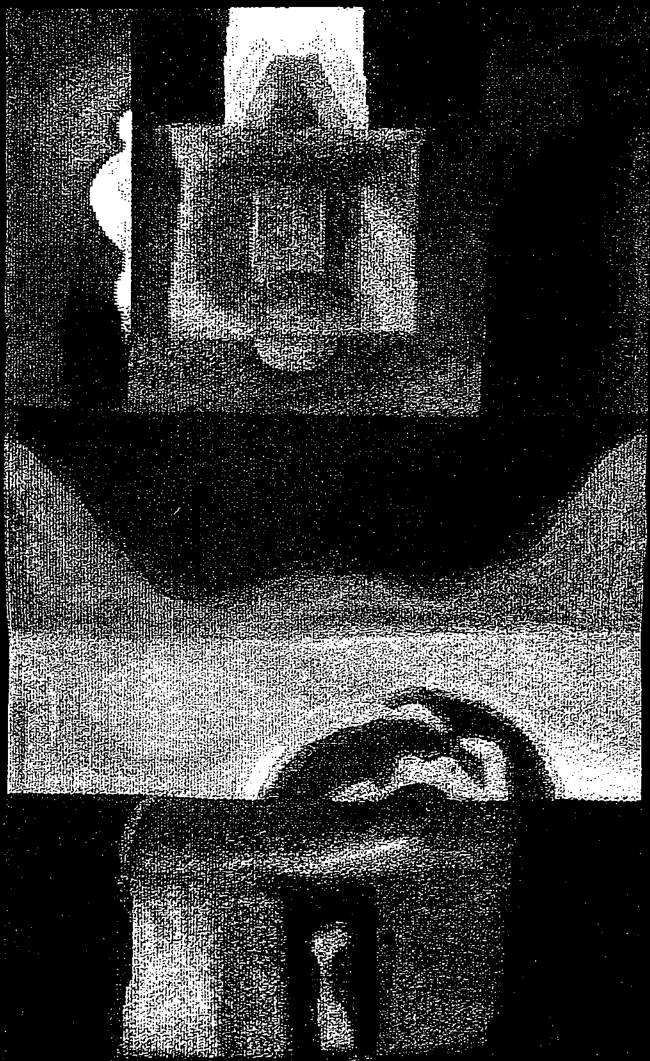
Annual Report 1997

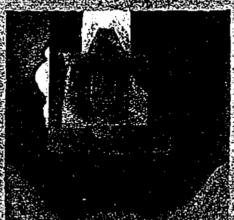


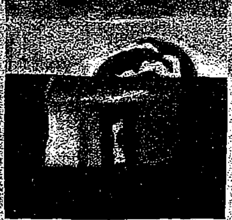
KREDITTILSYNET

The Banking, Insurance and Securities Commission of Norway

[illegible]

[illegible] National College of Art and the Royal College of Art in London. She had her studio in London and now works and lives at Ekely, Oslo. She is represented in several public and private collections and has embellished a number of public buildings.





Front cover: [illegible] Tapestry 180 x 110 1994. Property of the artist.

All photos were taken by Alf Magne Andersen.

Kredittilsynet

Kredittilsynet's function and objectives

Kredittilsynet is responsible for the supervision of banks, finance companies, mortgage institutions, insurance companies, pension funds, securities trading, estate agents, debt collection and accounting and auditing activities.

Kredittilsynet shall ensure that the institutions under its supervision operate in an appropriate and proper manner in accordance with law and provisions issued pursuant to law.

Act on the supervision of Credit Institutions, Insurance Companies and Securities Trading [illegible]

Kredittilsynet's mission is to contribute, together with the institutions under its supervision, to enabling the financial market and financial institutions to fulfil their role in an appropriate manner.

Kredittilsynet's functions are four-fold:

- *supervision and monitoring*
- *framing, improving and administering legislation and guidelines*
- *providing pro-active, specialist advice to the Ministry, supervised entities and the general public*
- *ensuring preparedness for crisis situations*

Kredittilsynet seeks to instil confidence in the financial system by promoting:

- *satisfactory levels of capital strength, risk awareness, management and control in financial institutions under its supervision*
- *preparedness and systems designed to pre-empt situations that threaten the stability of the financial system*
- *orderly conditions, compliance with laws and rules and a high ethical standard among operators in the financial market*
- *an up-to-date and appropriate regulatory framework that fosters smoothly functioning markets, both for supervised institutions and the users of their services.*

From Kredittilsynet's strategy

Contents

«Reflection», tapestry, 190 x 130, 1994. In a private collection.

Preface

1997 was the fifth consecutive year of expansion in the Norwegian economy. For most financial institutions it was a good year. Losses were low, and many players benefited from the positive trend in the securities market in evidence for much of the year. Banks, however, saw their underlying profitability deteriorate owing to narrower interest margins. Insurance companies' loss ratio rose markedly. Developments reflect many institutions' focus on expansion to increase or maintain market share in a period of constant or rising costs.

