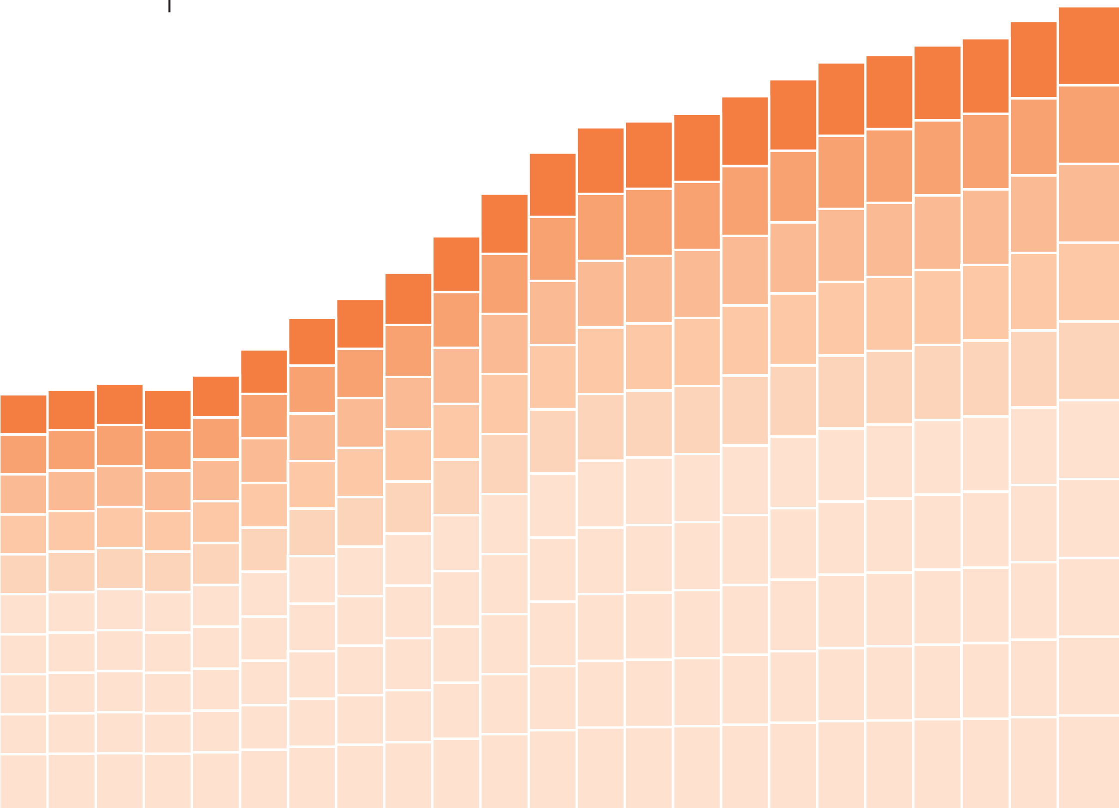
Norwegian Ministry
of Finance

Summary

Meld. St. 14 (2017–2018) Report to the Storting (white paper)

Financial Markets Report 2018



Meld. St. 14 (2017–2018) Report to the Storting (white paper) Summary

Financial Markets Report 2018

Translation from Norwegian. For information only.

Financial Markets Report 2018

Meld. St. 14 (2017–2018) Report to the Storting (white paper)
Summary

Recommendation of the Ministry of Finance of 27 April 2018, approved by the Council of State on the same day. (Government Solberg)

A summary

Introduction

The Government submits an annual financial markets report to the Storting. This summary corresponds to Chapter 1 of the report, which provides an overview of key policy developments, and a summary of the other chapters. Chapter 2 of the report reviews the financial stability outlook. Chapter 3 discusses the financial markets from an industry perspective, and addresses both the financial sector as an industry in its own right and the financial sector as a capital source for other industries. Chapter 4 provides an overview of how consumer protection is attended to in financial markets regulations, and discusses the need for changes. An overview of the activities of Norges Bank, Finanstilsynet, Folketrygdfondet and the International Monetary Fund (IMF) in 2017 can be found in chapters 5 to 8 of the report. Chapter 9 outlines amendments to legislation and licences in 2017.

Robust financial markets for freedom of choice and economic growth

The financial markets account for a major portion of the Norwegian economy, and provide services of importance to people's lives. The main role of banks is to receive savings in the form of deposits, and to make loans to households, businesses and municipalities. Deposits with Norwegian banks amount to about NOK 2,500 billion, which corresponds to almost two Norwegian fiscal budgets. Banks lend about twice as much as they hold in deposits, and fund the difference through capital market borrowing. Each year, life insurance companies and pension funds receive pension savings in excess of NOK 100 billion, and have invested about NOK 1,600 billion in securities and other assets on behalf of their customers. Norwegian securities markets, where large businesses and municipalities raise loans and equity directly from savers, represent about NOK 4,200 billion. The saving and borrowing opportunities provided by Norwegian financial markets offer households, businesses and municipalities the freedom to adapt their investments and consumption over time, irrespective of when income is received. This freedom of choice is valuable to individuals, and is fundamental for value creation and economic growth.

