through setting the interest rate on the deposits at the central bank. The holding of these accounts at the central bank is also an important precondition for ensuring an efficient payment system and for helping to stabilise financial markets and financial institutions in a crisis situation. It is proposed that its role as bankers' bank, etc., be retained in Section 3-1 in the proposal on a new central bank act.

According to current law, the right to hold an account at Norges Bank is largely confined to financial undertakings with a bank license. The right to hold an account at Norges Bank applies both to Norwegian banks and Norwegian branches of foreign banks. A more limited right is conferred on banks that are authorised to provide banking services from an established place of business in other EEA countries. In special cases, other undertakings may also be granted the right to hold an account at the central bank.

The Commission proposes that Norges Bank to fulfil its purposes be granted a general right to offer undertakings in the financial sector to hold

an account at the Bank. This means that the Bank can offer more undertakings than earlier to hold an account if the Bank judges that this facilitates the conduct of monetary policy or enhances the efficiency of the payment system.

Norges Bank sets the terms and conditions for deposits from and credit to financial undertakings. Such terms and conditions include interest rate terms and other conditions. The terms and conditions can vary according to the type of financial undertaking.

The practice whereby Norges Bank requires adequate collateral for all credit should be established by law. The collateral requirement for credit should also apply to loans on special terms, i.e. loans provided by the Bank as lender of last resort in a crisis situation (S-loans). The collateral requirements for S-loans are also in line with current practice. Norges Bank should continue to accept the loan portfolios as collateral and be given legal protection for that without having to satisfy the same statutory requirements that apply to other lenders.

The Commission also proposes that Norges Bank should be granted the right to use reserve requirements as part of liquidity management, i.e. that it set minimum requirements for deposits from undertakings that hold an account at Norges Bank. This is an instrument that most other central banks can use.

The Commission proposes to retain Norges Bank's right to trade in financial markets and to issue its own debt instruments, etc. These are instruments that Norges Bank has not used frequently in the conduct of monetary policy, but which could become relevant in certain situations. Other central banks have, for example, bought long-term securities to influence market interest rates and supply liquidity to the general public. Many central banks trade in their own debt instruments to manage liquidity in the banking system.

Norway's foreign exchange reserves are owned and managed by Norges Bank. The Commission proposes that ownership be established by law and that the reserves management function be assigned to Norges Bank in order to serve the Bank's purposes (see Section 3-2 of the proposal on a new central bank act). Norges Bank also decides, as mentioned, the size of the reserves. The reserves shall in particular serve as a contingency when financial stability is threatened. Nor can the possibility be excluded that the reserves may be needed to influence the Norwegian krone exchange rate. Moreover, the reserves

shall be used to meet the Bank's international commitments, in particular to the IMF.

#### 1.2.4 The payment system

Section 1 of the current Norges Bank Act confers on Norges Bank chief responsibility for promoting an efficient payment system. A stable payment system is of particular value in and of itself and is a precondition for financial stability. With the appropriate supervision and regulation, the payment system should function even in times of unrest and turbulence in financial markets. As the bankers' bank, Norges Bank operates the central settlement system, Norges Bank's settlement system (NBO). The Bank is the supervisory and licensing authority for interbank systems under the Payment Systems Act. Under Section 1 of the current Norges Bank Act, the Bank monitors developments in other payment and settlement services.

The Commission is of the view that Norges Bank's responsibility for the payment system should be part of the Bank's purpose, cf proposed new Section 1-2. To specify and strengthen the Bank's legal basis in this area, the Commission proposes that a new provision concerning Norges Bank's responsibility for overseeing the payment system be included in the act (see proposed new Section 3-3, second paragraph). Norges Bank shall also provide for stable and efficient systems for interbank payment, clearing and settlement, including the responsibility for operating the central settlement system (see new Section 3-3, first paragraph).

Norges Bank currently has the sole right to issue banknotes and coins, and the Bank decides their denomination and design. Today, banknotes and coins account for a small and decreasing proportion of means of payment. Nonetheless, the Commission stresses the importance of some specific features of banknotes and coins issued by the central bank.

For the public, cash represents claims on Norges Bank, while bank deposits are claims on private banks. Confidence that deposit money can quickly and simply be converted into a corresponding amount in cash has been important for the public's trust in deposit money as a generally accepted means of payment. Confidence in deposit money also depends on appropriate regulations and oversight arrangements that foster a robust banking sector. In crisis situations, trust in banks can be impaired, and demand for low-risk, liquid savings instruments may increase. Cash can then

be important as a contingency payment solution. The Commission proposes that Norges Bank's exclusive right to issue Norwegian banknotes and coins should be retained in Section 3-4 of the new act. The Commission is also of the view that the central bank should continue to decide the denomination and design of banknotes and coins to be put into circulation.

Current Section 14 establishes by law that Norges Bank's banknotes and coins are legal tender. This means that anyone who owes money will always be able to settle his or her payment obligations towards the payment recipient using banknotes and coins, as will those with outstanding claims, unless otherwise agreed between the parties. Some have argued that banknotes and coins should no longer be legal tender. Banknotes and coins usually involve higher costs for banks and other firms than electronic payment instruments. Banknotes can also be regarded as a vehicle for facilitating tax evasion and other types of criminal activity. At the same time, banknotes and coins are still widely used and are particularly important for clubs and associations etc. and for individuals who for different reasons do not have access to a bank account or a payment card. Cash also functions as a contingency payment solution in the event of a failure in payment system technology or in times of economic crisis. Cash also plays a role in protecting privacy as payments cannot be tracked in the same way as electronic payments. The Commission proposes in Section 3-5 of the new central bank act that the provision defining banknotes and coins as legal tender should be retained. According to Section 16-4 of the Act on Financial Undertakings and Financial Groups, banks are required to accept cash from customers and make deposits available to customers in the form of cash to meet customer expectations and needs. Norges Bank's power to instruct banks to ensure cash distribution for contingency purposes is included in Section 3-3, third paragraph, of the proposed act, cf 1.1.2.

The Commission does not exclude the possibility that demand for cash will gradually dwindle and that payments will be made almost exclusively electronically or digitally. This would raise the issue of whether an electronic or digital form of legal tender should be established. Central banks in many countries, including Norges Bank, are assessing this matter. The work is at an early stage. The Commission assumes that an issue of most types of electronic or digital central bank money to the public will require a legislative

amendment based on a separate, extensive report on this matter.

### 1.2.5 Other functions

Norges Bank is the government's bank and the administrator of Norway's commitments as a member of the International Monetary Fund (IMF). The Commission also discussed provisions relating to international agreements and the government's right to introduce protective measures in the event of balance of payments problems etc.

As mentioned in 1.1.2, the Commission proposes including a provision in the act allowing the Government to delegate the provision of financial services for the government, as previously, to Norges Bank (see Section 3-7).