After several years of low or moderate credit growth, in 1997 domestic credit expansion outstripped growth in production of goods and services. Since overall firm and household indebtedness remains moderate, the main concerns raised by the strong growth in bank lending in 1997 refer to issues of quality and risk in the lending context, the danger of increasing pressures in the economy and that banks' equity will fail to increase in step with the higher risk exposure resulting from heavier lending.

In the year to end-September 1997, 10 of 14 commercial banks and 27 of the biggest savings banks showed a fall in tier 1 capital as a ratio of weighted assets. If lending growth continues as in 1997, tier 1 capital will probably show a further fall.

Under the accounting rules loss provisions only cover losses foreseen at the point in question. Loans which could potentially cause losses in the event of an economic turnaround can not be taken into account. Equity capital is the only cushion against possible setbacks. Kredittilsynet therefore considers it essential for banks to have ample capital. To achieve this bank managements must dampen lending growth, and owners should devote operating profit to strengthening own funds rather than paying dividends.

Kredittilsynet has for several years kept a close eye on banks' lending practice. Guidelines and standards have substantially improved in recent years. Even so surveys of home-financing have shown inadequate institutional compliance with the guidelines for lending. Rapid growth and intense competition for customers are important contributory factors. There is also room for improvement in the quality and systematics of credit procedures where loans to commerce and industry are concerned. Monitoring internal control in institutions will therefore be central to the supervisory effort ahead.

Norwegian financial markets are now dominated by eight financial conglomerates accounting for almost three-quarters of the market. Kredittilsynet considers it essential for these institutions to be financially sound and to operate in accordance with the rules. Merger and buy-out applications in 1997 were unsuccessful. Kredittilsynet considered it important to avoid making prior judgements that might impinge on the application process. Concurrently it strove to ensure that the ownership limitation rules are respected by all players. Developments witnessed among our neighbours in Europe show that the Norway's financial market structure could show further changes in the years ahead. This will create new challenges for concession policy.

Life insurance companies have used the schemes introduced by the authorities in 1993 and the subsequent favourable economic climate to substantially strengthen their buffer capital. The healthy profits posted in 1997 should also go to boosting supplementary provisions, especially where companies wish to invest in equity in excess of 20 per cent of their technical provisions, for which the Ministry of Finance is considering giving the green light. Non-life companies' weak results on their insurance business will prompt them to consider measures to bring down costs, reduce compensation payments and raise premiums.

Securities trading has acquired far greater significance in financial markets and the economy in recent years. Competition for savings is growing, and saving in shares and securities funds is becoming commonplace for more and more families. Since securities funds are acquiring an absolutely central role, strict requirements as to competence, capacity and ethical norms must applied to their administration.

For one thing it is important to inform the public of the risk involved in saving in securities. Investment firms' transition from the role of intermediaries to independent, all-round market players confronts them with new requirements in terms of overview and management. It is important that investment firms discharge their tasks on a basis of respect for and equal treatment of their customers.

Financial institutions, investment firms and fund managers are dependent on public confidence in order to fulfil their functions in society. Just as important as a solid financial foundation is the obligation to run business activities in accordance with laws, rules and general standards of decent conduct. Like 1996, 1997 saw examples of players acting counter to statutory rules and norms which have to be complied with if the public is to have confidence in the market. Kredittilsynet's response included withdrawing the licences of the perpetrators and reporting them to ØKOKRIM[1]. Kredittilsynet also recommended more precise rules for market players' own account trading.

In 1997 Kredittilsynet strengthened its surveillance of enterprises and transactions in the securities market, primarily through redeploying its human resources. Thanks to ampler financial resources and a strong goal orientation, Kredittilsynet has in recent years built a stronger and more competent organisation with a heavier accent on preventive activity and dialogue with institutions and sectors under supervision. Given the challenges now facing Kredittilsynet in the shape of technological developments and continued strong growth of the securities market, it may be difficult to maintain administrative and supervisory standards in the years to come without a further injection of resources.

Oslo, 9 January 1998

Erling Selvig
Board Chaiman

Bjørn Skogstad Aamo
Director General

[1]National Authority for Investigation and Prosecution of Economic and Environmental Crime.

«Wonderment», tapestry, 120 x 310, 1997.
Central government office building, Oslo.

