

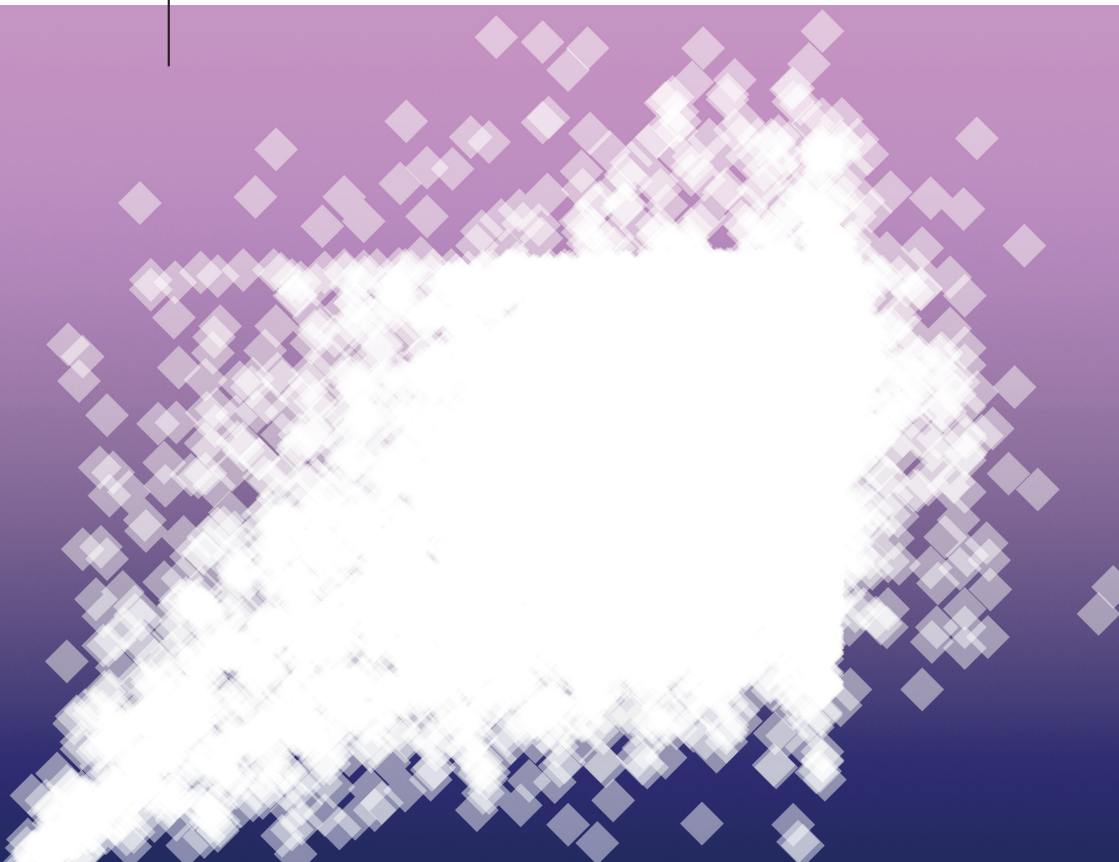


Norwegian Ministry  
of Finance

Summary

Meld. St. 22 (2019–2020) Report to the Storting (white paper)

# Financial Markets Report 2020







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*Recommendation of the Ministry of Finance of 24 April 2020,  
approved by the Council of State on the same day.  
(Government Solberg)*

## Summary and key developments

### 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 financial market policy developments, and a summary of the other chapters. Chapter 2 of the report addresses 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 market regulations, and discusses the need for changes. An overview of the activities of Norges Bank, Finanstilsynet, Folketrygdfondet and the International Monetary Fund (IMF) in 2019 can be found in chapters 5 to 8 of the report. Chapter 9 outlines amendments to regulatory frameworks and licences in 2019.

At the moment, the financial market situation and outlook are heavily influenced by the ongoing coronavirus outbreak and the strong measures triggered thereby. A number of measures and events have a direct impact on financial markets. These are briefly outlined where relevant, but the Government does not provide any detailed analysis or evaluation of the effects in this report. Reference is also

made to propositions submitted by the Government to the Storting this spring with proposed measures to counter the financial effects of the coronavirus disease outbreak, as well as to the Revised National Budget to be submitted in May. This report will largely address structural matters and regulatory developments pertaining to financial markets, and thereby also financial market developments prior to the coronavirus disease outbreak.

### *Main roles and key figures for the Norwegian financial sector*

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. Bank deposits amount to about NOK 2,800 billion, which corresponds to about two Norwegian fiscal budgets. Banks lend about twice as much as they hold in deposits, and fund the difference through capital market borrowing.

In 2019, life insurance companies and pension funds received pension savings and premiums in excess of NOK 120 billion, and have invested about NOK 1,900 billion in general lending, 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 5,000 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 36 billion in compensation for anything from personal injury to theft and damage to buildings and cars. In addition, businesses use various financial instruments to reduce their financial risk, e.g. the risk of 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.

More than 2.5 billion card payments are processed through the Norwegian payment system every year, and the average Norwegian resident uses payment cards more than 500 times a year. The Norwegian system processes payments in a secure manner and at a low cost. This promotes stability and efficiency in the Norwegian economy.

## **Financial stability outlook (chapter 2)**

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 build-up of financial imbalances, and trigger turmoil and deep economic setbacks. The Government is therefore committed to ensuring that the financial markets are robust to disturbances, and have the capacity to maintain their services through challenging times.

The positive outlook for the Norwegian economy at the beginning of this year turned sharply negative as a result of the strong measures taken from March this year in response to the coronavirus pandemic. This spring has been characterised by extensive layoffs and steep unemployment growth, low activity levels and considerable uncertainty regarding future developments. In addition, the oil price has declined steeply. The increased turmoil in financial markets and the oil price decline have caused the Norwegian krone to depreciate sharply. Norges Bank has reduced the key policy rate twice, and the key policy rate is currently 0.25 percent. Norges Bank has also launched comprehensive measures to ensure liquidity access for banks, and has stated that it is continuously considering the need for intervening in the market by purchasing Norwegian kroner. The duration of the strict infection control measures and the financial measures is subject to considerable uncertainty. The Ministry will be presenting updated assessments of the economic outlook in Norway and internationally in the Revised National Budget in May.

In recent weeks, economic developments, securities exchanges and financial indicators all over the world have been severely affected by the coronavirus pandemic, and the economic outlook is highly uncertain. Activity will in most countries be sharply reduced for as long as the strictest infection control measures remain in effect, and there is considerable uncertainty as to when and how swiftly economies will rebound. Central banks in several leading economies have reduced policy rates significantly and have provided markets with liquidity through a range of other measures. If the pandemic results in a lengthy economic shut-down, the risk of financial market imbalances having an impact on the real economy will increase. A key risk factor is the increased level of business debt observed ahead of the coronavirus pandemic.

In the somewhat longer run, the risk that new trade barriers will be erected in a number of countries, as well as the unclear effects of Brexit, also add uncertainty to the international growth and financial stability outlook.

### *Household and financial sector vulnerabilities*

The average debt of Norwegian households is now about 2.3 times disposable household income. This is a high level, both historically and compared to other countries. This debt accumulation is linked to steep housing price growth over many years. Housing prices rose in the first half of 2018, after having declined throughout 2017. Housing price developments were fairly moderate in 2019, but price increases were accelerating at the beginning of 2020. There is considerable uncertainty as to how the outbreak of the coronavirus will affect the housing market.

A sustained increase in the debt burden is an indication that financial imbalances have built up. This is one of the most important vulnerabilities in the Norwegian financial system. The rate of household debt growth has declined somewhat in the last year and was 4.9 percent at the beginning of the year; about the same level as the rate of disposable income growth. Consumer credit growth has levelled off after several years of steep increases. The growth rate decline was especially distinct in 2019. The annual growth rate as at yearend 2019 was 1.6 percent, adjusted for the sale of portfolios in default. Consumer credit represent



4 percent of household debt, but the interest expenses account for no less than 13 percent of overall interest expenses, and add to the vulnerability.