It is also common in other countries for the central bank to perform financial services for the government, although to a varying extent. The new act should not hinder the performance of banking services for the government by agencies other than the central bank if this is considered appropriate in the future.

The scope of these services should be clearly defined, for example in the mandate or written agreements between the Ministry of Finance and Norges Bank. Norges Bank's remuneration for these services should also be included in the agreement. The current practice of cost coverage based on efficient operation should be retained.

Current Section 28 provides that the Government should have the right to implement necessary protective measures if capital inflows and outflows could lead to substantial problems in the balance of payments or significant disturbances in capital markets. The Commission proposes that the provision on protective measures, with some adjustments to the wording, be retained (see Section 3-9 in the proposal on the new central bank act).

Norges Bank engages in extensive international activities. The Bank is a member of the Bank for International Settlements (BIS), cooperates with other central banks and takes part in a range of international fora and working groups. According to current Section 25, Norges Bank is also required to administer the rights and fulfil the obligations ensuing from Norway's membership of the IMF. The Commission proposes that the task of administering Norway's membership of the IMF is retained in the new central bank act (see Section 3-10).

Current Section 26 provides for Norges Bank to enter into agreements on deposit, credit and

guarantee arrangements with other central banks as well as with international economic organisations and institutions provided that its claims are satisfactorily secured and the agreements are approved by the Government. The approval requirement is particularly included to address the consideration that such agreements «in reality could affect economic and political relations between Norway and other states».<sup>1</sup>

Norges Bank's international agreements vary widely in nature. Norges Bank concluded agreements with other central banks such as the Federal Reserve and the ECB when the financial crisis erupted in 2008. The object was to stabilise financial markets, and the agreements formed part of Norges Bank's conduct of monetary policy and its work to promote financial stability. It was important to conclude the agreements quickly. The Commission is of the view that this type of agreement should not be subject to approval by the Government.

Norges Bank also entered into a multi-year credit agreement with the Central Bank of Iceland in 2008. The object of the agreement was primarily to support the Icelandic government in its work to stabilise economic developments. The Norwegian government and the Storting agreed to provide a government guarantee.

The Commission proposes that key parts of current Section 26 are retained in the new act (see proposed new Section 3-10). The requirement that claims must be satisfactorily secured must be retained. If Norges Bank is in doubt about the security provided, the Bank must request a government guarantee, and the government and Storting must come to a decision on the agreement.

### 1.2.6 Duty of confidentiality, administrative procedures etc.

The Commission notes that the Public Administration Act and the Freedom of Information Act are applicable to Norges Bank's activities.

This means that the general provisions of the Public Administration Act concerning administrative procedures, impartiality requirements, duty of secrecy, etc, apply to the Bank's activities. The Commission proposes that the new act clarifies that the right of appeal under the provisions of the Public Administration Act is excluded for decisions concerning central bank loans and account management (see Section 5-1). These instruments

<sup>1</sup> Proposition No. 25 to the Odelsting (1984–85) p. 109.

are used to achieve the Bank's objectives in the area of monetary policy and financial stability. The authority of the Ministry of Finance to overrule the Bank is regulated in the new act by Section 1-4, second paragraph on instruction.

Under the Freedom of Information Act, the public has right of access to case documents, journals, etc. The Commission proposes that preparatory documents exchanged between Norges Bank and the Ministry of Finance and Norges Bank and Finanstilsynet (Financial Supervisory Authority of Norway) may be exempted from public disclosure.

### 1.3 Organisation of Norges Bank and the management of the GPF

#### 1.3.1 Introduction

The Commission is tasked with assessing whether the organisation of Norges Bank is suited to its assigned functions. The Commission is also to assess the Bank's relationship to the Ministry of Finance, the Government and the Storting.

Under the terms of the mandate, the Commission is to present proposals for governance models for Norges Bank, both where the Fund remains under the management of Norges Bank and where the Fund is separated from Norges Bank. The Commission is also to present proposals for a governance model for investment management in the case where the Fund is separated from the Bank.

In all of the models it is clearly specified that Norges Bank is the central bank of Norway and that central banking functions are regulated by the central bank act. The Bank shall be a separate government-owned legal entity with the capacity to be a party to legal proceedings.

#### 1.3.2 Norges Bank's central banking functions

In the Commission's proposed governance model for Norges Bank's central banking functions (model A1), the management of the Fund is not under the Bank. In its choice of model, the Commission has given weight to the evolution of the Bank's functions over the past decades and has also drawn on lessons learned by other central banks and organisations of other types.

This is the background for the Commission's proposal for the establishment of a *monetary policy and financial stability committee* (see draft Chapter 2 of the Act). An important precondition

for conferring the responsibility for interest rate setting and other instruments on an independent central bank is a sufficiently high level of professional competence among the members of the decision-making body. Committees therefore ordinarily comprise experts in the relevant fields. In addition to persons from the Bank's senior management, suitable members may be persons from academia and persons who have otherwise acquired relevant insight (see 1.1.1).

The Governor and the Deputy Governor, who are the chair and vice chair of the committee and the external members, are appointed by the Government. One member, who is an employee of the Bank, is appointed by the board (see Section 2-6 on the appointment and composition of the committee in the proposal on a new central bank act). The committee's functions are presented in Section 2-7.

The committee shall not have administrative responsibility for the central bank. This will be conferred on a Norges Bank board, which will also be given the responsibility for those central banking tasks that are assigned to the current Executive Board, but will not be assigned to the committee (see point 6 in Section 1.1.1). The tasks of the board are set forth in Section 2-4.

The board shall consist of seven members all of whom are external and independent of the administration, of the requirements under the general rules and regulations for corporate governance and control; see proposed Section 2-3 relating to the appointment and composition of the board. Members of the board should be well acquainted with Norges Bank's role in economic policy and as a whole have insight into central banking functions. There should also be members with management and administrative experience, and it would be advantageous for the board as a whole to have expertise in law, economics and accounting. The Governor prepares matters for the board and implements the board's decisions. The Governor is the external representative of the Bank (see draft Section 2-11).

The proposed act provides a fairly general description of the division of responsibilities between the committee and the board. The Commission is of the view that the committee and the board should draw up detailed guidelines for the division of responsibilities. If necessary, the Government may issue a further clarification of the committee's tasks.