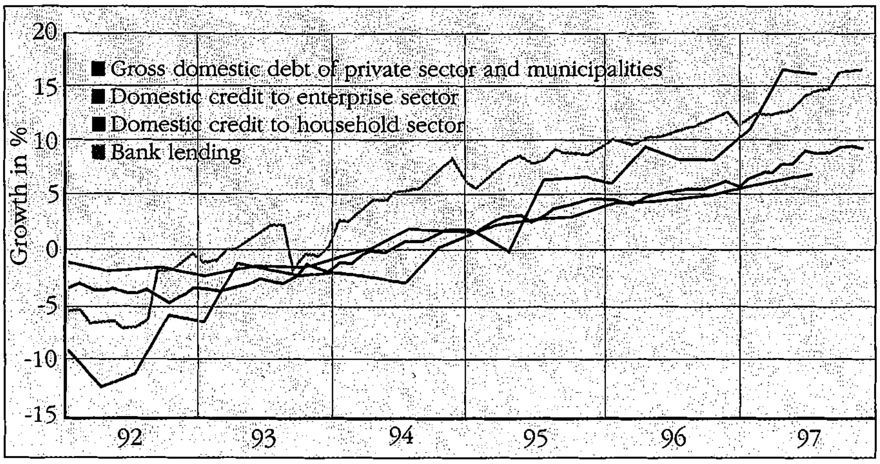
Current trends and analyses

Credit growth clearly higher than growth in the Norwegian economy

Trend in credit, securities and property markets

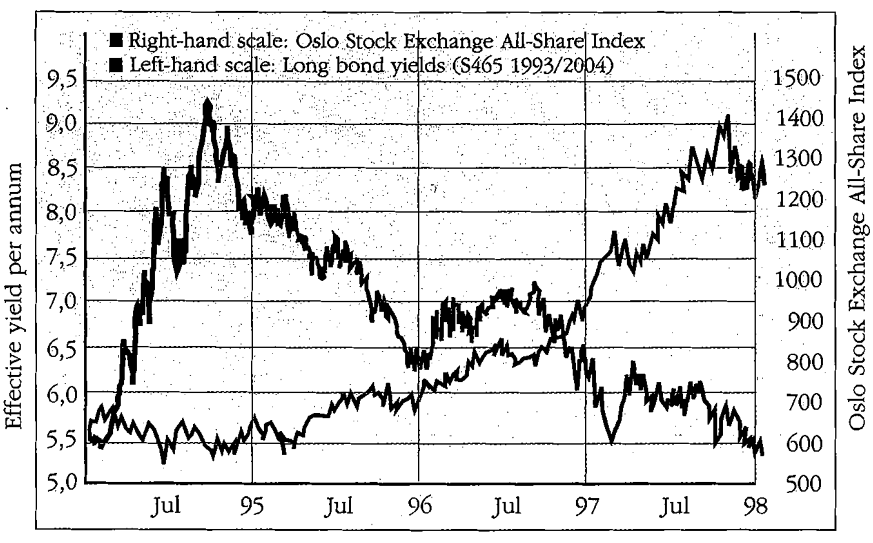
The Norwegian economy is undergoing a period of strong expansion. Despite high activity levels, inflation remains low. There are however signs of pressure in parts of the labour market, at the same time as trends in credit, securities and property markets reflect vigorous demand in the Norwegian economy. Whereas developments in property and credit markets are largely determined by domestic economic conditions, share and bond markets are heavily influenced by trends in international markets.

Chart1: Growth in domestic credit



Source: Norges Bank

Chart 2: Trend in share and bond markets



Source: EcoWin

Cross-effects between markets tend to be self-augmenting. Above all vigorous lending growth will strengthen a surge in property markets and securities markets. Moreover, a steep rise in property prices and in the value of shares, bonds and other securities may, by boosting wealth, increase credit institutions' willingness to lend, thereby reinforcing a credit market advance. There is reason to believe that self-augmenting mechanisms are now in evidence in the Norwegian economy.

- Credit markets

Domestic credit growth has risen since 1992 and at end-November 1997 was almost 10 per cent. As a result, inflation-adjusted credit expansion is now clearly higher than the growth in the Norwegian economy. Banks are the main contributory factor. At end-November bank lending was rising at a rate in excess of 16 per cent, and in the preceding 12 months bank outstripped total domestic credit growth. Finance company lending, which has little effect on the overall picture, also rose strongly.

Household loan debt has risen at a steadily increasing rate since 1993. Firms' loan debt has risen far quicker than household debt in recent years, notably in 1997. However, part of the increase is due to the increase in foreign exchange debt as a result of appreciation of the US dollar against the Norwegian krone. Banks have made a major contribution to the increase in households' and firms' indebtedness.

At the start of 1998 firms and households are in a markedly better financial position than earlier in the 1990s, and in the short term there is little danger of a strong increase in credit institutions' losses. In the somewhat longer term there is a risk that firms and households will fail to take sufficient account of possible interest rate increases and economic setbacks and increase their loan debt beyond prudent levels. Continued increases in credit growth place great demands on credit institutions' credit assessments and lending practice, requiring institutions to have sufficiently ample tier 1 capital to meet future setbacks. This is discussed below.

- Securities markets

Since the international recovery in 1994 long rates have edged down, both internationally and in Norway. The decline in international long rates reflects both low and stable inflation and the fact that most countries have seen improved national finances. Norwegian bond yields fell from September 1996 to February 1997. A modest rise ensued, followed by a renewed fall after the general election last autumn. In the last three months of 1997 Norwegian securities markets were affected by the turbulence in South-East Asian financial markets. Yields in international bond markets fell partly because many investors opted to replace part of their shareholdings with bonds.