The scope for insuring against risk provides predictability for households, and is a prerequisite for stability and profitability in businesses. Last year, non-life insurance companies in Norway paid more than NOK 37 billion in compensation for anything from personal injury to theft and damage to buildings, cars and ships. In addition, businesses use various financial instruments to reduce their financial risk, e.g. relating to changes in commodity prices, exchange rates and interest rates. Life insurance companies also sell insurance policies that pay compensation in the event of disability or death, either separately or as part of pension plans.

Almost eight million transactions are processed through the Norwegian payment system every day. The system processes payments in a secure manner and at a low cost. This promotes stability and efficiency in the Norwegian economy.

Stable access to financial services is important for the well-functioning of modern economies. The societal costs of financial market turbulence and crises can be large and persistent. In particular, the interaction between the banking sector and the rest of the economy may result in the accumulation of financial imbalances, and trigger turmoil and deep economic setbacks. The Government is therefore committed to ensuring that the financial markets are robust in the face of disturbances, and have the capacity to maintain their services through challenging times. In order to achieve this, it is necessary to impose requirements that promote solvent financial undertakings, and to facilitate well-functioning and transparent securities markets.

In order to reduce the vulnerability of the provision of financial services and contribute to strong competition, the Government is also committed to promoting diversity amongst providers in all financial markets. Norwegian markets shall be open to foreign financial undertakings, and there shall be low barriers to establishing new businesses. The regulatory framework should be stable and sound, out of consideration for both the significance of the financial sector to activity in other parts of the Norwegian economy and the important industry the financial sector is in its own right.

Good solvency is necessary, but not sufficient, to protect the customers of financial undertakings. Consumers need special protection and strong rights in financial markets. Robust consumer protection shall serve to level the playing field between consumers and financial undertakings, without relieving consumers of the risk associated with financial contracts and investments. Consumer protection is a key feature of financial markets regulation and supervision, and the Government will continue to accord high priority to protecting consumers.

Financial stability outlook (chapter 2)

Chapter 2 of the report discusses the financial stability outlook. The solvency and liquidity situation of Norwegian financial undertakings is healthy, but there are vulnerabilities in the financial system. The most important vulnerabilities are the high debt burden of Norwegian households and high real estate prices. In recent years the Government has implemented a number of measures to curtail the risk these vulnerabilities pose to financial stability and the Norwegian economy, such as stricter capital requirements for banks and regulation of banks' residential mortgage lending practices.

Healthy solvency and liquidity in Norwegian financial undertakings

There is a political consensus in Norway that solvency and stability should be given priority in financial markets policies. The Government wants the financial sector to contribute to growth in the Norwegian economy over time, and will therefore continue its efforts to reduce the risk of disturbances that may impair the growth capacity of the economy. Such a policy is in contrast to the policy in some countries in the years leading up to the international financial crisis in 2008–2009, when weak capital requirements combined with rapid growth in the financial sector served to increase risk.

Norwegian financial undertakings are solvent and profitable. Last year, banks earned pre-tax profits of NOK 55 billion, and all but one bank met the minimum capital requirements. Over the last decade, banks' solvency has improved two-fold, measured by the risk-weighted capital adequacy ratio. This means that the ability of banks to handle any future setback in the Norwegian economy has been significantly improved. The strong earnings of banks pave the way for additional capital accumulation in coming years. Banks have strengthened their solvency in line with the phase-in of new requirements in the wake of the financial crisis. An already strong solvency position for Norwegian banks, as well as favourable developments in the Norwegian economy, enabled Norway to be one of the countries that have introduced new requirements most rapidly. At the beginning of March this year, the Storting adopted what is thus far the last of the banking reforms after the financial crisis; a new framework for bank recovery and resolution. The legislation will serve to reduce risk in the banking sector, and may over time deliver major cost savings for the Norwegian economy and the public sector.

Apart from equity, banks' funding is primarily comprised of customer deposits and borrowings in capital markets. Market funding enables banks to manage their liquidity risk in a manner not feasible with deposits, but may also make them vulnerable. If banks assume that new market funding will always be available on short notice, they may encounter problems if markets were to become less liquid, as happened during the international financial crisis. As the assets of

Norwegian banks are predominantly denominated in Norwegian kroner, dependency on short-term market funding in foreign currency may make them particularly vulnerable to volatility in international markets. Norwegian banks have become less dependent on short-term market funding in recent years, and have built up considerable liquidity buffers in line with the liquidity coverage requirement introduced in the wake of the financial crisis. Banks have thus become more robust against market turmoil.

The traditional business model of life insurance companies and pension funds – to offer contracts with life-long guaranteed benefits – has in recent years been challenged by increasing life expectancy and a persistently low interest rate level. However, the companies and funds have managed to cut costs and adjust their risk-taking, e.g. by refocusing the sale of new insurance policies to contracts where the insured carries more of the risk. Last year, the companies and funds earned pre-tax profits of about NOK 13 billion. The non-life insurance market is characterised by a relatively diverse supply side, including both Norwegian and foreign companies, combined with strong earnings. Last year, the pre-tax profits of non-life insurance companies were NOK 8.7 billion. With one exception, all insurance companies and pension funds met the minimum solvency requirements as at yearend 2017.