In the view of the Commission, Norges Bank's independent position, budgetary autonomy and important role in society require in particular that



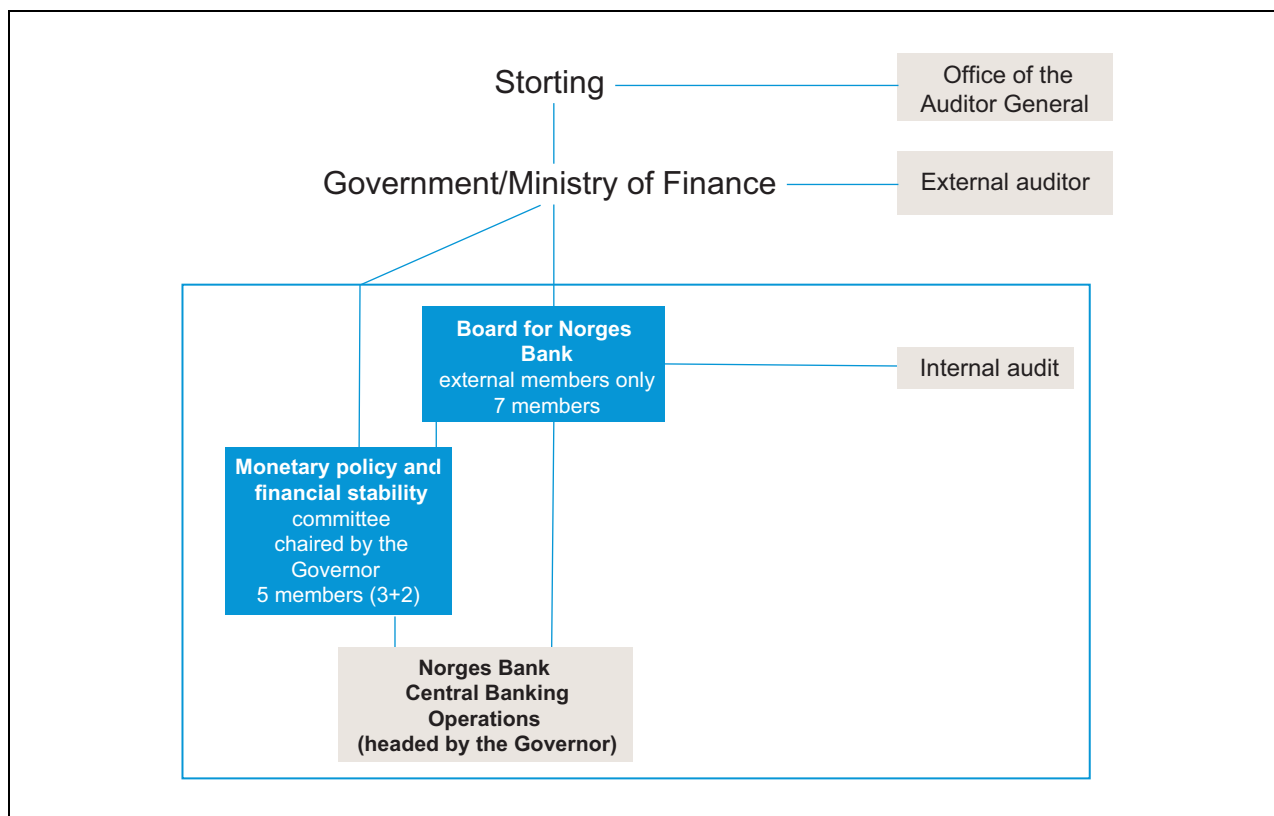


Figure 1.1 Proposed governance structure for Norges Bank's central banking operations (Model A1).

*the Bank be subject to adequate control and oversight.* The proposed governance model provides clear lines of responsibility for overseeing the Bank.

The Supervisory Council currently fills a function as an independent oversight body, owing in part to the Governor's dual role as both chair of the Executive Board and general manager of central banking operations. The Supervisory Council also approves the Bank's budget. With an independent board granted responsibility for oversight of daily management and operations in other respects, there is no longer a need for a separate oversight body at the Bank. Oversight of the board's activities will then be assigned to the Ministry of Finance and will no longer be performed by a body in the Bank. Currently, the Ministry of Finance also evaluates the Executive Board's use of judgement in monetary policy, its work on promoting financial stability and investment management. The Ministry of Finance's responsibility for overseeing the board and evaluating the Bank's goal performance in the areas of responsibility of the board and the committee is set forth in Section 4-1 of the proposed new central bank act (see also Section 1.1.1). The duty to report to the Storting is set out in Section 1-8.

With a model without a supervisory council, the Commission has considered whether the Storting should also participate in the appointment of members of the board. However, such a shared appointment function would result in blurred lines of responsibility, while in the view of the Commission, the control function of the Storting can best be addressed in other ways. The Storting will receive reports from the Ministry of Finance and the Office of the Auditor General. The Standing Committee on Finance and Economic Affairs may enhance and strengthen the current hearing institute for the Bank's management by increasing the frequency of hearings. The Commission's proposal for governing bodies at the Bank provides for hearing others than the Governor. The Standing Committee on Finance and Economic Affairs may also consider hearing the Governor and Deputy Governor after being appointed and perhaps also other members of the monetary policy and financial stability committee and the board chair. The Ministry should evaluate monetary policy objectives and objectives in other areas in accordance with Section 1-4 of the act on a regular basis, for example every five years and present its evaluations to the Storting.