The Norwegian share market has essentially shadowed the trend in international share markets where growth has been very steep for several years. Among the larger countries, only Japan has not shown stronger share market growth than Norway. Although the fall in share markets in South-East Asia affected countries outside the region, the rise in Europe and the US as a whole was strong in 1997, with share prices on the Oslo Stock Exchange rising by as much as 31.5 per cent. Bourses elsewhere in Europe showed even higher growth rates.

The events in South-East Asia have added to the uncertainty surrounding share market developments ahead. Banks are little exposed to price fluctuations in securities markets. Life and non-life insurance companies for their part are far more exposed to market risk even though a large portion of their securities holdings carry a long-term investment horizon. Life insurance companies have built up a buffer against decline in securities markets in recent years, partly as a result of market developments and steps taken by supervisory authorities. This receives further mention below.

The turmoil in financial markets served to focus attention on possible settlement system failure in the event of a rapid fall in share prices. Norwegian tests of the consequences of investment firms' inability to settle up with other brokers on a daily basis revealed weaknesses of a legal and technical nature. In 1997 Kredittilsynet continued its work on analysis and measures aimed at reducing settlement risk.

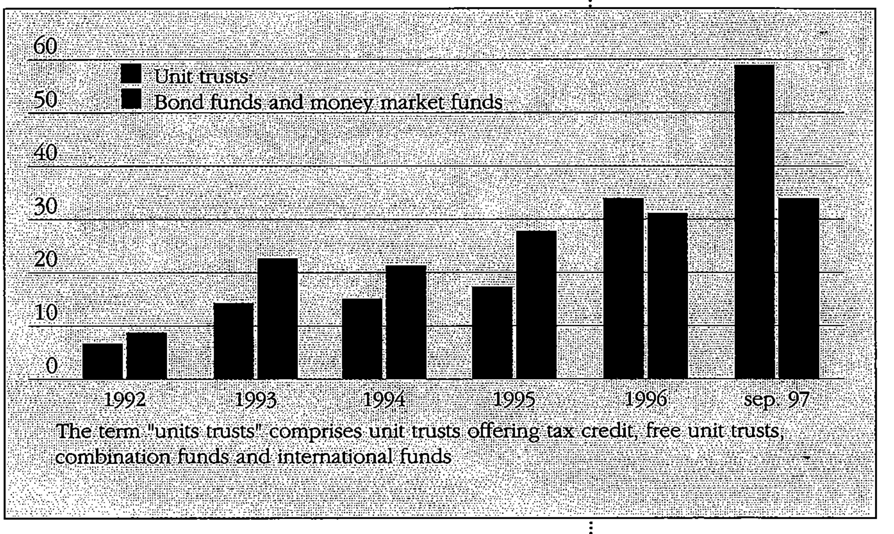
- Savings market

Demographical changes, high returns in securities markets compared with returns from traditional bank saving in recent years, and improved financial asset positions, have led to changing saving patterns in most countries. Saving via direct investment in securities markets, via insurance companies or via securities funds is increasing at the expense of traditional bank saving. The chart below illustrates the trend for securities funds in Norway.

The particularly strong growth in the first half of 1997 stems from an increase in unit trusts' total assets. Households account for about 60 per cent of all units held in securities funds.

Although household saving in securities funds, notable unit trusts, is growing, such saving still constitutes only a relatively small share of households' total holdings of financial assets.

Chart 3: Total assets in securities funds*



Source: Kredittilsynet

*) Part of the growth is due to a general vise in security values as opposed to new investments.

Kredittilsynet expects the structural changes in evidence in the savings market in Norway, which mirror the international trend, to continue in the years ahead. It is too early to foresee the effects of the new products available in pension saving and life insurance.

Changing saving patterns are among the driving forces behind structural changes in the financial markets in the form of concentration, cooperation agreements and the emergence of financial conglomerates. The banks in particular have been alert to the diminishing significance of bank deposits. They have endeavoured to adapt by establishing or buying out subsidiaries, and by utilising existing

Table 1: Household sector financial assets (at period-end)*

	1991	1992	1993	1994	1995	1996	June 97
Bank deposits	46	46	43	41	40	39	38
Units in securities funds	1	1	2	3	3	4	5
Shares and bonds	11	10	12	11	12	12	13
Claims on insurers	32	33	34	34	35	35	34
Other	9	10	9	10	10	10	10
TOTAL	100 %	100%	100 %	100 %	100 %	100 %	100 %
Total financial assets, NOKbn	646	681	739	774	825	885	947

Source: Norges Bank/Kredittilsynet

Little risk of a steep increase in credit institutions' losses in the short term

A longer-term risk is that firms and households will fail to make sufficient allowance for interest rate increases and economic setbacks

Share values rose 31.5 per cent on the Oslo Stock Exchange in 1997

Households account for about 60 per cent of all units held in securities funds

distribution networks and customer portfolios to generate income through sales of security fund and insurance products.