For households that have accumulated especially high debt, even minor interest rate changes may require them to curtail consumption. The monetary policy tightening initiated in September 2018 and the subsequent residential mortgage rate increase somewhat increased the interest burden of households. The outbreak of the coronavirus triggered a reversal of the monetary policy tightening, and the key policy rate reduction has reduced residential mortgage rates, which means, when taken in isolation, a lower interest burden. At the same time, many households are currently experiencing an income reduction. These households may experience a significant increase in the proportion of income spent on servicing their debts, and many of these may need to defer interest and instalment payments.

Most financial crises in Norway and internationally have occurred after periods of strong growth in asset prices and rapid build-up of debt. One of the risks is that many households might choose to cut back on consumption if incomes were to decline or interest rates were to 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.

In the autumn of 2019, the European Systemic Risk Board (ESRB) warned Norway that high indebtedness and high housing prices represent a systemic risk for the Norwegian economy. A number of other countries, including the other Nordic countries, were given a corresponding warning. The IMF and the OECD have also highlighted household debt and high housing prices as continued material risk factors for the Norwegian economy.

In addition to household lending, banks' lending to non-financial enterprises may represent a vulnerability. This applies, in particular, to lending to commercial real estate firms, as commercial real estate prices have increased steeply in recent years, especially in Oslo. Such lending accounts for a major portion of overall bank lending. Although

losses have been low in normal times, lending to such firms has historically imposed the largest losses on banks. A setback in the economy may cause commercial real estate vacancies, thereby reducing the debt servicing capacity of commercial real estate firms. If this is accompanied by a decline in the prices of the properties that are put up as collateral for the loans, banks may incur large losses. Commercial real estate prices have generally fluctuated more in tune with business cycles than housing prices.

A long period of strong performance in the Norwegian economy is reflected in several years of low loan losses and high earnings on the part of banks. The profitability of Norwegian and other Scandinavian banks is high compared to that of banks elsewhere in Europe. Norwegian banks have also achieved about the same return on equity as Danish and Swedish banks, despite having significantly higher equity. They have strengthened their solvency significantly in recent years, in line with stricter capital requirements, and their ability to withstand setbacks in the Norwegian economy is held to be good. Banks are at the same time facing risks on both the lending and the funding side. If banks incur large losses, they may exacerbate economic setbacks by curtailing their lending.

Customer deposits account for about half of Norwegian banks' funding, whilst the remainder is borrowing in the form of notes and bonds (wholesale funding). Wholesale funding enables banks to manage their liquidity risk in ways not possible with deposits. Norwegian banks have enjoyed ample access to wholesale funding, which has become slightly cheaper in recent years. However, international market turbulence may affect the price of, and access to, funding for Norwegian banks, and risk premiums have increased sharply in the bond market in the wake of the coronavirus outbreak.

Many banks internationally encountered liquidity problems during the financial crisis. Those banks had become dependent on short-term funding, and found it difficult to refinance during the crisis. Challenges rose quickly and simultaneously for a large number of banks. The crisis demonstrated the importance of strong liquidity risk management on the part of banks. In recent years, a somewhat higher proportion of banks' wholesale funding is long-term, and banks meet both the liquid-

ity coverage requirement introduced in 2017 and the upcoming net stable funding requirement. This strengthens the resilience of banks.

Covered bonds currently account for about half of Norwegian banks' wholesale funding. Covered bonds have thus far been a secure and stable source of funding. The relatively low price of covered bond funding is owed to such bonds being secured on residential mortgage portfolios with a low loan-to-asset value ratio and other collateral, thus implying low risk for investors. During the recent bond market risk premium increase, the percentage increase has been less for covered bonds than for other types of bonds. The emergence of covered bonds has reduced the short-term nature of banks' wholesale funding, but also entails new vulnerability. Housing market developments are a risk factor for banks' scope for using covered bonds to fund themselves, and banks also make considerable investments in each other's covered bonds to comply with the liquidity coverage requirement. If many banks need to sell covered bonds simultaneously, both value and liquidity may suffer. Housing market setbacks may exacerbate such a development.

Solvency requirements for insurance companies and pension funds have also been strengthened in recent years. Increasing life expectancy and the persistently low interest rate level have highlighted the need for improved solvency in undertakings and a more risk-sensitive regulatory framework. Undertakings have accumulated reserves to account for higher life expectancy, and meet new solvency requirements. The interest rate reduction in the wake of the coronavirus disease outbreak increases the interest rate risk associated with the liabilities of undertakings with large portfolios of guaranteed pension obligations. At the same time, the investments of such undertakings are directly affected by the financial market turbulence. Also, the current situation may mean that non-life insurance companies need to be prepared to make higher compensation payments.

### *Macroprudential regulation and bank solvency requirements*

Macroprudential regulation means monitoring and regulation of the financial system as a whole aiming to reduce risk in its interaction with the rest of the economy. Traditionally, financial sector regulation

has been focused on each individual bank, with the aim of protecting customers and creditors against loss. The financial crisis was a stern reminder that this does not suffice. The traditional approach is now often referred to as microprudential regulation.

Important macroprudential tools are bank capital adequacy requirements based on general systemic risk, such as the counter-cyclical capital buffer and the systemic risk buffer. The capital requirements are intended to ensure that banks are able to absorb losses without having to excessively tighten lending. Table 1.1 provides an overview of the key macroprudential tools, including liquidity requirements and lending practice requirements, which are discussed in more detail below.

Capital requirements for Norwegian banks have long been stricter than in many other countries, partly in reflection of experience from the Norwegian banking crisis in the 1980s and 1990s. Strong bank solvency benefited the Norwegian economy during the international financial crisis, and it is a strength in the challenging situation facing the Norwegian economy at the moment. Since there is currently considerable uncertainty regarding future developments, it is important that banks refrain from distributing profits in a manner that may impair their solvency. The Ministry of Finance has therefore expressed an expectation that Norwegian banks and insurance companies hold off on payment of dividends, etc., until the considerable uncertainty regarding economic developments has been reduced.

After the financial crisis, Norway increased banks' capital requirements in line with international recommendations and new EU rules more rapidly than most countries. This was possible because of relatively strong banks and healthy performance in the Norwegian economy, but also reflects a political prioritisation of financial sector resilience. Most of the increase in capital requirements takes the form of various buffer requirements on top of the CET1 minimum requirement. The buffer requirements are national macroprudential tools, and address various forms of systemic risk.

If many banks were to sustain losses at the same time, this might trigger or exacerbate a setback in the economy. An important macroprudential consideration is therefore that there shall be scope for

drawing on the various capital buffers without the bank finding itself in breach of its licence conditions. When a bank fails to meet the overall buffer requirements, it is automatically subjected to certain restrictions with regard to, inter alia, dividend and bonus distributions. If the consequences of undershooting the buffer requirements are perceived to be costly or uncertain, for example due to reduced confidence in the bank on the part of customers or the capital market, banks may be unwilling to draw on the buffers, even if faced with major losses. In order to counter this, the buffer requirements may be lowered or deactivated whenever needed, provided that the specific risks addressed by the buffer requirements have been reduced.

The countercyclical capital buffer requirement shall vary over time in response to the financial cycle, and may be tailored to the state of the Norwegian economy. The requirement shall as a main rule be between 0 and 2.5 percent. The Ministry of Finance has gradually increased the buffer requirement in recent years in line with a build-up of financial imbalances. The most recent increase was to 2.5 percent with effect from yearend 2019. The magnitude of the increases has been in conformity with advice from Norges Bank. As a policy response to the coronavirus crisis, the Ministry reduced the countercyclical capital buffer requirement to 1 percent with immediate effect in March at the advice of Norges Bank. A reduced requirement may serve to prevent a tightening of lending practices, which could have added to the downturn in the Norwegian economy. Finance Norway has estimated that this may boost the lending capacity of banks by between NOK 500 and 600 billion.