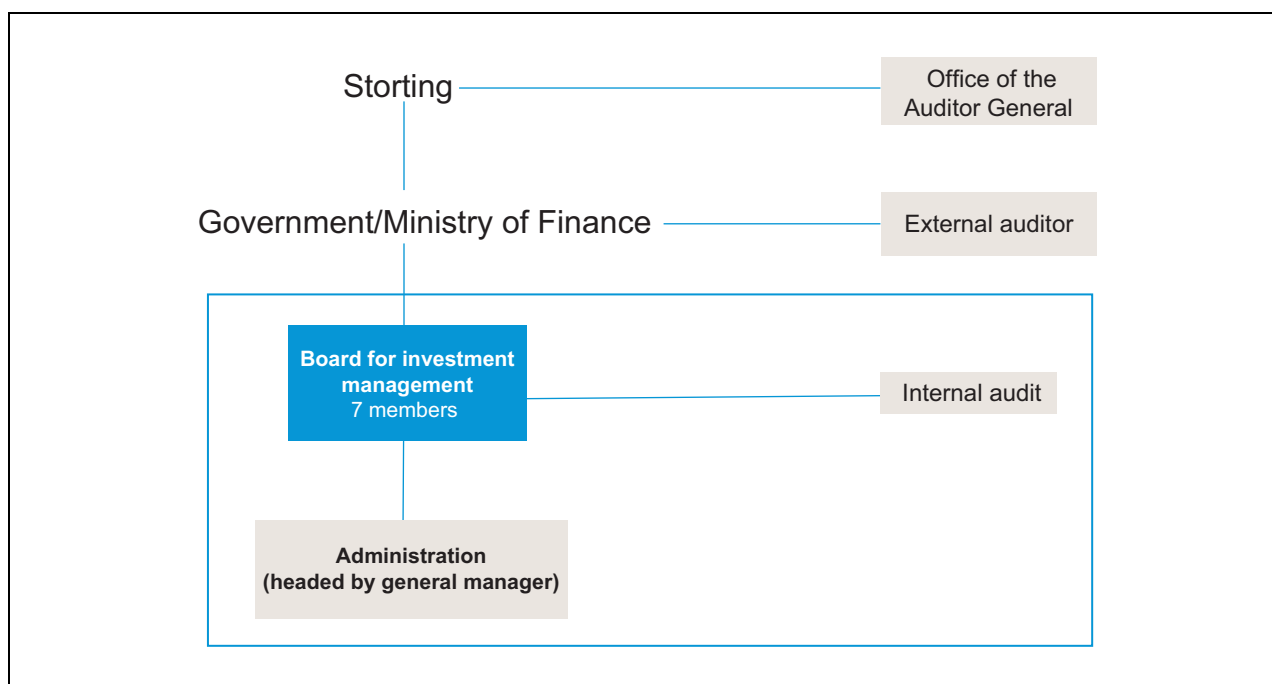


Figure 1.2 Government-owned statutory entity for the GPF (the Norwegian Government Investment Fund, NGIM), (Model A2).

### 1.3.3 An investment management entity separated from Norges Bank

The Commission proposes a governance model for the management of the GPF separated from Norges Bank, model A2. A government-owned statutory entity will safeguard the specificities and adjustments that are or may be needed for the governance and investment management of the Fund. Such an entity will provide a fairly uniform framework for the management of the two parts of the Government Pension Fund (cf the Act on Folketrygdfondet (Government Pension Fund Norway)).

The fundamental governance principles for the investment management entity are laid down in the proposed act on the basis of the current Act on Folketrygdfondet. The division of roles between the Storting, the Ministry of Finance and the investment management entity should not entail any substantial change as a consequence of a separation from Norges Bank (cf Section 1.1.1).

The investment management unit at Norges Bank, NBIM, can as an organisation be retained broadly as is, but in a separate entity delinked from the Bank (cf Section 1.1.1). The Commission assumes that all of NBIM, including the real estate investment unit NBREM, will then be transferred from Norges Bank to the new entity.

The board of the entity will be responsible for generating value and overseeing investment management. As the highest decision-making body, the board is to ensure that the entity is organised appropriately and to approve plans, budgets and guidelines for the entity. The board will oversee daily management and operations in other respects. By formulating strategies and providing leadership, the board will promote a high-quality investment management organisation with a healthy culture. The choice of general manager is therefore important, at the same time as the general manager requires guidance and support to meet the defined objectives and generate value for the Fund's owners.

The board of the entity should have specialised competence in finance and investment management. Moreover, the board needs to have a thorough understanding of the Fund's role in the Norwegian economy and economic policy. Members with management experience in similar businesses and in risk management but also in other sectors will be an asset to the board. There are further considerations that may suggest the possibility of appointing English-speaking members and thus of establishing English as the board's working language. Nevertheless, reporting to the Ministry of Finance and to the public must be in Norwegian. The Commission is of the view that seven is an appropriate number of members.

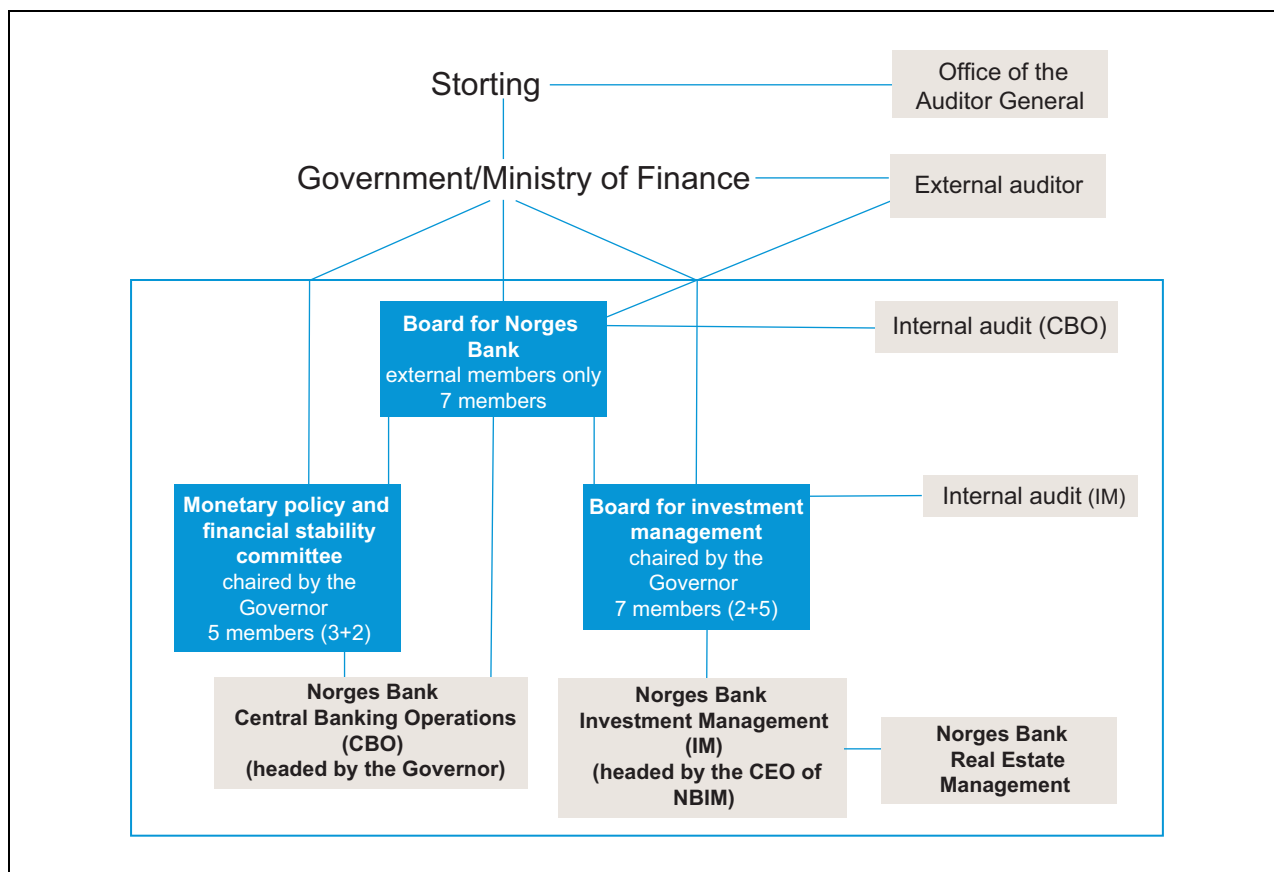


Figure 1.3 Governance model for Norges Bank where the GPFG remains under the management of the Bank – model B.