- Housing market

Strong expansion of the housing market in 1997

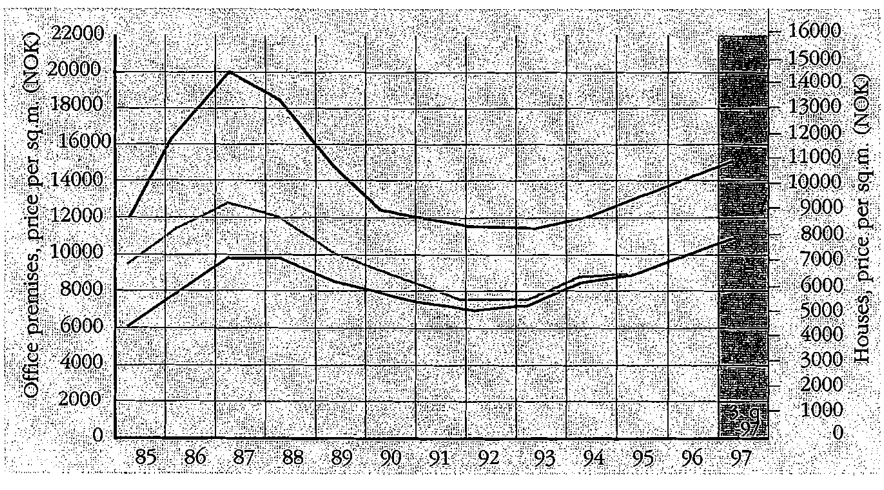
The general recovery in the Norwegian economy gradually led to vigorous upswing in the housing market. Higher employment, falling real interest rates, low nominal rates and increased incomes were contributory factors, as in 1996. There are also indications that financial institutions have relaxed their credit practices, which also has the effect of pushing up prices.

Since the trough in 1992-93 house prices have risen about 69 per cent and were markedly higher in 1997 than in the peak year 1987. Inflation-adjusted prices are however still somewhat lower than at the end of the eighties. The chart below shows both nominal prices and real prices in 1996 kroner.

Kredittilsynet's focus on banks' credit practices in 1997

Norges Bank and Statistics Norway expect a continued increase both in current house prices and inflation-adjusted house prices in 1998. In other words, real house prices could this year reach levels witnessed at the last price peak in the latter half of the 1980s. Financial institutions should be prepared for housing market imbalances in the 1990s too, accompanied by falling prices.

Chart 4: Price trend in property markets



■ Office premises: Prices of centrally located office premises in Oslo (OPAK) – left-hand scale
■ House prices: Average price per sq.m. for various house types (NEF/ECON) – right-hand scale
■ House prices: Average real price per sq.m. for various house types (NEF/ECON) – right-hand scale

- Commercial properties

Optimism in the commercial property market

1997 was marked by optimism in the market for commercial properties, driven by employment growth, low interest rates, moderate inflation and sound profits in the enterprise sector. There are wide price differences between attractive and less attractive properties. Both rentals and sale prices have risen in recent years. In the case of commercial properties, however, nominal sale prices remain appreciably lower than in the peak year 1988, as illustrated by the chart below.

The total area of vacant office premises declined in 1997. Commercial property starts were the highest so far in the 1990s, but nonetheless far lower than in the peak years in the eighties. Market practitioners appear to foresee little risk of a substantial price fall. Long completion times for new projects mean that construction projects which in good times are expected to yield ample profits may turn out to be a bad investment in an ensuing economic downturn. With both the Fornebu and Gardemoen areas set to be filled with new commercial premises, premises in the Oslo area could remain vacant in the event of an economic turnaround. At the end of the eighties a substantial price fall was witnessed in the property market as a result of over-investment.

The main risk facing banks in the market for commercial properties relates to loans. In the 12 months to the end of the third quarter lending to this sector rose about 20 per cent, while total bank lending growth in the same period was just over 16 per cent. A pertinent concern both in regard to commercial property loans and home loans is whether banks' lending policy may be overly «cocyclical», helping to intensify price fluctuations in the property market.

Over the past two years life insurance companies have expanded their property activities to become substantial players in the property market. Three of the biggest property companies in Norway are now owned by life insurance companies. At end-June 1997 life insurance companies owned properties to a total value of NOK 17.4 billion, constituting 6.3 per cent of their total assets. Life insurance companies now have a buffer to cushion losses resulting from a slump in the property market.

Banks' credit practice

The strong growth in bank lending places great demands on risk management, credit practice and prudent risk pricing. Kredittilsynet focused attention on credit practice through surveys of banks' home loans and some aspects of banks' corporate loans. A close analysis was also made of bank loans for the purchase of securities and of the scope of security for loans in the form of a mortgaged securities.

- Home loan survey

Kredittilsynet has in recent years conducted several surveys of financial institutions' guidelines and practice in regard to home loans. The 1996 survey showed that few banks were able to break down their home loans in terms of debt:finance ratios. This lack of overview together with rapidly rising house prices and lending growth, as well as the findings of various interview surveys showing that about 40 per cent of all home purchases were fully debt-financed, prompted Kredittilsynet to ask the banks to review and report on the first 100 home loans each one granted in 1997. This type of lending is decentralised. Each bank was asked to submit its report via the board of directors since experience from inspections shows that the board does not have a full overview of the latest developments.