The current EU prudential framework for banks (CRR/CRD IV) was enacted in 2013, and has in all key respects been implemented in Norway, although it was not incorporated into the EEA Agreement until December 2019. Such incorporation required the Norwegian capital requirements to be amended in some respects. The so-called Basel I floor, the purpose of which has been to ensure that the risk-based requirements are not too low, was abolished, and the solvency requirement for banks' lending to small and medium-sized enterprises (SMEs) were reduced. This reduces capital requirements for many Norwegian banks.

**Table 1.1 Overview of the most important macroprudential tools**

Group	Tool	Purpose
Capital requirements for banks	Systemic risk buffer	Make banks more solvent and robust to loan loss and other disruptions that may occur as the result of structural vulnerabilities in the economy and other non-cyclical systemic risk.
	Countercyclical buffer	Make banks more solvent and robust to loan loss in a future downturn and reduce the risk that banks will deepen a potential downturn by restricting their lending.
	Buffer for systemically important banks	Reduce the likelihood that systemically important banks encounter financial difficulties that may have severe negative implications for the financial system and the real economy.
	Risk weight floors for residential and commercial real estate loans	Ensure that banks use prudent risk weights to reflect potential price bubbles in the Norwegian residential and commercial real estate markets.
	Stress test of ability to withstand interest rate increase	
Requirements applicable to banks' lending practices	Capping of borrowers' loan-to-asset value ratio	Contribute to more balanced development in the Norwegian housing and credit markets, increase the resilience of households and banks, and reduce the risk posed by consumers loans to the Norwegian economy.
	Capping of borrowers' debt-to-equity ratio	
	Instalment payment requirement	
	Flexibility quota for banks	
Liquidity requirements for banks	Liquidity coverage requirement	Improve banks' resilience to financial market turbulence, by making them less dependent on short-term funding and liquidity from central banks.
	Net stable funding requirement	

Source: Ministry of Finance.

To maintain the real capital requirements for banks, the Ministry of Finance decided in December 2019 to increase the systemic risk buffer requirement from 3 to 4.5 percent, as well as to introduce temporary floors for average risk weighting of property loans in banks that use the internal ratings-based approach (IRB banks). The increased systemic risk buffer requirement enters into effect as at yearend 2020. For smaller banks, which use the standardised approach, or foundation IRB approach, for the treatment of credit risk, the increase will enter into effect two years later. This has to do with such banks only benefiting from the introduction of the SME discounting factor and not from the abolition of the Basel I floor. The Ministry will in accordance with the EU/EEA rules assess the level of this buffer requirement every other year in the years to come. The new systemic risk buffer requirement and the introduction of floors for risk weighting of property loans may serve to increase capital requirements for foreign banks' operations in Norway, and thereby also contribute to stability and a more level playing field in the Norwegian banking market.

New regulatory amendments in the EU may in a few years' time have an impact on the real capital requirements faced by Norwegian banks. A number of amendments to the CRR/CRD IV framework and the Bank Recovery and Resolution Directive (BRRD), referred to as the "banking package", were adopted in the spring of 2019. In addition to an expansion of the SME discounting factor and a new discounting factor for lending to infrastructure projects, the package includes, inter alia, new provisions on the capital requirements which supervisory authorities may impose on individual banks on top of the general requirements (the so-called Pillar 2 requirements), and the MREL requirement. Finanstilsynet has appointed, at the behest of the Ministry of Finance, a working group charged with proposing, inter alia, Norwegian implementation of the banking package by the end of October this year.

### *Macroprudential regulation and lending practice requirements*

The Government has imposed restrictions on banks' lending practices in order to promote more sustainable household debt development. A temporary regulation on new lending secured by residential mort-

gage was adopted in the summer of 2015. The Residential Mortgage Regulations have been renewed three times, most recently from 31 December 2019 for a period of one year. The consultative rounds in connection with the renewal of the Regulations and other input received by the Ministry indicate that such lending regulation has received increased support over time, although there is a desire for the regulatory requirements to be evaluated on a regular basis. Some consultative bodies have expressed concern that the Regulations may exclude some groups, such as first-time buyers, from the housing market or hinder construction of new homes in sparsely populated areas. However, the purpose of the Regulations is to reduce vulnerabilities caused by high household debt, and one should as a general rule refrain from using these to pursue other housing policy objectives. Other policy tools, such as for example the Norwegian State Housing Bank, will be better suited in addressing other objectives.

The Residential Mortgage Regulations are likely to have reduced household borrowing. Fewer households are taking out loans that are very large relative to their income or the value of their home. Finanstilsynet conducts an annual survey of new loans granted by banks and secured by residential mortgage. The residential mortgage survey from the autumn of 2019 shows that there has in the last few years been a small increase in the proportion of loans that exceed the limits under the Regulations. The proportion is nonetheless lower than before the Regulations were tightened in 2017:

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- 5 percent of loans exceed the regulatory limit of 5 times annual income, as compared to 16 percent in 2016, prior to the introduction of this requirement.



- 5 percent of instalment loans had a loan-to-asset value ratio in excess of 85, as compared to 9 percent in 2015.

It is total household debt which poses a risk to financial stability. Housing debt is the main component, but high consumer debt, in many cases on top of high housing debt, may serve to increase the risk of severe consumption retrenchment if income falls or interest rates increase. On 12 February 2019, the Ministry therefore also adopted a temporary regulation on banks' consumer lending practices, largely mirroring the Residential Mortgage Regulations. The regulation shall apply until 31 December 2020.

The lending regulations are not suited for fine-tuning of housing and credit market developments, but define a framework for banks' lending practices. The regulations balance the prevention of excessive risk accumulation in the Norwegian economy against the promotion of efficient credit markets. Detailed lending regulations might reduce banks' incentives to perform independent risk assessments. It is important for banks to continue to perform genuine risk assessments, also in cases where a loan meets the requirements under the regulations. The scope for banks to grant a certain proportion of loans that do not meet the requirements under the regulations serves to ensure that responsibility for the risk assessments still remains with the banks.

In order to ensure predictability on the part of banks and borrowers, the requirements for a maximum loan-to-asset value ratio, stress testing of borrowers' debt servicing capacity and maximum debt-to-income ratio should not be subject to frequent adjustment. If a sustained levelling off of housing and credit market growth or conditions in the Norwegian economy indicate that lending regulations should be eased, an increased flexibility quota may be a suitable policy tool. This would retain the prudent lending practice framework defined by the regulations, whilst expanding banks' scope for conducting their own risk assessments. Correspondingly, the flexibility quota may be reduced if developments give cause for renewed concern.

The coronavirus outbreak and its financial implications have caused the Government to provide banks with additional flexibility by

expanding the flexibility quota under the Residential Mortgage Regulations to 20 percent, initially for the second quarter of 2020. This initiative is premised on banks' increased need for flexibility to find solutions for their customers in an extraordinary situation, and not on adapting the regulations to housing and credit market developments. The self-employed may for example need to increase loans secured by residential mortgage. The Ministry has, at the same time, highlighted that both the Residential Mortgage Regulations and the Consumer Loan Regulations permit instalment and interest deferral for up to six months for existing loans to customers whose ability to pay has been temporarily impaired. Repercussions of the coronavirus disease outbreak and the response measures clearly fall within the scope of this provision.

The debt servicing capacity and debt-to-income ratio requirements are the same under both sets of lending regulations, thereby ensuring consistent regulation of lending practices. Concern for uniform regulation suggests that any amendment to these requirements should be implemented simultaneously in both sets of regulations. The Residential Mortgage Regulations were renewed for a period of one year from 1 January 2020, such as to expiry at the same time as the Consumer Loan Regulations. This facilitates a joint assessment of the two sets of regulations, including whether it might be appropriate to have one set of regulations for all bank lending practice requirements, as well as the duration of such regulations. The Ministry of Finance will also examine whether financial stability considerations suggest that limits should also be imposed on loans that fall outside the scope of the current regulations. The Ministry of Finance has in a letter of 24 April 2020 asked Finanstilsynet to evaluate bank lending practice regulations and advise on their renewal and structure from 1 January 2021. Finanstilsynet has been asked to obtain assessments from Norges Bank.