Recent regulatory developments in Norway are largely based on new EU legislation, which are based on international consensus in various fora. As it has become ever easier to move capital and provide financial services over long distances, it has become necessary to establish common international standards for much of the financial markets regulation. The financial crisis highlighted how turbulence can spread rapidly throughout global markets. Although there are major benefits from having more uniform rules internationally, there is a need for maintaining room for manoeuvre at the national level in order to tailor regulations to economic conditions and desired risk tolerance. The Government is committed to using the room for national flexibility in the relevant EU frameworks to set requirements appropriate for Norwegian conditions. The Government also accords priority to ensuring a level playing field for all financial undertakings in Norway, irrespective of whether these are headquartered in other countries.

High indebtedness and high real estate prices

The debts of Norwegian households has been increasing more rapidly than income for a long time. Average debt is now more than two times households disposable income. This is a high level, both historically and compared to other countries. A sustained increase in the debt burden is an indication that financial imbalances have been accumulating. This is one of the most important vulnerabilities in the Norwegian financial system, as also highlighted by Norges Bank, Finanstilsynet, the IMF and the OECD.

Most financial crises in Norway and internationally have occurred after periods of strong growth in asset prices and rapid debt accumulation. One of the risks associated with high household indebtedness is that many households might choose to curtail consumption if incomes were to decline or interest rates increase. Experience shows that households accord priority to servicing their residential mortgage loans, even when incomes are in decline. Lower consumption may reduce the earnings and debt servicing capacity of businesses, which may then result in increased losses on the part of banks, thus impairing their capacity to make new loans to both households and businesses. The interaction between the financial system and the rest of the economy may give rise to turmoil and deep economic setbacks.

After several years of rapid igrowth, Norwegian housing prices declined throughout 2017. These price developments must be considered in the context of the steep price increases in recent years, as well as expanded housing construction. Lower housing price growth may over time serve to curtail the increases in household debt.

A number of measures have been introduced in recent years to limit the risk posed to financial stability and the Norwegian economy by high household indebtedness. In addition to the general strengthening of capital requirements for banks, the capital requirements for residential mortgages have been raised further. Moreover, the countercyclical capital buffer requirement shall, as part of the new capital requirement framework, serve to make banks more robust against loan losses in any future recession, and reduce the risk of banks exacerbating a cyclical downturn by reducing their lending. The countercyclical capital buffer requirement shall be tailored to developments in the Norwegian economy, and was activated for the first time with effect from June 2015. The buffer requirement has been tightened twice since then, most recently with effect from yearend 2017.

In the summer of 2015, the Government adopted a temporary regulation on new lending secured by residential mortgage, in order to promote a more sustainable residential mortgage market. The regulation was renewed, subject to some tightening, with effect from 1 January 2017. The regulation caps the loan-to-value (LTV) ratio on residential mortgage loans at 85 percent. The regulation includes a debt-to-income (DTI) requirement which stipulates that a borrower's total debt can not exceed five time their gross income. Furthermore, the regulation requires that lenders make allowance for an interest rate increase of 5 percentage points when assessing a borrower's debt-servicing ability. Banks should nonetheless have some flexibility to provide loans to creditworthy customers. This is ensured by allowing up to 10 percent of the quarterly lending volume to be loans that do not meet all requirements under the regulation. Because of the partcicularly rapid housing price growth in 2016, loans secured on dewellings Oslo was made subject to a somewhat lower flexibility quota of 8 percent, along with a lower maximum loan-to-value ratio for loans secured on second homes in Oslo. The current regulation will expire on 30 June 2018. The Ministry of Finance has recently circulated for consultation a proposal from Finanstilsynet for the regulation to be extended indefinitely, subject to certain modifications. The Government will decide whether to extend the regulation and, if so, in what form, before the current regulation expires.

Digital vulnerability

Increased digitalisation and use of new technology facilitate more efficient production of financial services, but may also increase the financial sector's exposure to cyberattacks and technical errors. Internationally, the financial sector is the sector most exposed to cyberattacks, and the scale and frequency of attacks are on the increase.

The financial infrastructure in Norway has thus far proved to be robust, and there is a high level of trust between market participants. However, there have been incidents in which key services have been unavailable for up to 24 hours. If cyberattacks or other disturbances interfere with the availability of essential services or result in sensitive information being compromised, it may undermine confidence in individual undertakings and the financial system as a whole, and may ultimately threaten financial stability.