The entity reports to the Ministry of Finance, which oversees the board compliance and governance and evaluates the entity's goal performance. The Storting controls the entity by means of its deliberations on the Ministry's white papers and reports by the Office of the Auditor General. In connection with such deliberations, the Storting may hear the chair of the board and the general manager, along with the Minister of Finance. The Storting may also consider whether it would be beneficial in its work relating to oversight of investment management for the chair of the board to appear before the Standing Committee on Finance and Economic Affairs immediately after being appointed.

### 1.3.4 Norges Bank with the GPFG under the management of the Bank

The Commission presents two alternative governance models where the Fund remains under the management of Norges Bank (cf Section 1.1.1). As mentioned, one model, model B, is based on the Commission's proposed governance model for central banking functions, but with the addi-

tion of a separate board for investment management.

The board for investment management will be the highest decision-making body for the management of the Fund and will be chaired by the Governor. The Deputy Governor is vice chair, and in addition there will be five external members. The board will be responsible for value generation from investment management and for overseeing investment management activities.

This model entails a number of challenges and asymmetries. The Government appoints both boards at Norges Bank, but the Ministry of Finance does not oversee the board for investment management. The Ministry of Finance will oversee the board for Norges Bank, designate an external auditor and approve the accounts for central banking operations, but the board for Norges Bank will oversee the board for investment management. At the same time, the internal audit function under the board for Norges Bank will only apply to central banking operations. The Governor will chair the monetary policy committee and serve as general manager of central

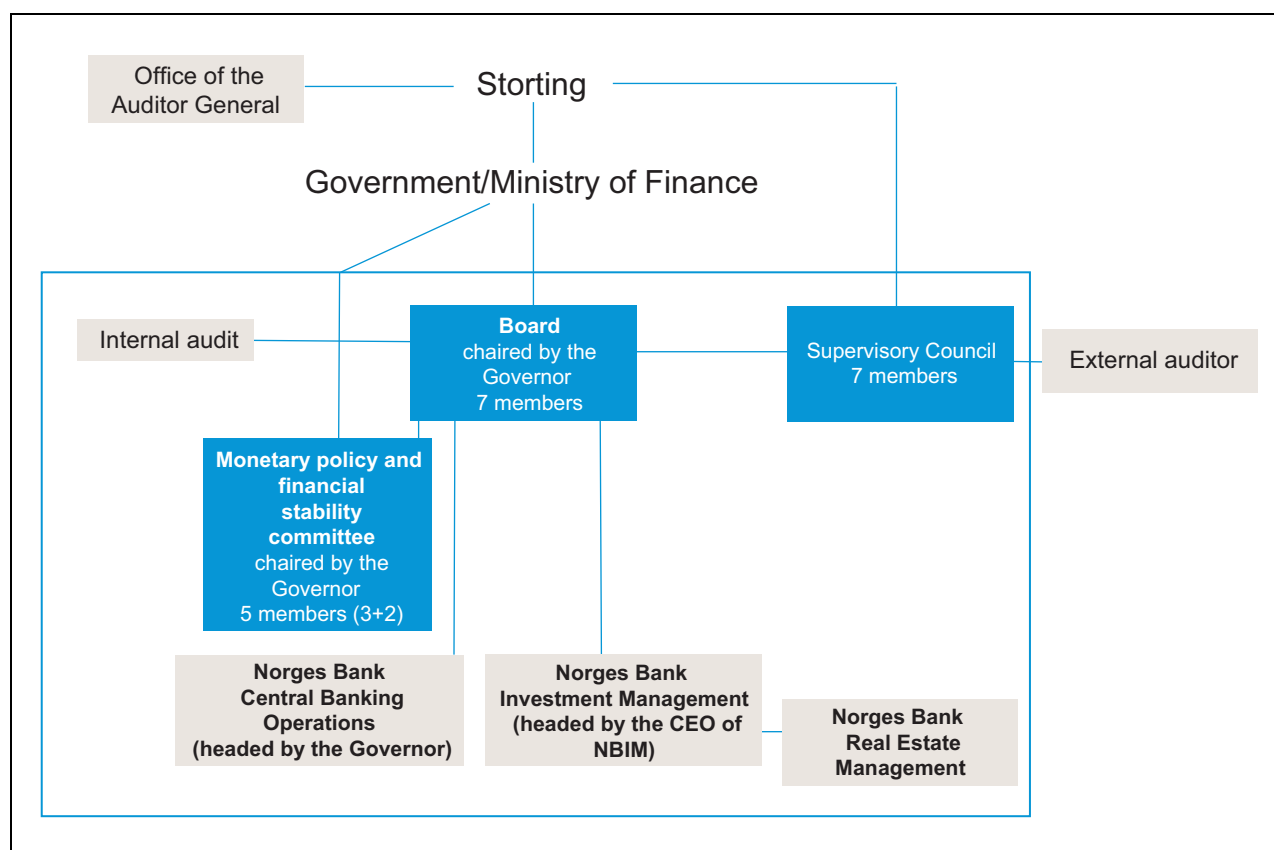


Figure 1.4 Model based on the current governance structure with the addition of a monetary policy and financial stability committee and a supervisory council (model C).

banking operations, but chair the board for investment management.

The other alternative governance model if the Fund remains under the management of the Bank, model C, is more similar to the current governance model, with a board and supervisory council, but with the addition of a monetary policy and financial stability committee (see Section 1.1.1). Owing to the board's responsibility for management of the Fund, the board must be chaired by the Governor. The composition of the board in other respects must be adjusted to reflect the board's professional responsibility for investment management and the professional and administrative responsibility for central banking operations, but where the responsibility for monetary policy and work on financial stability is transferred to the committee. This will reduce the scope of responsibilities and tasks for members of the board, but not for the Governor.

The tasks and responsibilities of the Supervisory Council will be by and large retained in this model, but with some changes. In the opinion of the Commission, a supervisory body will be able to discharge its duties better and more efficiently

with fewer members than currently. The Commission proposes reducing the number of members from 15 to seven, but they will still be appointed by the Storting. As is the case today, the supervisory council will not have oversight responsibility for the board's or committee's use of judgement, and should not have responsibility for operational decisions at the Bank.

### 1.3.5 The Commission's assessments and recommendations

To assess the alternative governance models, the Commission discusses a number of important considerations that good governance models should safeguard:

- The organisation of Norges Bank and the management of the Fund must be assessed in the light of Norway's traditions in the areas of constitutional law and public administration policy.
- The lines of responsibility must be clearly defined.
- The entities must enjoy the necessary legitimacy and trust. A widely accepted organisatio-

nal model, a high degree of credibility and a good reputation are important.