#### *Recovery and resolution in the banking sector*

The new framework on recovery and resolution of banks, which entered into effect on 1 January 2019, require, inter alia, each bank to

prepare a plan for how to restore the bank's financial position if it were to be impaired (recovery plan), whilst Finanstilsynet shall prepare plans for dealing with each bank in more severe instances (resolution plan). Bail-in is a key resolution tool under these rules, and involves write-down of own funds and conversion into equity of parts of the failing bank's debt, thereby covering losses and strengthening solvency sufficiently to enable a continuation of all or part of the operations. This requires the bank to have enough liabilities that can be converted into equity, so-called eligible liabilities. Finanstilsynet shall therefore stipulate a minimum requirement for the sum of own funds and eligible liabilities (the MREL requirement) when relevant. Finanstilsynet has stated that it would be appropriate to stipulate MREL requirements for a majority of Norwegian banks, and has thus far stipulated requirements for the largest banks.

The capital in the Norwegian Banks' Guarantee Fund has been transferred to two new funds set up to finance the deposit guarantee scheme and crisis management measures, respectively. The capital of the two funds was NOK 17.2 and 21.1 billion, respectively, as of yearend 2019, which is much more than is required under the EU directives. Well-capitalised funds enable any problems in the banking sector to be managed appropriately.

The introduction of the new recovery and resolution rules was accompanied by a continuation and strengthening of the Norwegian deposit guarantee scheme. There is now an unlimited guarantee for up to 12 months on certain deposit types relating to, inter alia, housing purchases, special life events, insurance proceeds and certain forms of compensation. Moreover, the recovery and resolution framework provides higher priority for non-guaranteed deposits from individuals, as well as from small and medium-sized enterprises.

### *Risk of money laundering and terrorist financing*

Banks and other financial market participants are subject to anti-money laundering and terrorist financing regulations. Compliance with such regulations has been attracting mounting attention internationally, especially in the Nordic region, following major revelations of

rule violations, some of which are quite extensive, on the part of large banks. These cases have resulted in fines, notices of impending fines, civil compensation litigation and licence revocation. Thus far, there have been no revelations of systematic long-term violations in the same order of magnitude in Norway, but the supervision reports of Finanstilsynet have identified room for improvement on the part of most reporting entities.

The EU has in the last few years considerably expanded its regulations in this regard, but the large-scale revelations have led to calls for further reforms. In December 2019, ECOFIN decided to ask the European Commission to examine whether collaboration between relevant authorities may be strengthened, whether parts of the regulations should be laid down in the form of a commission regulation, and whether supervisory responsibilities and powers should be shifted to an EU body. A supranational supervision structure, similar to those established for banking, insurance, pensions and securities trading, may require modifications to the EEA Agreement.

The new Norwegian anti-money laundering regulations entered into effect on 15 October 2018. Norwegian authorities are currently in the process of introducing the regulatory amendments required to implement the Fifth EU Anti-Money Laundering Directive, which was enacted in May 2018 with an EU implementation deadline of January 2020. The Directive has not been incorporated into the EEA Agreement as yet. Some necessary regulatory amendments circulated in draft form by the Ministry of Finance closed for consultation on 23 March. The Ministry is also preparing regulatory provisions on the creation of a register of beneficial owners to increase transparency regarding ownership and control of legal entities in Norway.

Its strengthened anti-money laundering effort has resulted in Norway no longer being subject to “enhanced follow-up” by the Financial Action Task Force (FATF), the international collaboration organisation which sets standards on measures to combat money laundering and terrorist financing. This was confirmed upon the publication of a follow-up report in December 2019, in which progress since the country report of 2014 was evaluated and recognised.

### *Digital vulnerability*

Financial stability might be threatened if a major financial undertaking, a key infrastructure undertaking or numerous banks are knocked out for more than a brief period of time as the result of operational fault or cyberattack. The Government has identified financial services as one of 14 critical societal functions, thus meriting special attention to vulnerabilities, security and preparedness.

The financial infrastructure in Norway is considered robust in all key respects, also in the current extraordinary situation. Despite many operational duties being performed from the homes of employees, operations have been stable and customer service provision has functioned as normal. However, alternative methods of operation may entail increased operational risk, and it may be more challenging to carry out systems changes and necessary maintenance.

The number of ICT incidents reported to Finanstilsynet was at about the same level in 2019 as in 2018. The number of reported attacks has remained low, and consequences have been limited. Although a significant increase in unwanted activity has been observed in recent years, only a minor portion of such activity has resulted in security incidents which needed to be reported to Finanstilsynet.

Although the industry is held to be well prepared for handling incidents of both an operational and a malicious nature, certain developments may make the provision of financial services more vulnerable in coming years. This applies, in particular, to the increasing dependence on complex ICT systems in the sector, the growth in outsourcing of operational duties to a small number of key service providers, the digitalisation of customer-oriented services, as well as new technology and new regulation allowing for third-party providers. Both the authorities and the financial industry itself must continue to promote a robust financial infrastructure in the face of these developments.

Financial sector regulation and preparedness form part of the overall effort to secure the digital ecosystem in Norway. The Government published a new digital security strategy in January 2019. The new Security Act, which is under implementation in, inter alia, the financial sector, forms part of this strategy.

Banks have since 2019 been required to tailor their cash solutions to documented and quantitative assessments of the risk of increased cash demand, although they may take electronic preparedness into account in dimensioning the cash solutions. Finanstilsynet has in its follow-up found that most banks have taken appropriate measures, but many of them have room for improvement on, inter alia, testing of the solutions.

### *Climate risk in financial markets*

Climate change and the transition to a low-carbon economy in line with the ambitions in the Paris Agreement will affect how financial markets operate, and may have financial stability implications. Physical climate risk is the result of more frequent and severe episodes of draught, flooding and storms, as well as rising sea levels. Transition risk relates to climate policy change and expansion, development of new technology, as well as changing customer preferences and investor requirements, which may cause sudden changes in the market value of large groups of financial assets. How financial markets are affected by climate change will depend on whether global society takes measures that are sufficient to meet climate targets, and on whether the transition to a low-carbon economy is implemented in accordance with the expectations of market participants or in a disruptive manner.

Central banks, supervisory authorities and regulatory authorities, both in Norway and internationally, are seeking to improve both their own and market participants' understanding of how climate-related risk may affect financial markets and financial stability. Climate risk management has been highlighted in the Ministry's letter of allocation to Finanstilsynet in the last three years. Both Finanstilsynet and Norges Bank have joined a network of central banks and supervisory authorities promoting a greener financial system. The network aims to contribute to the development of environment and climate risk management in the financial sector and to mobilize mainstream finance to support the transition toward a sustainable economy.

In March 2018, the European Commission published an action plan on financing sustainable growth. The main objectives of the

action plan are to channel private capital into more sustainable investments, to manage climate risk and environmentally-related risk, as well as to promote transparency and a long-term perspective in financial and economic activities. The Government endorses the objectives of the action plan, and is following the EU's implementation of the plan closely. In March 2020, Norway joined the EU's International Platform on Sustainable Finance.

The core component of the Commission's action plan is a taxonomy (classification system) for sustainable economic activity. The objective is to establish a common understanding of which activities and investments can be considered sustainable from an environmental and climate perspective. Pan-European criteria are intended to make it easier for investors to compare investment opportunities across countries and sectors, and will provide companies with incentives to make their business models more sustainable. Political agreement was reached on a commission regulation on the taxonomy framework in 2019. This regulatory framework is EEA-relevant and is scheduled to enter into effect in the EU on 31 December 2021.

Robust reporting of relevant and comparable climate-related information from companies is of decisive importance to the financial sector's management of climate risk and the channelling of capital into sustainable investments. Frameworks for the reporting of both how companies affect the climate (climate reporting) and how companies' business models are affected by climate change and climate policy (climate risk reporting) have been developed in the last few decades.