Efforts are being pursued both in Norway and internationally to prevent cybercrime and strengthen the ability of the financial sector to withstand cyberattacks and other types of digital risk. The Norwegian regulatory framework includes extensive requirements pertaining to ICT systems use and outsourcing, and supervision is carried out by Norges Bank and Finanstilsynet. The financial industry devotes considerable resources to preventing attacks and technical errors, and has participated in the establishment of the Nordic Financial CERT, which is tasked with enabling financial institutions to respond to cyber security threats and online crime rapidly and efficiently. In the EU, the European financial supervisory authorities are mapping current supervisory practices, and assessing the need for issuing ICT risk management guidelines.

The Financial Stability Board (FSB) has considered whether the emergence of private virtual currencies poses a risk to financial stability. According to the FSB, the limited volume of such currencies means that they do not currently constitute any systemic risk, and it is improbable that they will attain such volumes that this will change. However, individual currencies may potentially affect financial stability if they become widely used.

Climate risk

Climate change, as well as society's adaptation to climate change, may give rise to new vulnerabilities in the financial system. More frequent extreme weather may result in more damage to real estate and infrastructure and larger claims for non-life insurance companies. It may also result in impairment of the investments of financial undertakings and the mortgaged assets that secure banks' lending. The transition to a low-carbon economy also entails risk, e.g. if technological developments and political decisions cause sudden changes in the value of financial assets relating to fossil fuel production. Experience has shown that such sudden changes in asset values may have financial stability implications.

Initiatives have been launched both internationally and in Norway to improve the understanding of how climate change may affect financial markets and financial stability, as well as how the financial sector may contribute to the transition to a low-carbon economy. These include the European Commission's launch, in March 2018, of an action plan on the financing of sustainable growth. In Norway, the Climate Risk Committee has been tasked with examining, until December 2018, the significance of climate risk for the Norwegian economy and how such risk can most appropriately be identified, analysed and presented.

A task force appointed by the FSB has examined, at the request of the G20, how companies can report on climate-related risk in a better and more systematic manner. The recommendations from the task force provide a good framework for climate-related financial reporting, and may, if adopted by enterprises internationally, make it easier for investors to assess climate risk. The Government will assess the need for changes to company reporting requirements in relation to climate-related risk, in view of how the recommendations from the task force are followed up on by market participants, as well as the recommendation of the Climate Risk Committee and international regulatory developments.

The financial markets in an industrial perspective (chapter 3)

The three previous financial markets reports have included a chapter with discussions of key aspects of the financial market policy and their interaction with other policy areas, and this is continued in this year's report. The chapter addresses both the financial sector as an industry in its own right and the financial sector as a source of funding for other businesses, with a specific focus on innovation and new technology.

Economic growth and access to capital

The Norwegian financial sector is profitable and has accounted for a significant portion of growth in the Norwegian economy and tax revenues from Norwegian businesses. The size and growth of the sector were negatively affected by the Norwegian banking crisis in the 1990s and the international financial crisis, but the financial crisis had a much lesser impact on the financial sector in Norway than in countries that experienced steep financial sector growth in the lead-up to the crisis, e.g. Ireland and Iceland. The number of employees in the Norwegian financial sector has declined somewhat in recent years following the development of new self-service and service automation initiatives.

A well-functioning capital market shall provide businesses with funding at prices that reflect the project risk, thus contributing to an efficient allocation of capital. If markets do not bring about optimal resource allocation on their own, government regulation may have an important role to play, for example via rules of conduct, solvency requirements for financial undertakings and financial reporting requirements. Solvent financial undertakings can support restructuring and growth also in times of economic turmoil, both by contributing to profitable projects maintaining their access to funding and by channelling capital away from projects that are no longer profitable.

Firms' access to capital in the Norwegian market is currently good, both from banks and securities markets. Businesses benefit from the diversity within the Norwegian banking sector, with the local knowledge of smaller banks supplementing the financial strength of larger banks. The Norwegian banking sector is dominated by Norwegian-owned banks, but foreign banks have stepped up their presence in recent years. In the capital markets, the Norwegian supply side and the integration with foreign markets provide Norwegian businesses with a diversified and attractive range of funding alternatives. Larger businesses have good access to both bank lending and securities lending, whilst smaller businesses may be more dependent on local sources of finance.

The Government seeks to facilitate continued well-functioning national markets, as well as a stable and secure affiliation with international markets. In order for Norwegian and European financial markets to continue to have well-aligned rules and well-functioning affiliations, EEA-relevant EU legal acts should be incorporated into the EEA Agreement as swiftly as possible. There is currently an above-average backlog of legal acts awaiting incorporation into the EEA Agreement because it took time to reach agreement on EEA adaptations to the European System of Financial Supervision, and because many of the EU legal acts adopted after 2010 are based on elements of this system. In addition, the scope and complexity of the legal acts have increased in recent years. The Government is seeking to reduce the backlog as quickly as possible, although this will necessarily take some time.

In a small, open economy like that of Norway, the expanding cross-border integration of financial markets increasingly decouples businesses' access to capital from domestic savings decisions, thus making businesses less dependent on Norwegian investors. A significant portion of the funding of Norwegian businesses has been raised from foreign investors. The financial markets nonetheless also serve an important function in facilitating private savings, not least for Norwegian households. Such savings may, for example, take the form of bank deposits, or investments in funds and other securities, as well as pension savings in occupational pension schemes and individual pension schemes. The Government has sought to facilitate private savings through the introduction of a new individual pension scheme, a new equity savings account scheme, as well as by expanding the scope of the home investment savings scheme for youth.