- The entities must be transparent
- The entities should be organised in accordance with principles for good governance. The organisation and governance framework must facilitate the work of Norges Bank and the Fund with a view to attaining the objectives defined by the Storting and the Government.
- The composition and competence of the board (or boards) and executive management must reflect the tasks involved and the specificities of the activities. While central banking is a government task, management of the Fund is a profit-maximising activity.
- On average, several persons collectively make many decisions better than a single person.

#### Considerations for GPFG:

- It is important to ensure the stability of the organisation and the framework for the management of the Fund and Norges Bank
- The board and senior management for investment management must have the competence and will to manage the activity with a view to achieving the highest possible return at a carefully weighed risk level.

The proposed governance models are assessed against these criteria:

All the governance models (A – C) have attributes enabling them to meet important criteria for an appropriate governance model for Norges Bank and the management of the Fund. At the same time, some of them have various drawbacks. It is the view of the Commission that several of the criteria suggest that the current organisation should be changed.

All of the models largely conform to *Norway's constitutional law traditions*. They also address the requirement for *democratic control* of central banking and the Fund. Furthermore, in all of the models it is proposed that key decisions are to be made by a group of people on a committee or a board and not only by a single person.

*The scope of the Executive Board's and the Governor's tasks is currently substantial*. Moreover, decisions pertaining to central banking functions rest largely with the Governor and Deputy Governor. The establishment of a monetary policy and financial stability committee will serve to *strengthen the expertise of the decision-making body for monetary policy and work on promoting financial stability*. As stated, the part-time external members can be on an equal footing with central

bank management in preparing the committee's deliberations. With part-time external members, the risk of conflict with other business or occupational roles is also reduced.

Furthermore, in models A and B, the board for Norges Bank is independent of the administration. This provides *clear lines of responsibility from the Bank to the Ministry of Finance and the Storting*. Oversight of the board for Norges Bank is then the responsibility of the Ministry of Finance. Nevertheless, in model B, the lines of responsibility are blurred in that the Ministry of Finance, as representative of the owner of the Fund, does not oversee the board for investment management, but the board for Norges Bank does. This is considered to be a weakness of model B.

In the light of *the substantial scope of responsibilities and tasks*, it will be demanding to compose specialised boards that will both have responsibility for central banking functions and the Fund (cf Section 1.1.1). If the management of the Fund is separated from Norges Bank, the governance bodies in model A can be tailored to the tasks of each activity. There is also a separate board for investment management in model B, but the scope of the Governor's responsibilities in this model will continue to be substantial. In addition, the work on central banking tasks could be strengthened by a separate organisation for these functions.

For the same reason, the *objective of the highest possible return at a carefully weighed risk level* is an argument in favour of a separation. Specialised boards with the competence and culture for generating value will better guide the activity towards this objective. This in turn is an argument in favour of models A or B.

An important reason that Norges Bank was initially chosen as investment manager was the Bank's *high degree of legitimacy and credibility*. In principle this may be an argument for retaining the Fund under the management of Norges Bank (cf models B and C). On the other hand, both central banking functions and the management of the Fund have become more complicated with new demands on the board and management. Greater complexity increases the risk of negative incidents, accompanied by a loss of *credibility and reputation*. For that reason, with both functions combined at Norges Bank, the risk also increases that negative incidents in investment management will damage the central bank's reputation and vice versa.

As investment manager, Norges Bank has likely contributed to a *stable operating framework*

for investment management. The threshold for replacing the board or general manager of a central bank if investment management results in losses is likely to be high. Such stability is important. At the same time, the Commission has not found an organisational model for Norges Bank that would not fairly rapidly again raise the question as to whether the solution is appropriate. In the view of the Commission, a proposal for a new organisation delinked from the Bank will be better suited to settling the issue of organisation in the period ahead. Models B and C may be perceived as fairly complicated and not particularly transparent. They could easily be viewed as only a first step towards separating the Fund from the Bank.

*After the examination of different governance models, the Commission recommends that the management of the GPF be separated from Norges Bank as described in model A.* This solution is consistent with the criteria stated above. An investment management entity can then be established with an organisational framework that is suited for its purpose. The sole task of the organisation and the board will be to manage the Fund. Central bank management will have increased capacity to follow up the conduct of monetary policy and the work on financial stability and the payment system.

A separation process must be carried out in an efficient manner (cf Section 1.1). The Commission is also proposing a strengthening of the formal framework for the GPF.

### **1.3.6 Some amendments to the Government Pension Fund Act**

The Government Pension Fund Act is a key component of the economic policy framework in Norway. Saving in the Fund has made it possible to separate oil revenue spending from current revenue flows. The Fund currently helps to finance a substantial portion of the welfare state's expenditures. Separation from the Bank should not in itself change the role of the Fund in economic policy.

The Commission proposes a number of amendments to the Government Pension Fund Act. These amendments will reinforce the Fund's current framework and is independent of the organisational solution for investment management.

The Commission proposes strengthening the formulation of objectives in the Government Pen-

sion Fund Act concerning the Fund's role as a source for financing the welfare state across generations. This is achieved by an investment management strategy that seeks to attain the highest possible return at an acceptable risk while promoting responsible investment. This is therefore proposed for insertion as a new Section 2 of the Act.

The Fund is a savings instrument for Norway. This implies that it must be invested outside Norway. Investing abroad is also a precondition for the Fund's role as a fiscal policy instrument. At the same time, it facilitates investment diversification and risk reduction. The Commission proposes enshrining in law a provision to the effect that the Fund shall invest outside Norway and in foreign currency in a draft new Section 6 of the Act on the Government Pension Fund.

It is furthermore important that the Fund is built up to reflect real government saving. There is little purpose in building up and maintaining a fund if at the same time the government borrows to finance a portion of its expenditure. The Commission therefore recommends enacting as a new Section 7 a provision barring the government from financing government budget expenditure by borrowing as long as there is capital in the Fund.

These provisions are set out in earlier legislative proposals and are already part of management practice or set out in the management mandate laid down by the Ministry of Finance. Enshrining them in law serves to strengthen the operating framework.

The fiscal rule, which states that fiscal spending of petroleum revenues shall not exceed the real return on the Fund over time, is not suited to being enshrined in law in the same manner. The size of the withdrawal in a particular year must be approved by the Storting on the recommendation of the Government as part of the budget process. The fiscal rule is intended to apply as an average over time. For a particular year, a considerable discrepancy may arise between the amount transferred from the Fund and the expected long-term real rate of return. This may reflect developments in the domestic economy or unexpected movements in the value of the Fund. Both the fiscal response to cyclical fluctuations and the pace of withdrawal readjustment will require a well-considered use of judgement that is not suited to being regulated by legislation.

## Chapter 2

# Excerpts from the draft act on Norges Bank and the Monetary System, etc.

### Chapter 1 General Provisions

#### *Section 1-1 The central bank of Norway*

- (1) Norges Bank is the central bank of Norway.
- (2) The Bank is a separate legal entity with the capacity to be a party to legal proceedings and is owned by the government.