The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) define a climate risk reporting framework which enjoys broad international support. The Climate Risk Commission recommended that Norwegian businesses make use of the TCFD framework in their corporate reporting, whilst at the same time advising Norwegian authorities against the introduction of detailed statutory climate risk reporting requirements. The Government endorsed the Commission's assessments in the Financial Markets Report 2019, and expects major Norwegian companies to include information in their corporate reporting on how they are affected by, as well as how they manage, climate risk. In order to ensure comparable reporting across

companies, sectors and countries, companies should adhere to international standards such as the TCFD framework.

In the EU, the climate reporting requirements applicable to large enterprises are laid down in the Non-Financial Reporting Directive. In January 2020, the European Commission announced a review of the Directive. It is expected that the Commission will publish a regulatory proposal by the end of 2020. The Government is monitoring the EU evaluation of the Directive and is currently awaiting the regulatory proposal, which will be EEA-relevant.

### **The financial markets in an industrial perspective (chapter 3)**

The Government is of the view that broad diversity in the range of service providers in all parts of the financial markets may serve to reduce the vulnerability of the service offering and promote sound competition. 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. This includes a stable and secure affiliation with international markets.

Although the quality of international financial market regulation has improved in recent years, national authorities will nonetheless often be best placed to assess the implications of various legal acts in their markets. Hence, there will still be a need for assessing the extent to which the scope for tailored solutions under the EU/EEA provisions should be used to have stricter requirements where merited by national circumstances, as has been done by Norwegian authorities to e.g. ensure appropriate bank solvency requirements. However, the rules shall not be such as to place Norwegian banks at a disproportionate competitive disadvantage internationally or in relation to foreign banks operating in Norway.

The Ministry of Finance is maintaining a constructive dialogue with the financial industry through, inter alia, consultative rounds, ongoing contact on individual issues and scheduled meetings with a



broad agenda. The dialogue with Finance Norway and other organisations provides the authorities with valuable insight into the assessments, experience and views of the industry. This provides a sound basis for balancing different regulatory considerations, and for collaborating on helpful solutions for pension savers, consumers and users of public services. A constructive dialogue also provides a sound basis for joint efforts to, inter alia, safeguard financial services as a critical societal function, and for dealing with extraordinary situations that may arise and impose a shock on the economy, as currently observed in the wake of the coronavirus disease outbreak.

#### *Access to capital for businesses*

Norwegian businesses need a well-functioning capital market to fund profitable projects at prices that reflect expected return and risk. The Government will continue to promote a well-functioning capital market and easier access to risk capital and competent investors in accordance with the Granavolden platform.

The overall impression of the capital market in Norway in a normal situation is that Norwegian securities markets are well-functioning, that Norwegian financial undertakings are solvent and liquid, and that government schemes serve to fund projects which would not readily attract ordinary market funding. The Norwegian supply side and integration with international markets provide businesses with a diversified range of funding, and the overall outcome appears to be that profitable projects have good access to funding in normal times.

Bank loans have over time been the dominant source of debt funding for Norwegian businesses. Whilst Norwegian banks and major Norwegian businesses may raise capital in international securities markets and from international financial undertakings, new and small business may be more dependent on Norwegian and local sources of capital.

The Government will contribute to making the Norwegian securities market an efficient source of funding for businesses and attractive to investors. This requires market participants to be confident that the market is well-regulated and transparent, that relevant information is

in the public domain, and that violations of applicable regulations are prevented, uncovered and dealt with.

The authorities have launched capital market-oriented measures to prevent viable businesses from folding due to liquidity problems in the extraordinary situation brought about by the coronavirus outbreak. A government guarantee scheme for bank loans for small and medium-sized enterprises was established in late March, and this scheme was expanded to also encompass larger enterprises in early April. The Government Bond Fund has been reinstated to improve liquidity and capital access in the bond market. Increased grants for businesses with research and innovation activities are being provided through the direct grant schemes, which is important to maintain restructuring and growth capacity when the outbreak is over.

#### *Securitisation and covered bonds*

Securitisation involves bundling and converting loans and other financial assets into transferable securities. Assets will in most cases be securitised by a bank, aiming to manage its risk or fund its lending activities, but any undertaking holding loans and other financial assets may in principle conduct securitisations. Securitisation may improve access to credit for certain borrower groups, and provide additional alternative investment opportunities. However, securitisation may also increase complexity in the financial system, and potentially entail significantly higher systemic risk if regulation is not sufficiently robust, as seen in the US in the leadup to the financial crisis. Securitisation has been little used in Norway as the result, inter alia, of the rules enabling this type of transaction having been abolished upon the enactment of the new Financial Institutions Act in 2016, but it has been widely used elsewhere in Europe and, to an even greater extent, in the US.

The EU has adopted a new regulatory framework intended to promote the prudent use of securitisation. The Securitisation Regulation was enacted in December 2017 and entered into effect in the EU on 1 January 2019. The Securitisation Regulation and related amendments to other EU regulations are EEA-relevant, but have yet to be incorpo-

rated into the EEA Agreement. A report on how the new securitisation provisions can be implemented in Norway was circulated by the Ministry of Finance and closed for consultation on 30 September 2019, and the Ministry is in the process of preparing a legislative proposition.

In February 2019, the European Parliament and the Council of the European Union reached agreement on the provisions of a new regulatory framework on covered bonds, based on a proposal from the European Commission in March 2018. The regulatory framework was formally enacted by the EU in November 2019. Its objective is to promote the use of covered bonds in Europe, both as a source of funding and as an investment object. The regulatory framework shall, inter alia, harmonise covered bond definitions and characteristics, including the establishment of “European Covered Bonds” as a label that meets certain requirements, and strengthen consumer protection through new supervisory duties. It is intended for the regulatory framework to enter into effect in Norway at the same time as in the EU. Finanstilsynet has recently examined how this can be implemented, and the Ministry circulated its report for consultation on 23 March 2020. In the process of adopting national regulations, harmonisation considerations will be emphasised in using the national room for manoeuvre.

#### *The role of the financial industry in the transition to a low-carbon economy*

The financial industry plays a key role in the transition to a low-carbon economy. As lender and investor, the industry may be a driver for private sector restructuring. The industry may contribute by developing financial instruments and products which make it easier for investors to identify sustainable investments, and by offering financial products that provide customers with incentives to cut emissions.

The industry currently provides a number of financial products with a “green” or sustainable profile aimed at the retail and corporate markets. The industry also has a role in managing the issuance of green bonds to fund projects which have positive climate and environmental effects or which facilitate climate change adaptation. The

absence of universally accepted principles for classifying green financial instruments and products may inhibit growth in the market, and makes it challenging for customers to compare products. The lack of standards for green financial products also leaves scope for so-called greenwashing, where products are marketed as green without having any demonstrable climate or environmental effects.

The establishment of standards may increase customers' and investors' confidence in such products, and facilitate growth in these markets. The development of a classification system for sustainable economic activity and standards and labelling schemes in the EU may reduce the risk of greenwashing, and make it easier for professional and non-professional investors to identify sustainable investments.

Non-life insurance companies are directly exposed to the physical effects of climate change in the form of increased compensation payments due to more frequent natural disasters. Norwegian non-life insurance companies are an important partner for the authorities with regard to climate change adaptation and natural disaster prevention. The companies have accumulated extensive climate and natural disaster risk knowledge through their operations, in the form of loss data which the companies share with the Norwegian Directorate for Civil Protection.

### *Digitalisation and financial technology*

The Norwegian financial industry was an early adopter of digital solutions and of cost-effective digital services to its customers. The rate of financial services innovation remains high and may trigger further market structure changes in coming years. The EU's revised Payment Services Directive is expected to increase competition in the payment services market over the next few years. Statutory and administrative provisions implementing the key aspects of the directive in Norway entered into effect on 1 April 2019.