Life insurance companies and pension funds manage a considerable portion of household savings in the financial markets. These assets will predominantly be paid out as pensions in the future. The Government is pursuing several regulatory processes with a view to ensuring the efficient management of pension assets until these become payable, whilst at the same time attending to the main consideration behind the regulation of pension providers, the safeguarding of future pensions. The Ministry of Finance has circulated for consultation a proposal for a designated "individual pension account" in defined-contribution pension schemes, in which employees may consolidate pension capital from various sources. The proposal is intended to promote more efficient management of funds through the exploitation of any economies of scale in asset management, as well as to provide individuals with a better understanding of, and more influence over, their own pensions. In November 2017, the Ministry of Finance also appointed a working group charged with examining whether it would be feasible to make any amendments to the regulatory framework governing the management of pension products with contractually-defined benefits, including defined-benefit occupational pension schemes and paid-up policies, that are clearly in the interest of customers.

Financial market innovation

The Norwegian financial industry has been an early adopter of digital solutions and of digital services, which its customers have been quick to start using. Competition and the pace of development in the payment services market may intensify in coming years as the result of new technology, new regulations and the entry of new providers. The EU's revised Payment Services Directive (PSD2) may be of major importance over the next few years. The directive aims to modernise the regulatory framework, enable innovation and competition, facilitate lower prices and promote more secure solutions. Innovation in financial services is being done both by established financial undertakings and providers specialising in the adoption of new financial services technology, often termed "fintech".

The emergence of fintech raises the question of whether the financial markets regulation is able to accommodate technological innovation. The authorities should ensure that the regulatory framework does not unintentionally impede business models based on new technology. In addition, the complexity of certain well-founded requirements may inhibit innovation and competition. In order to tailor regulation to small and new providers, the regulatory framework does in some cases provide room to apply proportionality. Information and guidance initiatives may also have a role to play.

In September 2017, Finanstilsynet established, at the behest of the Ministry of Finance, a contact point for fintech firms. In addition to readily accessible information and guidance, the contact point is charged with contributing to the supervisory authority's understanding of technological developments and identifying any need for regulatory amendments.

Governments in a number of countries have established frameworks to actively facilitate fintech activities. Whilst efforts are in some countries limited to guidance for new businesses, other countries have chosen to establish so-called regulatory sandboxes in which undertakings can provide its services to a limited number of customers without having to comply with all requirements applicable in the open market. ICT Norway and Finance Norway have recently launched a proposal on how to establish a regulatory sandbox in Norway. In March 2018, the European Commission published a fintech action plan in which it observed that the emergence of fintech may contribute to financial inclusion, more efficient financial services production and more well-functioning capital markets, but also increased risk. The action plan aims to dismantle barriers to innovation, whilst at the same time managing the risk. The EU financial supervisory authorities have been tasked with mapping how current rules are used to regulate fintech, and assess the need for new guidelines or rules.

The Government will assess the need for additional measures to facilitate fintech innovation in Norway. The experience garnered by the Finanstilsynet contact point, as well as elements of the ICT Norway and Finance Norway proposal, are relevant in this assessment. The Government will also draw on experience from other countries and the fintech efforts in the EU.

Crowdfunding platforms that connect investors with businesses and others who need capital are a business model made possible by new technology. Such platforms have emerged as a supplement to traditional financial undertakings and marketplaces. The Government is committed to making it easier to access crowdfunding in Norway, and will assess the need for clarification of, or amendments to, the regulatory framework. Regulatory developments in the EU may also influence future Norwegian regulation of financial crowdfunding platforms.

The emergence of Bitcoin and other virtual currencies raises a number of new issues, such as how to prevent virtual currencies from being used for money laundering and terrorism financing, how to tax those who hold and trade in such currencies, and whether the use of these currencies may have financial stability implications. Many of the challenges require international solutions. Finanstilsynet and a number of other supervisory authorities have warned against investing in virtual currencies, and have pointed out the high market risk and the fact that consumers are not protected by any of the guarantees and protective measures applicable to regulated financial services. The Government is closely monitoring developments, and will assess the need for measures in view of international regulatory developments. The Ministry of Finance intends to lay down rules in a regulation that will make providers engaged in exchange services between virtual currencies and fiat currencies, as well as custodian wallet providers, subject to the Anti-Money Laundering Act.

In managing the challenges posed by the emergence of virtual currencies, the authorities should avoid causing unintended obstacles to lawful operations and innovation. The underlying technology and the infrastructure behind the virtual currencies may offer opportunities that merit examination independently of the currencies themselves. As they mature, blockchain technology and other new technologies, may potentially lay the foundation for efficiency improvements and business developments.