The survey findings showed a substantial number of loans with a debt:finance ratio in excess of 80 per cent. All banks participating in the survey provided full financing. Moreover, although half of all home-loans were backed by additional security, it is not clear what proportion of these were loans with a debt:finance ratio in excess of 80 per cent. Furthermore, routines for assessing debt-servicing ability were inadequate in some cases, since the guidelines requirements as to «ability to pay» and varying requirements as to additional security give the individual home-loan officer much room for discretion. In many cases signs of aggressive price competition were in evidence where actual mortgage interest rates were substantially lower than the bank's «normal» lending rate as advertised. The survey showed this was especially the case for loans with a high debt:finance ratio.

In June 1997 all commercial and savings banks received a circular showing the results of the survey. Kredittilsynet expressed the view that lending in excess of 80 per cent of a prudent property valuation must be regarded as dubious unless satisfactory additional security is furnished. The board of directors of each bank was asked to review their guidelines in this area to verify that its home loan activity was in conformity with the recommendation previously given by Kredittilsynet in regard to satisfactory credit practice. Kredittilsynet followed up the survey with inspections at a number of banks.

The replies to the circular show that most banks consider their current lending policy and guidelines to be in line with the requirements and intentions set out in the circular. Of the 28 banks surveyed, eight resolved to tighten requirements as to additional security and good debt-servicing ability in the case of loans with a high debt:finance ratio. Inspections show that general guidelines and requirements as to administrative procedures in this area appear to be satisfactory. Poor monitoring and control of these guidelines, coupled with failure to respond when guidelines are breached, are a recurrent feature. At some banks the board of directors has adopted various measures to ensure proper compliance with the guidelines. Such measures range from issuing branches with a written reprimand and clarifications to follow-up enquiries, training programmes for home-loan officers and clarification of lending authorisations.

Kredittilsynet expects banks to tighten their practice in this area after the attention focused on home loans in 1997. A follow-up survey will be conducted in 1998.

- Survey of corporate loans
The home loan survey indicated that banks' credit practice had slackened. Pinpointing credit practice on the corporate customer side is more difficult. Against a background of strong growth in banks' corporate lending, and because this type of loan exposes banks to greater risk, Kredittilsynet carried out a survey of the biggest banks' credit practices in the corporate customer market. The focus was on banks' risk classification system, lending growth, risk pricing and other indicators of changes in the quality of the loan portfolio. Lending to the property sector received special attention.

The survey gave no basis for clear-cut conclusions, partly because several banks did not have the requested data available, and partly because banks differ in terms of management systems, portfolio composition etc. Importantly, the survey revealed an inadequate overview at several banks, particularly in key areas such as classification of new loans, risk pricing and debt:finance ratios for loans to the property sector. Weaknesses were also revealed in the use of sensitivity analyses to calculate the consequences of higher interest rates on property loans. There is also a clear potential for improvement at some banks as regards guidelines and limits on lending to the property sector.

Poor credit practice routines will raise banks' risk profile and increase the risk of loan losses in the future. This can happen even though households' and firms' financial position overall is currently healthy.

- Loans against mortgage on securities
In the autumn of 1997 Kredittilsynet also conducted a survey of loans secured by mortgage on financial instruments, with particular emphasis on loans for the purpose of purchasing securities. The survey focused on a selection of eight commercial banks and six savings banks. The survey was carried out in light of new loan products devised by a number of banks in the last couple of years for financing purchases of securities. Since securities tend to fluctuate widely in value at times, loans secured by mortgage on securities present institutions granting such credit with substantial challenges in terms of monitoring and control. Where the security provides protection against losses, it is important to continually monitor the value of the mortgage. There will also be a need for unambiguous agreements with borrowers which guarantee the opportunity to rapidly call for extra security in the event of value fall, as well as an opportunity to realise the security immediately once a default is confirmed.

This type of loan may, if it acquires a substantial scope, also in itself contribute to reinforcing fluctuations in securities markets. Raising a loan to purchase securities increases the borrower's exposure in the securities market for a given volume of equity. This normally increases the return in the event of rising prices, but also increases the losses when prices fall. Debt-financed investors will therefore have to react more rapidly than other investors to curb losses resulting from a price fall. In a market that is essentially debt-financed such action may not only lead to quicker price corrections, but experience from other countries shows that debt-fi-

Kredittilsynet's home-loan survey showed a substantial number of loans with a debt: finance ratio above 80 per cent

Kredittilsynet broached the need for stricter credit practice in a circular to banks and during on-site inspections

At end-September 1997 loans against mortgage on securities totalled just over NOK 7 billion

Kredittilsynet's corporate loan survey showed that several banks had a poor overview of key areas such as classification of new loans, risk management and debt:finance ratios

Bank loans secured by mortgage of securities do not constitute a threat for the banks or for the Norwegian securities market in general

Financial institutions with large share- and bond holdings could face problems in the event of higher interest rates combined with a share market slump

nancing contributes heavily to wider effects in the event of price falls.