Established financial undertakings are challenged by both new fintech operations and large technology companies that have started to provide financial services in recent years. The Financial Stability Board has noted that the entry of major technology companies into the finan-

cial services market may increase competition in the short run, although there is a risk of new market concentration in the longer run. Strategic collaboration has recently been emerging between technology companies and established financial undertakings, for example between Google and Citigroup and between Apple and Goldman Sachs. A similar trend has been observed in Norway, with several examples of established financial industry firms collaborating with both global providers and local newcomers.

The emergence of Bitcoin and other virtual currencies has raised a number of new issues. There is a broad international consensus that virtual currencies pose a money laundering and terrorist financing risk. The European Commission has, on the basis of contributions and advice from the supervisory bodies EBA and ESMA, called for consultative input on virtual assets falling within the scope of EU provisions on financial instruments under MiFID II or classified as e-money under the E-Money Directive. For virtual assets currently falling outside the scope of the EU provisions, the Commission is considering joint regulation to address, *inter alia*, consumer protection and market integrity.

A recent development in the virtual asset market is the emergence of crypto-assets with stabilisation mechanisms (“stablecoins”). The Financial Stability Board has defined stablecoins as crypto-assets designed to maintain a stable value relative to another asset or a basket of assets. These may be collateralised by selected traditional currencies or commodities, or supported by algorithms. A G7-appointed working group has stated that no such global crypto-assets should be launched in the market until the legal and regulatory problems have been resolved.

New market participants and the use of new technology in financial services production may increase demand for regulatory guidance, especially from new providers with little experience of regulation and supervision, but also from established financial undertakings wishing to provide services in new ways through the use of technology. Supervisory authorities in several countries have in the last few years sought to facilitate innovation through the establishment of guidance contact points and so-called regulatory sandboxes.

Regulatory sandboxes enable selected businesses to test specific products, technologies or services on a limited number of customers,

for a limited period of time and under the guidance of the supervisory authority. The intention is both to expand supervisory authorities' understanding of new technological solutions in financial markets and to improve innovative businesses' understanding of regulatory requirements and how the regulatory framework is applied to new business models, products and services.

In November 2018, the Ministry of Finance asked Finanstilsynet to establish a regulatory sandbox by yearend 2019, as part of a broader information and guidance initiative. Finanstilsynet started taking sandbox applications on 12 December 2019, with an application deadline of 12 February 2020. 12 applications were received, and these are currently being assessed for potential admission to the first sandbox round. In view of experience with the first batch of applications, the Ministry will, in consultation with Finanstilsynet, consider whether to allow continuous admission to the sandbox, as well as other potential modifications.

Digitalisation serves to improve both public and private sector efficiency and productivity, whilst simplifying life for consumers. There are positive feedback effects between public sector and financial sector digitalisation, and the financial industry is a valuable collaboration partner in the government digitalisation effort. In June 2019, the Government, represented by the Ministry of Local Government and Modernisation, published its digitalisation strategy for the 2019–2025 period. Close collaboration with the financial industry will remain a key pillar of this strategy, including the Digital Public Private Collaboration (DSOP) project. The financial industry is through DSOP contributing to the development of digital solutions that may generate major savings for the economy. The coronavirus situation has highlighted the benefits of a digitalised society. The technical solution for the business compensations scheme launched by the Government after the outbreak is, for example, based on earlier DSOP efforts and solutions.

### *Crowdfunding*

Crowdfunding platforms that connect investors with businesses and others who need capital have emerged as a supplement to traditional

financial undertakings and marketplaces. The Capital Access Commission (NOU 2018: 5) identified facilitation of crowdfunding, as a source of both debt and equity, as one of several proposals for improving access to capital for Norwegian businesses. The Government will facilitate crowdfunding through both simplifications for the industry and increased safeguarding for consumers. The regulations have been modified to prevent uncertainty about so-called “individual cases” from being an unintended impediment to the expansion of loan-based crowdfunding in Norway. The Ministry will monitor developments in the Norwegian market and assess the need for further regulatory amendments. In particular, the Ministry will monitor regulatory developments in the EU, as well as the implications of pan-European crowdfunding regulations for future Norwegian regulation of financial crowdfunding platforms.

#### *The EEA Agreement and Norway's relationship with the UK*

The EEA Agreement is Norway's most important trade agreement, through which a single market in financial services has been established. Our financial market is deeply integrated with markets in the Nordic EU member states, and a well-functioning single market is of major importance to Norway. Financial market regulation in Norway is largely based on EEA provisions, which are themselves often aligned with international recommendations.

It is important for the single market affiliation of Norwegian undertakings and markets that relevant EU provisions are swiftly incorporated into the EEA Agreement and implemented in Norwegian law. When the EEA Agreement was signed in 1992, it included 45 legal acts on financial services, and about 135 new legal acts had been added by August 2016. The incorporation rate has increased after the legal acts establishing the European System of Financial Supervision were adapted and incorporated into the EEA Agreement in September 2016. More than 350 legal acts were incorporated between September 2016 and December 2019, of which no less than 267 were incorporated in 2019. 17 legal acts have been incorporated into the EEA Agreement thus far in 2020. As at mid-March, 97 financial legal acts enacted by

the EU had yet to be incorporated into the EEA Agreement. The Government will in 2020 continue to pursue the incorporation of EEA-relevant legal acts into the EEA Agreement and the implementation of these in national law.

The Ministry is closely monitoring developments in EU financial market regulations. The Ministry will continue to focus on the importance of equal regulation of equal activities and equal risk, as well as on the maintenance and strengthening of financial stability. We will in this context highlight, inter alia, the need for national flexibility in the preparation of regulations and requirements, including equity and liquidity requirements. Where relevant, the Ministry is pursuing a joint effort with other affected ministries, such as in the follow-up of the Commission's sustainable finance initiative.

The UK left the EU, and thereby also the EEA Agreement, on 31 January 2020. The EEA terms will continue to apply for a transition period that expires on 31 December this year, unless the EU and the UK agree an extension by 1 July. The transition period may be extended for a maximum of two years. Norway and the two other EEA/EFTA countries are negotiating with the UK in parallel with the EU. A key objective for Norway is to maintain the best economic relations with the UK that are possible within the EEA framework, on the basis of mutuality. The objective is for Norwegian market participants to retain as good access to the UK market and the financial infrastructure in London as the EU member states have.

### **Consumers in the financial markets (chapter 4)**

Consumers need special protection and strong rights in financial markets. Consumers may not be well placed to assess the risks, costs and yield potential of some financial services before entering into contracts. 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.

The regulatory framework shall ensure that consumers can trade securely with professional financial undertakings, but does not



exempt consumers from risk or responsibility. The Government is focused on consumers having the knowledge and information to enable them to make prudent decisions regarding their own finances.

### *Current regulatory efforts*

Consumer protection is a key priority in financial market regulations and supervision, as exemplified by customer service, disclosure and advice requirements. In addition, much of consumer protection is embedded in general regulatory provisions under the auspices of other ministries, such as for example the Competition Act and the Marketing Control Act under the Ministry of Trade, Industry and Fisheries and the Ministry of Children and Families, respectively. The Ministry of Children and Families is also responsible for the Debt Restructuring Act, which the Government is currently in the process of revising. The Ministry of Justice and Public Security is pursuing amendments to the Debt Collection Act on the basis of a proposal which is being circulated for consultation until this summer, and will soon submit a proposal for extensive revision of the Financial Contracts Act. The purpose of such revision of the Financial Contracts Act is to implement EU directives on residential mortgages, consumer credit, payment accounts and payment services, to introduce measures to tackle debt problems, to modernise the structure of the Act and to codify provisions that are currently found in non-statutory contract law.

Finanstilsynet has uncovered that a number of international undertakings and their branches in Norway, but also some Norwegian undertakings, are not affiliated with an approved dispute resolution scheme, such as the Norwegian Financial Services Complaints Board. This implies that the customers of such undertakings have weaker protection of their rights and interests, for example because of the inapplicability of provisions on covering the consumer's legal costs in certain cases. In the autumn of 2019, the Ministry circulated for consultation a set of draft regulatory provisions requiring all undertakings that provide financial services to consumers in Norway to be affiliated with an approved dispute resolution body. The Ministry

intends to follow up on the consultative proposal in the form of a regulation and proposed legislative amendments.