Safe and sound financial services for consumers (chapter 4)

It is necessary to pay special heed to consumers in the financial markets because they may not be well placed to assess the risks, costs and yield potential of some financial services before entering into contracts. Besides, decisions with a major impact on personal finances, such as taking up residential mortgage loans and choosing pension plans, are only made a few times in a lifetime and there may be little room for "trial and error". Consumers need to navigate ever-more complex markets for financial services, and often have to take more responsibility for how their own pension assets are managed.

Consumer protection shall ensure that consumers can trade more securely with professional financial undertakings, but does not exempt consumers from risk. The Government is focused on consumers having the knowledge and information to enable them to make prudent decisions regarding their own finances. The Government's emphasis on consumers in the financial markets policy is reflected in the fact that a separate chapter in this year's financial markets report is dedicated to consumer issues. It provides an overview of how the authorities currently contribute to ensuring that consumers receive sound and secure financial services and discusses the need for change, with a special focus on customer mobility and competition, banks' compliance with their obligation to make cash available, as well as measures targeting the rapidly growing consumer loan market.

Customer mobility and competition

Healthy competition between financial service providers may deliver lower prices and better solutions for customers. In recent years, foreign providers have stepped up their presence in Norway. At the same time it has become easier for consumers to get an overview of which products are being offered, as well as to switch between banks or insurance companies. This has served to increase diversity and competition.

The *Finansportalen* financial services portal is operated by the Norwegian Consumer Council, and is one of the services that has made it easier to get an overview of financial services. Since July 2016, it has been mandatory for financial undertakings to include a link to *Finansportalen* wherever they present their products online. Over the decade that the portal has been in operation, mobility and negotiation activity on the part of consumers of the compared services have increased.

The Government believes that it should be straightforward to switch service providers. It is currently not possible to bring along one's account number when switching banks. This may constitute a barrier to switching. However, any restructuring of the account number system would entail considerable challenges and costs. At the same time, major transformations are currently underway in payment services, of both a technological and regulatory nature, which may improve customer mobility in other ways. The "addresses" of bank accounts may follow customers in other ways than before, e.g. when using mobile payment services such as *Vipps*, where telephone numbers link the payor and the payee. The EU's revised Payment Services Directive (PSD2) will allow for new services that may enable consumers to access account details and payments in one place, irrespective of which banks are involved, and reduce the need for submitting account numbers in various contexts. Moreover, the Government is working on a proposal for a new Financial Contracts Act that, among other things, is ment to make it easier to compare banking services and switch banks, including new rules on banks' obligation to help consumers switch banks. An ever-increasing number of fintech providers are also offering solutions outside established payment channels.

The need for changing the Norwegian account number system should be further assessed when more is known about the market developments. If the market does not bring about appropriate solutions, despite the opportunities arising from new technology and regulation, it will be relevant to take a closer look at personal account numbers and other measures to enhance competition and customer mobility. Other countries are also faced with such issues. The European Commission has announced a cost-benefit analysis of so-called account number portability in the EU in the autumn of 2019.

Banks' cash services

According to Norges Bank, only every tenth payment was made in cash in 2017, compared to every fourth a decade earlier. Although electronic solutions currently meet most needs of many people, cash still remains an important means of payment and is an asset for store of value. Some customer groups will need cash services for many years to come. Cash has properties not offered by current electronic solutions, such as immediate settlement without third-party involvement, secure store of value, as well as anonymous payment. Norwegian kroner banknotes and coins are claims on Norges Bank, and a mandatory means of payment in consumer relations.

The exclusive right of banks to accept deposits is matched by the right of their customers to deposit and withdraw cash. Banks'obligation to make cash available has been laid down in a provision in the Financial Undertakings Act, effective from 1 January 2017. Finanstilsynet has examined how banks comply with this obligation, and assessed whether the rules need to be tightened. The conclusion is that cash services in bank branches have largely been replaced by ATMs, cash deposit machines, in-store cashback services and post office banking services. These solutions ensure that cash services are available throughout the country, even though 124 of 422 municipalities; primarily municipalities with small populations, currently have no bank branches. Finanstilsynet is of the view that current services by and large meet the needs of customers, but would encourage banks to collaborate on improving opportunities for placing deposits. Finanstilsynet also notes the risk that cash services may be scaled back in coming years.

The Government believes that it is of major importance for the general public to have access to bank deposits and payment services in a convenient format. It is reassuring that Finanstilsynet has found that cash services are available throughout the country, but developments may give grounds for concern. Banks have a responsibility for maintaining satisfactory cash services in coming years as well. This responsibility is likely most effectively handled through joint solutions, as pointed out by Finanstilsynet and Norges Bank. If banks fail to deliver on their responsibility, the Ministry of Finance could adopt specific obligations for banks in a regulation. However, this may imply unnecessarily high costs compared to well-organised collaboration between banks. The Government will follow up on these issues together with Finanstilsynet and Norges Bank, and in dialogue with the financial industry, and provide the Storting with an updated overview in next year's financial markets report.