Kredittilsynet's survey showed that 11 of the 14 respondent banks had granted credit secured by mortgage on securities. Of these, nine had also defined loans specifically for purchase of securities as a separate product which they marketed to certain customer categories, or had available if customers enquired about them. According to figures reported by the banks, loans against mortgage on financial instruments currently constitute a very small portion of the 14 banks' total lending. Overall loans granted against mortgage on securities were reported at just over NOK 7 billion at end-September 1997, of which about NOK 3.5 billion was granted through loan schemes specifically for purchase of securities. The highest reported debt:finance ratios were in the range 50 to 80 per cent for loans mortgaged on shares quoted on the Oslo Stock Exchange's main list, and in the range 75 to 95 per cent for loans secured by mortgage on bonds. Debt:finance ratios vary widely with the risk the securities are assumed to represent.

Banks' difficulties in separating out loans mortgaged on securities that are not included in special-purpose loan schemes mean that the overall amount is probably higher than that shown by the reported data. Figures for mortgage of listed securities prepared by the Norwegian Registry of Securities (VPS) for Kredittilsynet appear to substantiate this. According to these figures, banks' mortgages on securities amounted to almost NOK 23 billion as at 21 November 1997, of which about 95 per cent referred to shares. If it is assumed that the entire amount was mortgaged in connection with loans, and that the banks employ an average debt:finance ratio of 50 per cent, total lending comes to about NOK 11 billion. However, banks also grant loans secured by mortgage of foreign securities which are not quoted on a stock exchange. On this basis Kredittilsynet estimates the overall volume of Norwegian banks' loans mortgaged on listed securities at not more than NOK 10-15 billion for shares and primary capital certificates, and NOK 0.5-1.5 billion for certificates and bonds (November 1997). By way of comparison the market value of shares and primary capital certificates quoted on the Oslo Stock Exchange came to NOK 587 billion at the start of November 1997, while the corresponding figure for certificates and bonds was NOK 422 billion.

Table 2: Loans mortgaged on financial instruments (14 Norwegian banks) and quoted shares and primary capital certificates mortgaged in favour of Norwegian banks

All figurs in millions of kroner - market values	Quoted securities mortgaged in favour of banks			Loans mortgaged on financial instruments (14 banks)
	31.12.95	31.12.96	21.11.97	30.09.97
Commercial banks inkl. Postbanken	9 005	8 827	18 260	5 877
Saving banks	4 140	4 176	4 493	1 272
Total	13 145	13 003	22 753	7 149

Source: Kredittilsynet / Norwegian Registry of Securities

Table 3: Mortgaged quoted shares and primary capital certificates by investor sector

All figures in millions of kroner - market values	31.12.95	31.12.96	21.11.97
Private companies with limited liability (limited companies etc.)	8 738	7 044	19 130
Foreign sectors, total	2 070	1 167	8 730
Households (wage-earners, pensioners, benefit recipients et al.)	3 209	2 988	5 277
Other sectors	799	5 134	5 058
Total	14 796	16 333	38 195

Source: Norwegian Registry of Securities / Kredittilsynet

The VPS figures show that in 1997 (up to November) there was a sharp increase in shares and primary capital certificates mortgaged in favour of commercial banks, including Postbanken. The increase far outstrips the rise in share prices on the Oslo Stock Exchange in the same period. According to VPS figures on sectors that have backed loans by mortgaging their securities, private limited liability companies posted the biggest increase in the value of mortgaged shares and primary capital certificates in the period in question. The figures referred to may indicate strong growth in the market for loans in question. Even so it is too early to draw firm conclusions, partly because it is uncertain how banks' involvement with investment firms affects the figures.

Kredittilsynet plans to monitor developments in this area ahead. For the time being loans granted by Norwegian banks against mortgage of securities seem neither to pose a threat to the banks or to the Norwegian securities market in general. However, some banks are far more exposed than most in this market. Should this type of lending assume large proportions in the future there could be a greater risk of losses in the financial system.

Ability to withstand economic setbacks

Profitability and financial strength in the Norwegian financial industry ahead will depend on two factors in particular. In the first place, developments in securities markets, which are influenced by the economic climate in Norway and abroad, will affect results and financial strength in institutions that are heavily exposed to market risk. This essentially refers to insurance companies' exposure to and ability to withstand fluctuations in securities markets. Second, banks' position in the future will depend on the further path of lending expansion and the trend in the quality of loan portfolios, as well as their ability, in terms of the size and quality of their own funds, to withstand future economic setbacks.