In October 2019, the Government appointed a committee to review the Estate Agency Act and propose forward-looking regulation. The committee shall, in accordance with the Granavolden platform, examine the scope for simplification and improved consumer protection. Confidence that property transactions will be executed in a simple and secure manner is of key importance for a well-functioning housing market. The committee shall submit its report in early 2021.

### *Customer mobility and competition*

It has become easier to switch banks and insurance companies in recent years, partly because Norwegian banks have signed up to Finance Norway's provisions on bank switching cooperation. The Ministry of Justice and Public Security's proposal for a new Financial Contracts Act will, inter alia, include codification of most of Finance Norway's provisions. The legislation shall facilitate swift and secure bank switching, in line with the EU's Payment Accounts Directive. The scope for providing proof of identity and signing account and loan agreements quickly and digitally by means of BankID has also made bank switching easier.

The proportion of customers switching residential mortgage provider has been about 8–10 percent in recent years, whilst the proportion renegotiating their residential mortgage has been approximately 25 percent, according to a Kantar survey. The main reasons customers give for not switching or renegotiating are that they are satisfied with the bank or that they think there is little to be gained. Few people state that they believe bank switching to be difficult. Even fewer state that they believe that it is difficult to switch non-life insurance company, and switching is indeed more frequent in this market. However, many people find it difficult to compare the life insurance and pension products on offer. Part of the pension product challenge may be resolved through the introduction of designated individual pension accounts, which are intended to gather pension entitlements from pension capital certificates and ongoing accruals in collective pension

plans together in one place. This will both make it easier for individuals to access such details and improve competition in the market.

The Government is committed to making it easy to switch banks, insurance companies and other service providers. This requires financial industry participants to agree on good solutions, and legislation and other aspects of the regulatory framework to be tailored to market developments.

The EU's revised Payment Services Directive (PSD2) entered into effect in Norway in April 2019, thereby opening up the prospect of new market entrants offering services based on account information from banks. This may increase competition between providers, and make it even easier to switch service provider or use multiple providers simultaneously. In the Norwegian market, one has thus far not seen any clear indication of new market entrants having captured any significant share of the payment services market. To the extent that the market structure has indeed changed, it has rather tended to involve cooperation between existing and new market participants and often on services based on digital infrastructure which has been in place for a while.

As and when the impact of new technology in a more open market becomes apparent, it may be appropriate to assess the need for additional regulatory modifications and other measures. The Government will also assess the European Commission's announced review of portable account numbers, i.e. the scope for customers to keep their account number when switching banks. This review was scheduled for completion in September 2019, but has been delayed. The Government will therefore revert to this issue in a future Financial Markets Report.

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. and to switch service provider. The portal brings together and presents comparable and easily accessible information on financial market products, thereby enabling consumers to find the best prices and terms. This spring, there has been a steep increase in traffic on *Finansportalen*, partly as the result of more bank customers accessing residential

mortgage interest rate comparisons. This serves to boost competition. Price data from *Finansportalen* are also used as a basis for the norm interest rate and the interest rate on government loans. The Government is of the view that it is essential that both consumers and authorities can rely on *Finansportalen* to provide price information which is of a high quality and which is updated at any given time. It must therefore be a priority for the Norwegian Consumer Council, which manages *Finansportalen*, to ensure that the information from *Finansportalen* is at all times correct and complete.

#### *Consumer loans and payment problems*

Access to unsecured credit, including credit card debt, provides opportunities for smoothing consumption over time, but also creates problems for those who borrow in excess of their debt servicing capacity. Consumer loans are often part of the backdrop to debt problems. In 2019, more than 1 in 10 consumer loans was in default for more than 90 days, whilst this applied to 1 in 14 consumer loans in 2018. In 2017, consumer loans averaged close to NOK 700,000 in debt restructuring proceedings. Banks' losses on consumer loans increased significantly in 2019, from 1.7 to 2.7 percent of total consumer loans, after having remained fairly stable in recent years.

The increase in defaults and losses on consumer loans is linked to the strong lending growth which characterised this market until recently. Considerable challenges have been observed in the market, including aggressive marketing and inadequate creditworthiness assessments on the part of banks. The Government has launched a number of measures, and additional measures are in the pipeline. Several of these measures have been implemented in 2019. In particular, banks have been required to observe the new lending practice requirements for consumer loans since May last year, whilst debt information service providers entered into operation over the summer. Access to information on the unsecured debt of loan applicants makes it easier for banks to avoid granting consumer loans to individuals who are already highly indebted. The lending practice requirements also serve to prevent consumers from taking on debts they will

not be able to service. This represents a major change to the regulatory framework under which consumer loan banks operate, when compared to the situation only one year ago, and this has probably contributed to the observed levelling off of consumer loan market activity. The steep default increase is nonetheless cause for concern. It is important that banks now comply with the numerous new obligations introduced in the last few years. The Government expects that this will also improve default figures over time.

The Government's proposal for a new Financial Contracts Act will include provisions that strengthen consumer protection upon the conclusion of credit agreements. After the proposal has been submitted to the Storting, the Government will examine, for example, the need for stricter rules on credit marketing. The review of the Debt Collection Act aims, *inter alia*, to reduce debt collection fees and ensure adequate debt collection procedures.

The Ministry of Children and Families will evaluate the Debt Information Act when debt information service providers have been in ordinary operation for two years, i.e. in 2021. The Act authorises expansion of the disclosure obligation to encompass all secured and unsecured debt. The Norwegian Consumer Council, Finance Norway and Finanstilsynet have all advocated use of these powers. The Government is of the view that such expansion would be in line with the intention behind the Debt Information Act and serve to increase the usefulness of debt information service providers.

Developments over the last year suggest, in the assessment of the Government, that there is no need for the introduction of so-called interest rate ceilings or cost ceilings for consumer loans, as examined in the Financial Markets Report 2019 at the request of the Storting. As long as there has not emerged a sizeable market for small loans with a short duration and very high effective interest rates, as has happened in some countries which have introduced such policy measures, the potential gains cannot justify the disadvantages. An interest rate ceiling may for example establish a norm or facilitate interest rate coordination between banks, thereby resulting in higher interest rates on total consumer loans. However, the Government is closely monitoring market developments and the effect of the introduced and announced

measures, and will assess the need for additional measures against that background.

### *Availability and use of cash*

Most payments in Norway currently involve electronic solutions such as payment cards, mobile payment and online banking. In the spring of 2019, fewer than 1 in 10 payments in retail outlets and between individuals were made in cash, whilst the same applied to every fourth payment in 2007. This is the result of an efficient electronic payment system. There is nonetheless still a need for cash as a means of payment and a store of value, as well as a backup in case of electronic payment system failure.

Banks have gradually scaled back their cash services over many years, and individual banks are under no obligation to maintain services on behalf of society. However, the Financial Institutions Act requires banks to provide cash services that meet customers' expectations and needs. Norges Bank and Finanstilsynet are of the view that current developments give rise to uncertainty as to whether this requirement will be satisfactorily complied with in coming years, and have proposed that specific requirements be imposed on banks in the form of regulations.

The Government has devoted special attention to developments in the cash service offerings of banks in the last two Financial Markets Reports. The general position of the Government is that banks' responsibility for cash services is probably handled more efficiently through the joint solutions of banks themselves than through regulation of individual elements such as, for example, capacity, opening hours and geographical distribution. In the Financial Markets Report 2019, the Ministry announced that such regulation might nonetheless be contemplated unless banks swiftly agree appropriate joint solutions, or individually conclude agreements that otherwise ensure access to satisfactory cash services for all banking customers.

Banks have over the last year developed a joint framework for depositing and withdrawing cash in shops, through a collaborative effort between Finance Norway and Bits AS, which is the infrastructure

company of the financial industry. In December 2019, Bits AS established a set of rules which, inter alia, enables each bank to agree that its customers may use cash services offered by other banks. Banks may also offer their customers to deposit and withdraw cash in shops affiliated with the BankAxept system, including through a service provider such as Vipps AS, which according to Finance Norway has now concluded agreements with a large number of banks. The solution will be available to bank customers in the spring of 2020. When the solutions have been in operation for one year, it will according to Finance Norway be examined whether there is a need for developing additional collaborative solutions, for example for cash deposit machines.