Moreover, on 17 April this year, the Ministry of Finance clarified in a regulation that banks are required to have arrangements in place to be able to meet increased demand for cash due to disruptions in the electronic payment systems. Cash has an important role in contingency arrangements, and the new rules will set a standard for banks' ability to provide payment services. The requirements are applicable from 1 January 2019.

Consumer loans and interest rate caps

The Norwegian market for unsecured consumer loans has grown rapidly in recent years. Growth was about 13 percent in 2017, which is twice the level of the overall increase in household debt. Consumer loans currently represent about 3 percent of total household debt, but give rise to approximately 12 percent of interest expenses. A large part of consumer loan growth is accounted for by specialised consumer loan banks, which have predominantly been established over the last decade.

Access to unsecured credit may offer households financial freedom, for example to handle unforeseen expenses, but may also create problems for individuals who, for one reason or another, borrow more than they are able to repay. Although the volume of consumer loans is still relatively low in Norway when compared to certain other countries, the Government is concerned about the growth rate, and has launched a number of measures to improve the functioning of this market.

Stricter requirements have been introduced on credit marketing and credit card invoicing, and Finanstilsynet has issued guidelines on prudent lending practices for consumer loans. Finanstilsynet has stipulated stricter solvency requirements for several of the consumer loan banks. The new Debt Information Act allows for the registration and dissemination of debt information for use in banks' credit assessments, and two firms have applied for permission provide debt information services. Amendments to the Financial Undertakings Act will from next year make it more expensive for consumer loan banks to be covered under the deposit guarantee scheme. Moreover, the Government is working on a proposal for a new Financial Contracts Act that, among other things, is ment to provide borrowers with stronger consumer protection. Possible measures include an obligation for banks to decline a loan application if the credit assessment shows that the customer is not likely to be able to service the loan, as well as regulation of excessively high interest rates (usury).

Although the Government anticipates that implemented and planned measures will be sufficiently strong to resolve most of the problematic aspects of the consumer loan market, the Government is closely monitoring the market to assess the need for additional regulation. In accordance with a request from the Storting, the Government has looked into whether it would be possible and appropriate to introduce an interest rate cap for consumer loans. An interest rate cap is a form of price regulation on credit, which caps the level of interest and costs associated with a loan. A number of countries have introduced such caps, with considerable variation in their level and structure.

The effect of an interest rate cap will depend on its level. A low interest rate cap may reduce access to credit for a large group, because the price banks are allowed to charge does not match the risk represented by the relevant customer group. Banks may also choose to increase interest rates for lower-risk customers in order to compensate for lost income. An interest rate cap that is significantly higher than the average interest rate will affect a smaller portion of the market, and predominantly small loans with short maturities and high effective interest rates. However, the market for such loans is considerably smaller in Norway than in for example Sweden, Finland and the UK, and those who sign up for such loans in Norway will often have few other opportunities for accessing the credit market. A high interest rate cap may nonetheless have a disciplining effect.

The Government is of the view that an interest rate cap may be a relevant policy measure, especially if the volume of small consumer loans with short maturities were to increase significantly in Norway. However, an interest rate cap would be an invasive measure, and should only be considered when more experience has been gained with the implemented and planned measures, and if these measures turn out not to be effective enough. The Government will provide the Storting with an updated overview of market developments in next year's financial markets report.

The activities of Norges Bank in 2017 (chapter 5)

Norges Bank is Norway's central bank, and shall promote economic stability and manage assets on behalf of society. Norges Bank monitors the stability of the financial system, and provides assessments of the financial stability outlook in public reports several times a year. It provides quarterly advice to the Ministry of Finance on the level of the countercyclical capital buffer requirement. Throughout 2017, Norges Bank maintained its advice on a 2-percent buffer requirement effective from 31 December 2017. The advice was given to, and adhered to by, the Ministry in December 2016. Norges Bank shall contribute to robust and efficient payment systems, and settles payments between banks in Norway. The central bank provides loans to banks and central counterparties, issues banknotes and coins, supplies banks with cash, and supervises the interbank systems. Norges Bank also manages the foreign exchange reserves.

Norges Bank is charged with the operational implementation of monetary policy pursuant to guidelines laid down in a regulation from the Government. Inflation targeting was introduced in 2001. Both monetary policy thinking and practice have evolved over the years since the introduction of inflation targeting. A new, modernised regulation was adopted by the Government in March this year. The aim of the modernisation has been to bring the regulation into line with the way monetary policy has been conducted in practise. The operational target of monetary policy shall be an annual consumer price inflation of close to 2 percent over time. The inflation targeting shall be forward-looking and flexible so that it can contribute to high and stable output and employment, and to counteract the built-up of financial imbalances. Often there is no conflict between low and stable inflation and the other considerations. If such a conflict arises, Norges Bank needs to weigh the various considerations against each other.

The key policy rate is the most important monetary policy tool. Norges Bank kept the key policy rate unchanged at 0.5 percent throughout 2017. The economic outlook improved during 2017, both in Norway and internationally. This occasioned a minor upward shift in the Norges Bank rate path towards the end of last year.