#### *Section 1-2 Purpose of Norges Bank*

- (1) The purpose of Norges Bank's functions is to maintain monetary stability and promote stability of the financial system and an efficient and secure payment system.
- (2) Norges Bank shall otherwise contribute to high and stable output and employment.

#### *Section 1-3 Functions of Norges Bank*

- (1) Norges Bank shall be the executive and advisory authority for monetary policy.
- (2) Norges Bank shall further have executive and advisory authority in the work to promote financial stability.
- (3) Norges Bank shall issue banknotes and coins, promote the central settlement system and oversee of the payment system.
- (4) The Bank may receive deposits from and extend credit to banks and other financial undertakings. The Bank may trade in financial markets and provide all forms of financial services.
- (5) The Bank owns the country's official foreign exchange reserves.
- (6) The Bank shall ensure efficient and sound investment management.
- (7) The Bank may further introduce measures that are common or natural for a central bank.

#### *Section 1-4 Decisions on the functions of the Bank*

- (1) The King in the Council of State may adopt resolutions regarding the objectives of the Bank.

The Bank shall be given an opportunity to express its views before such resolutions are passed. The Storting shall be notified of resolutions as soon as possible.

- (2) Norges Bank may not be instructed as to its activities under the present Act except in extraordinary circumstance. Such resolutions must be adopted by the King in the Council of State in accordance with the procedure set out in the first paragraph.

#### *Section 1-5 Advisory function*

- (1) The Bank shall express its views on matters submitted by the King or the ministry.
- (2) The Bank shall issue advice to the ministry when the attainment of the Bank's objectives requires measures to be taken by others than the Bank.

#### *Section 1-6 Duty to inform the ministry*

The Bank shall inform the ministry about matters of importance.

#### *Section 1-7 Information to the public*

- (1) The Bank shall inform the public about the basis for decisions that the Bank takes to achieve its objectives.
- (2) The Bank shall ensure that indicative exchange rates against the Norwegian krone are available to the public on all business days.

#### *Section 1-8 Reporting to the Storting*

- (1) The ministry shall at least once a year report to the Storting on the activities of Norges Bank and its supervision of the Bank.
- (2) The Office of the Auditor General shall control the minister's exercise of authority pursuant to

the Act relating to the Office of the Auditor General and the instructions laid down by the Storting.

(...)

## Chapter 2 Organisation of Norges Bank

### I. Introductory provisions

#### *Section 2-1 Bodies of the Bank*

(1) Norges Bank shall have a board and a committee for monetary policy and financial stability.

(2) The King in the Council of State may decide that the tasks of the committee shall be divided between two committees and determine the division of tasks between them.

(...)

### II. Board of Norges Bank

#### *Section 2-3 Composition of the board of Norges Bank*

(1) The board shall consist of seven members. The members are appointed for a term of four years by the King in the Council of State. (...) The King in the Council of State appoints the chair and vice chair from among the members.

(...)

(3) The following persons are disqualified for appointment as members of the board:

1. the Governor and Deputy Governor,
2. staff of Norges Bank,
3. government ministers,
4. political staff of the ministries,
5. ministry officials,
6. staff of the Ministry of Finance or the Office of the Prime Minister,
7. members of the Storting,
8. political staff of the Storting,
9. committee secretaries of the Storting.
10. (...)

(...)

(5) The ministry shall determine the remuneration of the members.

#### *Section 2-4 Tasks of the board*

(1) The task of managing Norges Bank shall be assigned to the board, with the exception of tasks that, pursuant to the Act, are assigned to the

committee. The board shall ensure the sound organisation of Norges Bank.

(2) The board shall determine the plans and budget for the activities of the Bank. The ministry shall be informed of the approved budget. The board may lay down guidelines for the Bank's activities.

(3) The board shall ensure that the Bank's activities, preparation of accounts and asset management are managed and controlled in a sound manner. The board shall oversee the daily management of the Bank and its activities. The board shall not oversee the exercise of judgement of the committee.

(4) The board may give instructions relating to the daily management of the Bank.

(5) The board shall have an audit committee. The members of the audit committee shall be appointed by and from among the members of the board. The King may further specify rules relating to the audit committee.

(6) The board may appoint a committee from among board members to prepare matters for the board.

(7) The board may decide that commercial activities that fall within the scope of this Act shall be performed by companies that are partly or wholly owned by the Bank. The board represents the Bank as owner at such companies.

(...)

### III. Committee for monetary policy and financial stability

#### *Section 2-6 Composition of the committee for monetary policy and financial stability*

(1) The monetary policy and financial stability committee shall consist of five members and should have the following composition:

1. the Governor of the Bank,
2. the Deputy Governor of the Bank,
3. a member who is employed by Norges Bank and who is appointed for a term of two years by the board on the proposal of the Governor, but for no longer than a total of six years.
4. two members who are appointed for a term of four years by the King in the Council of State. These members shall serve part-time at the Bank. A member cannot be reappointed if the person in question has served on the board for eight years or more at the beginning of the new term. Should a member resign from the



committee, a new member may be appointed for the remainder of the term.

5. In the event of a long period of absence, a new member may be appointed temporarily.

(2) The Governor and the Deputy Governor shall serve as chair and vice chair of the committee.

(...)

- (5) The ministry determines the remuneration for members specified in the first paragraph no. 4.

#### *Section 2-7 Tasks of the committee for monetary policy and financial stability*

(1) The committee shall be responsible for the Bank's executive and advisory authority for monetary policy and the work on promoting financial stability.

(2) The committee shall be responsible for the use of instruments to achieve the objectives of monetary policy and financial stability. The committee may for these purposes and in special circumstances depart from resolutions or guidelines adopted by the board. Wherever possible, the board shall be given an opportunity to express its views before such decisions are made.

(3) The committee shall inform the public of decisions taken by the committee and the basis for the decisions.

(4) The King in the Council of State may issue supplementary rules on the delimitation of the committee's tasks and responsibilities.

(5) The committee shall be given an opportunity to express its views before the board considers matters that affect the committee's tasks and responsibilities.

(6) The committee shall adopt a contingency plan for financial crises. The board shall be given an opportunity to express its views before the plan is adopted.

(...)

## **IV. Daily management**

### *Section 2-9 Appointment of the Governor and Deputy Governor*

The Governor and Deputy Governor are appointed by the King in the Council of State for a fixed term of six years. They may be reappointed for a further term of six years.

### *Section 2-10 Remuneration and pension*

The remuneration and pension of the Governor and the Deputy Governor are determined by the ministry.

### *Section 2-11 Tasks of the Governor as general manager*

(1) The Governor shall be responsible for the daily management of the Bank's activities and shall follow guidelines and orders issued by the board. The daily management does not comprise matters which by the Bank's standards are of an unusual kind or major importance.