The Ministry of Finance intends to ask Finanstilsynet and Norges Bank to review cash services anew after the banking industry's new solutions for maintaining cash services have been in operation for a few months. One will by then also have a better understanding of the implications of DNB having terminated the agreement with Posten on the provision of basic banking services, with effect from 1 July. This review will form the basis for a new assessment as to whether cash services for Norwegian bank customers can be considered satisfactory throughout the country, or whether there may be a need for further regulation of the obligations of banks.

Under the Financial Contracts Act, consumers always have the right to make payments to any payee in cash. There have been major changes in access to various payment solutions and in how financial agreements are concluded since the Act was enacted in 1999. There may thus be a need for examining whether the current provisions remain appropriate and whether there is a need for clarification. The Ministry of Justice and Public Security will take a closer look at the provisions on the right to cash payment in the wake of the preparation of the new Financial Contracts Act.

### *Pension*

The persistently low interest rate level and the increasing life expectancy of the population has affected the pensions market. Lower expected return and a longer benefit period has made it more expen-

sive to fund a given life-long annual pension benefit. Traditional defined-benefit schemes have been phased out over time, whilst new pension accruals are largely taking place in defined-contribution schemes. There nonetheless remains considerable capital behind rights under defined-benefit schemes, and especially under paid-up policies. The Government will facilitate a secure and predictable private pension savings framework through regulation of both pension providers and pension products.

A sound regulatory framework needs to be maintained and evolved for both the growing defined-contribution portion of the market and the management of the funds backing the pensions already accrued. For defined-contribution schemes, the introduction of a designated individual pension account and the question of including all wage income in the mandatory calculation basis for pension accrual are key issues, whilst the focus is on pension capital management regulations as far as defined-benefit schemes are concerned. The overarching objectives for the regulatory effort are safeguarding accrued pensions, efficient and rational pension capital management, good information and scope for influencing own pension, as well as effective competition in the pensions market.

### **The activities of Norges Bank in 2019 (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. 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 on



Monetary Policy. The Regulation stipulates that 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 build-up of financial imbalances.

The Storting enacted a new Central Bank Act on 17 June 2019. The Act includes a new object clause for the activities of the central bank. A new Monetary Policy and Financial Stability Committee has also been established.

The key policy rate is the most important monetary policy tool. Norges Bank increased the key policy rate three times over the course of 2019, from 0.75 percent to 1.5 percent.

The Ministry of Finance performs an annual assessment of Norges Bank's monetary policy conduct. The Ministry is of the view that monetary policy conduct was sound in 2019. In the Ministry's view, there is broad confidence in monetary policy among markets participants, academia and the general public.

Norges Bank also manages 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 a separate report.

### **The activities of Finanstilsynet in 2019 (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 2019, Finanstilsynet continued to refine models used to assess developments in the Norwegian economy and for stress testing of

banks. Finanstilsynet conducted stress tests of 20 Norwegian banking groups and close to 90 smaller Norwegian banks. In addition, eight consumer loan banks were stress tested. 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 2019, Finanstilsynet carried out a total of 24 on-site inspections with banks, mortgage companies and finance companies. It also carried out nine on-site inspections with follow-up of IRB approvals and five on-site inspections of ICT infrastructure, disaster solutions and contingency planning. Moreover, it carried out 23 special inspections relating to ICT, and 12 on-site inspections with insurance companies and pension funds. Finanstilsynet carried out a number of inspections in other fields, such as securities trading, accounting and auditing, as well as estate agency and debt collection

### **The activities of Folketrygdfondet in 2019 (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 268.7 billion as at yearend 2019. The return on the Fund was 12.4 percent in 2019, which is 0.4 percentage points more than the return on the benchmark index defined by the Ministry. Every spring, the Ministry publishes a separate report on the management of the Government Pension Fund in the previous year, including Folketrygdfondet's management of the GPFN. The

Ministry of Finance has against the background of the current coronavirus pandemic decided to defer the publication of the report *The Government Pension Fund 2020*.

### **The activities of the IMF (chapter 8)**

The International Monetary Fund (IMF) is charged with promoting international monetary corporation, strengthening financial stability globally and regionally, and facilitating international trade. By the end of February, a total of 18 countries had agreements with the IMF under the institution's general lending arrangements and 39 countries had agreements under the concessional arrangements reserved for low-income countries.

Norway is currently placing a total of SDR 11.7 billion (equivalent to above NOK 150 billion at the 29 February exchange rate) at the disposal of the general lending arrangements of the IMF. SDR 3.75 billion of this are quota resources which Norway is obliged to contribute. An additional SDR 1.97 billion are made available through the multilateral borrowing arrangement of the IMF (NAB) and SDR 6 billion are made available under a bilateral loan agreement. Participation in NAB and bilateral loans is voluntary, and the current agreements expire in 2022 and 2020, respectively. Norway also contributes resources to the special arrangements for low-income countries. Loans to the IMF are made through reinvestment of the Norges Bank foreign exchange reserves.

The financial obligations and rights of members, as well as their voting power, are linked to their national quotas. The IMF conducts periodic reviews of the level and distribution of quotas. In February, the IMF Board of Governors decided to conclude the current quota review with no change in quotas. This is primarily because the US, which has a blocking minority, did not support an increase. In practice, a quota increase would have increased the voting power of emerging economies.

It is important for Norway to have stable international relations, open markets and a well-functioning global safety net. The Government is of the view that Norway should continue to contribute to main-

taining the financial strength of the IMF. The global crisis caused by the coronavirus pandemic makes it especially important to ensure that the IMF has sufficient funding to assist distressed members. Confidence that multinational financial institutions have sufficient resources is also important to reduce capital drain from vulnerable countries in such a crisis situation and to improve countries' access to international capital markets.

The IMF's bilateral borrowing agreements will expire at the end of this year. The IMF's resources will then be considerably depleted unless new agreements are concluded. In January, the IMF Executive Board decided, to partly compensate for this, to double the amount of borrowing under the NAB arrangement with effect from January 2021. Norway has received a request in line with this. Furthermore, the IMF Executive Board approved the framework for a new round of bilateral borrowing in March. This calls for the loan amounts to be the same as under the current agreements, subject to a reduction in such amounts that matches the increases in NAB resources when the new NAB arrangement enters into effect. The IMF's lending capacity will thereby be maintained at the present level.

New loan agreements with the IMF require the consent of the Storting. The Government intends to ask the Storting for authorisation to double the Norwegian contribution to the NAB arrangement and to conclude a new bilateral loan agreement with the IMF in connection with the National Budget for 2021.

As part of its response to the coronavirus crisis, the IMF has asked member countries for contributions to top up the IMF Catastrophe Containment and Relief Trust, which is used to subsidise debt servicing for the poorest member countries if these are hit by major natural disasters, including epidemics. This targeted debt relief reaches the most vulnerable countries and releases funds for spending on crisis management.

The Government will in response to the IMF's request for contributions to the Catastrophe Containment and Relief Trust propose, in connection with the Revised National Budget for 2020, that Norway contributes NOK 180 million in the form of an appropriation via the international aid budget.

Surging demand for coronavirus crisis support from poor countries means that the IMF also needs additional resources for the low-income country borrowing arrangements funded through the Poverty Reduction and Growth Trust (PRGT). The Government intends to propose to the Storting, in the Revised National Budget for 202, that Norway makes new loan resources available for these lending arrangements.

### **Amendments to regulatory frameworks and licences in 2019 (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. An overview of the most important regulatory amendments in 2019 is provided in chapter 9. The chapter also includes a discussion of licences granted in 2019.







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Stylized illustration of new instalment loans by loan-to-value  
and debt-to-income ratios in the Residential mortgage lending  
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