The Ministry of Finance performs an annual assessment of Norges Bank's monetary policy conduct. In the view of the Ministry of Finance, the evolution of monetary policy practice has been positive. There is broad confidence in monetary policy among markets participants, academia and the general public. The development of monetary policy has continued through 2017, including a clearer description of the reasoning behind the judgment in the interest rate setting. Norges Bank is also charged with managing the Government Pension Fund Global (GPFG) on behalf of the State pursuant to provisions laid down by the Ministry of Finance. The management of the GPFG, including management performance and performance assessment, is addressed in Report No. 13 (2017–2018) to the Storting; the Government Pension Fund 2018.

The activities of Finanstilsynet in 2017 (chapter 6)

Finanstilsynet is the financial supervisory authority of Norway, and oversees financial undertakings' compliance with legislation and regulations. Finanstilsynet regularly conducts analyses of financial industry developments and economic conditions, nationally and internationally. One of the key objectives of Finanstilsynet is to promote financial stability, and its activities are focused on both the risk faced by financial undertakings as the result of macroeconomic developments, and the risk to the financial system and the economy that may be generated by financial undertakings as a whole. In 2017, Finanstilsynet worked on refining their modelling tools, and carried out stress tests for 20 Norwegian banking groups and close to 100 smaller Norwegian banks. Finanstilsynet participates in the European System of Financial Supervision, and works in close collaboration with other national supervisory authorities.

Finanstilsynet continually conducts document-based supervision on the basis of reporting from undertakings, and this forms the starting point, along with the monitoring of markets and the Norwegian economy, for a risk-based selection of undertakings for on-site inspection. On-site inspection is important in order to identify problems, and to establish close dialogue with senior managers and directors at an early stage, thus enabling necessary measures to be implemented in an effective manner. In 2017, Finanstilsynet carried out 21 on-site inspections with banks and mortgage companies, as well as ten special inspections covering banks' use of internal risk models. Finanstilsynet carried out a total of 15 on-site inspections with insurance companies and pension funds in 2017, and 23 on-site inspections of ICT and payment services. Finanstilsynet also carried out a number of inspections in other areas, such as securities trading, accounting and auditing, estate agency and debt collection.

The activities of Folketrygdfondet in 2017 (chapter 7)

Folketrygdfondet is a special legislation company wholly owned by the Norwegian state through the Ministry of Finance. Folketrygdfondet manages the Government Pension Fund Norway (GPFN) pursuant to specific management provisions laid down by the Ministry of Finance. The asset management objective is to maximise the return over time, measured in Norwegian kroner and net of costs. The market value of the GPFN was NOK 240.2 billion as at yearend 2017, and the return was 13.2 percent in 2017, which is 0.5 percentage points more than the return on the benchmark index defined by the Ministry. The management of the GPFN, including management performance and performance assessment, is addressed in Report No. 13 (2017–2018) to the Storting; the Government Pension Fund 2018.

The activities of the IMF in 2017 (chapter 8)

The International Monetary Fund (IMF) is charged with promoting international monetary corporation, strengthening financial stability globally and regionally, and facilitating international trade. Lending under the IMF's general lending arrangements is currently at its lowest level since the financial crisis. A total of 16 countries have agreements with the IMF under these, including two agreements under the precautionary Flexible Credit Line. The volume of new loan agreements under the consessional arrangements for low-income countries has been at a high level in recent years, and a total of 19 countries currently have programmes under these.

Norway is placing a total of SDR 11.7 billion (equivalent to somewhat in excess of NOK 130 billion) at the disposal of the general lending arrangements of the IMF. SDR 3.75 billion of this are quota resources, SDR 1.97 billion are made available through the multilateral borrowing arrangement of the IMF (the NAB arrangement) and SDR 6 billion are made available under a bilateral loan agreement. Norway also contributes voluntary resources to fund the lending arrangements for low-income countries.

Looking ahead, an important topic for the IMF will be the upcoming quota review, which is scheduled for completion by the 2019 IMF Spring Meetings and no later than the 2019 IMF Annual Meetings. The quotas determine the amounts of members' financial obligations and rights, and also to a considerable extent, the apportionment of voting rights in the governing bodies of the IMF.

Amendments to regulatory frameworks and licences in 2017 (chapter 9)

The financial market regulation predominantly takes the form of legislation and regulations. The Ministry of Finance submits legislative proposals to the Storting, and adopts more detailed rules in regulations. The Ministry also grants licences for the establishment or reorganisation of financial undertakings, and stipulates conditions for such licences. A number of amendments to the financial services legislation were enacted in 2017, and the Ministry of Finance adopted a total of 16 regulations.

Published by:
Norwegian Ministry of Finance

Public institutions may order additional copies from:
Norwegian Government Security and Service Organisation
E-mail: publikasjonsbestilling@dss.dep.no
Internet: www.publikasjoner.dep.no
Telephone: + 47 222 40 000
Cover Illustration: Stylisation of Norwegian households' debt burden from 1983 to 2017
Print: 05/2018 – Impression 50
07 Media AS 05/2018