(2) The Governor may further decide a matter on the authorisation of the board or when measures must be taken and there is no time or opportunity to present the matter to the board. The Governor shall forthwith notify in writing the board of the decision.

(3) The Governor is the external representative of Norges Bank.

(...)

## **Chapter 3 Norges Bank's tasks and instruments**

### *Section 3-1 Credit to and deposits from banks etc*

- (1) To fulfil its purposes, Norges Bank may
- a. receive deposits from and extend credit to banks and other financial undertakings,
  - b. buy and sell foreign exchange and financial instruments and otherwise engage in transactions involving these instruments,
  - c. issue and trade in its own financial instruments.

(2) The terms and conditions for deposits and credit shall be laid down by Norges Bank.

(3) To fulfil its purposes, Norges Bank may set minimum requirements for deposits from entities holding an account with the Bank.

(4) When warranted by special circumstances, Norges Bank may grant credit on special terms.

(5) Norges Bank shall require satisfactory collateral for credit. Norges Bank may by regulation lay down further rules on the pledging of collateral.

(6) The requirement for the special consent of the borrower pursuant to Section 45 of the Financial Contracts Act shall not apply to the transfer or collateralisation of claims to Norges Bank in connection with the provision of credit or other measures pursuant to this paragraph, or in connection

with the Bank's subsequent transfer of such claims.

#### *Section 3-2 The official foreign exchange reserves*

Norges Bank shall determine the size of the official foreign exchange reserves and how they are to be invested. The reserves shall be available to fulfil the Bank's purposes and international commitments.

#### *Section 3-3 Payment and settlement*

- (1) The Bank shall provide for a stable and efficient system for payment, clearing and settlement between entities with an account at Norges Bank.
- (2) The Bank shall oversee the payment system and other financial infrastructure, hereunder contribute to contingency arrangements.
- (3) The Bank may lay down regulations to implement this section.

#### *Section 3-4 Issuance of cash as a means of payment*

- (1) Norges Bank shall have the sole right to issue Norwegian banknotes and coins. The Bank determines the denomination and design of the banknotes and coins.
- (2) The Bank may decide that other operators may produce banknotes and coins.

#### *Section 3-5 Legal tender*

- (1) The Bank's notes and coins are legal tender in Norway. No one is obliged to accept in any one payment more than twenty-five coins of each denomination.

(...)

#### *Section 3-7 Banker to the government*

To the extent the King decides, the Bank shall carry out banking transactions for the government, perform financial services for the government and render services in connection with government debt issues and the management of government debt.

#### *Section 3-8 Credit to the government*

Norges Bank may not extend credit directly to the government. Nevertheless, the Bank may extend credit to the government that matures within one calendar day.

#### *Section 3-9 Protective measures*

The King may decide on special measures when capital flows to and from other countries may result in substantial balance of payments problems or major disturbances to the financial system. The Bank shall be given the opportunity to express its views before such a decision is made.

#### *Section 3-10 International agreements*

- (1) The Bank shall administer Norway's rights and obligations ensuing from membership of the International Monetary Fund.
- (2) To fulfil its purposes, Norges Bank may enter into agreements on deposit, credit or guarantee arrangements with foreign central banks and with international organisations and institutions, provided that its claims are satisfactorily secured.

### **Chapter 4 Supervision and control**

#### *Section 4-1 Supervision etc by the Ministry*

The Ministry shall supervise the activities of the board. The Ministry shall evaluate the Bank's goal performance.

#### *Section 4-2 Annual report, annual accounts and minutes*

- (1) Norges Bank has a statutory obligation to keep accounts in accordance with the Accounting Act and the Bookkeeping Act. The King may lay down regulations specifying rules for the Bank's annual accounts, annual report and bookkeeping that supplement or depart from the provisions in or pursuant to the Accounting Act or the Bookkeeping Act.
- (2) Each year, the board shall prepare an annual report and annual accounts. The annual accounts require the approval of the Ministry and together with the annual report shall be presented to the Storting.
- (3) The minutes of board and committee meetings shall be submitted to the Ministry.

#### *Section 4-3 Audit*

- (1) Norges Bank's annual accounts shall be audited by an accountant that is authorised pursuant to the rules in the Auditors Act. The Ministry shall elect an auditor and set the auditor's fee.
- (2) The King may lay down regulations specifying rules for auditing the Bank that supplement or depart from the provisions of Auditors Act.

*Section 4-4 Internal audit*

- (1) The Bank shall have an internal audit unit that reports to the board.
- (2) The internal audit unit shall assess the Bank's internal control, procedures and other conditions that are important to the Bank's operations.
- (3) The King may lay down regulations concerning the Bank's internal control.

*Section 4-5 The Bank's equity and distribution of profit*

- (1) Norges Bank shall hold equity that is sufficient for fulfilling the Bank's purposes.
- (2) The King in the Council of State shall lay down guidelines for the allocation and distribution of the Bank's profit. The Bank shall be given the opportunity to express its views before the guidelines are laid down. The guidelines shall be communicated to the Storting.

**Draft amendments to other acts**

The following amendments shall be made to **Act No. 123 of 21 December 2005 relating to the Government Pension fund**:

Section 1 Purpose of the Government Pension Fund shall read:

*The savings in the Government Pension Fund shall support the financing of the National Insurance Scheme's expenditure on pensions. These savings shall safeguard long-term considerations in the use of the government's petroleum revenues so that petroleum wealth benefits both current and future generations.*

New Section 2 shall read:

*The objective of the investments in the Government Pension Fund is to attain the highest possible return at an acceptable risk while promoting responsible investment.*

New Section 6 shall read:

*The Government Pension Fund Global shall invest outside of Norway and in foreign currency in accordance with further guidelines laid down by the Ministry.*

Section 7 new second paragraph shall read:

*The government shall not finance government budget expenditures by borrowing as long as there is capital in the Government Pension Fund Global.*

New Section 9 shall read:

*The Ministry shall evaluate the management of the Government Pension Fund Global and report to the Storting annually.*

The following amendments shall be made to **Act No. 17 of 10 June 2015 on financial undertakings and financial groups**:

New Section 1-7, second paragraph, shall read:

*The King in the Council of State may confer on Norges Bank the task of laying down a regulation on requirements for new residential mortgage loans. Section 1-4, second paragraph, of the Norges Bank Act shall apply accordingly.*

New Section 14-3, seventh paragraph, shall read:

*The King in the Council of State may confer on Norges Bank the task of preparing a decision basis and issuing decisions on the countercyclical capital buffer. Section 1-4, second paragraph, of the Norges Bank Act shall apply accordingly.*

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Published by:  
Norwegian Ministry of Finans

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Telephone: + 47 222 40 000  
Print: 07 PrintMedia 05/2017 – Impression 50