- Life insurance companies

When interest rates rise the market value of fixed-interest bonds falls. The share market is also highly likely to contract. Financial institutions with sizeable holdings of such securities may encounter problems in the event of an interest rate increase combined with falling share values. This is particularly true of life insurance companies, pension funds and non-life insurance companies, but to some extent also banks with large bond holdings. At the end of the third quarter of 1997 an interest rate increase of 2 per cent concurrent with a 30 per cent fall in share values would by itself have inflicted a loss on securities estimated at NOK 25 billion on life insurance companies and a loss on securities of about NOK 4 billion on non-life insurance companies. Life companies guarantee their customers a minimum return on investment and would have been compelled to draw on supplementary provisions and other buffers to honour the guarantee.

Since 1992 the supervisory authorities have taken several steps to improve life companies' ability to withstand fluctuations in securities markets:

- Reduction of the guaranteed basic return on new contracts to 3 per cent as from the end of 1993.
- Introduction of the right to make (tax-free) supplementary provisions to cover the guaran teed basic return in years of poorly performing securities markets as from the closing of the accounts for 1993.
- Conditional distribution of 75 per cent of unrealised gains on securities to insurance customers as from the closing of the accounts for 1993.
- Clarification of accounting rules for bonds held to maturity as from end-1994.

The table below shows the trend in life insurance companies' buffer capital against market risk, assuming fulfilment of the capital adequacy requirements, in the period 1992 to 30 September 1997.

Life insurance companies' buffer capital strengthened considerably after 1992 as a result of the measures referred to.

Life insurance companies' buffer capital strengthened appreciably in the period after 1992 as a result of steps taken by the supervisory authorities

The positive trend in securities markets in recent years has enabled companies to make supplementary provisions and build up revaluation reserves. Even so several factors indicate that priority should continue to be given to building up supplementary provisions and other buffers:

- The fall in interest rates in recent years has reduced the income buffer represented by the difference between the interest rate level and life insurance companies' guaranteed return, thereby increasing the significance of supplementary provisions and other buffers.
- Growing competition in the pension saving market from banks and securities funds increases pressures on life companies for competitive returns.
- After several good years in capital and share markets, there is a growing risk of a turnaround posing the risk of a fall in the value of securities holdings.

At the end of the third quarter of 1997 life insurance companies' buffer capital came to about NOK 29 billion, alongside an interim result of about NOK 6.5 billion. Life insurance companies could therefore withstand an interest rate increase of 2 per cent combined with a 30 per cent fall in share values. There is a wide spread between the major and small life companies in terms of vulnerability to negative turnarounds in markets.

- Growth, liquidity risk, earnings and capital adequacy

Banks have for several years shown quickening growth in lending and total assets. This poses a major challenge to banks in several areas, primarily in regard to capital adequacy and financial strength, but also to liquidity and interest rate risk.

The stronger the growth shown by the banks, the tighter the demands on earnings needed to generate sufficient equity capital via operations

Table 4: Trend in life insurance companies' buffer capital against market risk 1992 - 30.09.97

Billions of kroner	1992	1993	1994	1995	1996	30.09.97
Supplementary provisions	0,0	5,8	6,0	8,3	10,3	10,3
Unrealised gains	0,0	7,9	1,5	4,8	9,0	*17,7
Tier 1 capital in excess of 8%	0,0	0,0	0,5	0,6	1,5	0,4
Contingency reserves above minimum requirement	0,2	0,5	0,5	0,4	0,5	0,5
Total	0,2	14,2	8,5	14,1	21,3	28,9

Source: Kredittilsynet

** However, as a result of events in share markets in the last quarter of 1997, among them the turmoil in South-East Asia, unrealised gains on securities have been substantially reduced. At year-end they are estimated to have fallen from NOK 17.7 billion (cf. above table) to just under NOK 12 billion. Supplementary provisions are expected to rise somewhat as part of the closing of accounts for 1997.*

Rapid lending growth combined with changing saving patterns has contributed to an ever lower ratio of deposits to loans among savings and commercial banks alike. As a result banks have had to increase their funding in the money market and through issuance of bonds. The major banks have generally increased their borrowing in international markets. Thanks to Norway's healthy banks and economy in recent years, favourably priced capital has been available in these markets. Howe-

If banks manage to bring down lending growth to 10 per cent and concurrently secure a sound trend in financial terms, all categories of banks will be able to maintain current capital levels

With 15 per cent lending growth the biggest banks will see a large reduction in tier 1 capital despite a favourable economic path

ver, increased funding in the money market increases banks' exposure to interest rate risk. A potentially more serious risk is that international funding sources could dry up. This may happen if confidence in the Norwegian economy and/or financial sector should again be seriously impaired. Moreover, there is always a danger that loss of confidence in an individual bank will spread across the banking system. Banks have to ensure that they are in a position to handle the interest rate and liquidity risk resulting from rapid lending growth and changing saving patterns.
The strong lending growth is reflected in the basis for measuring capital adequacy and entails falling equity ratios. The stronger the growth in bank lending, the bigger the earnings required to generate sufficient equity capital through operations.

Chart 5: Tier 1 capital adequacy and lending growth as at 30.09.97 in selected banks

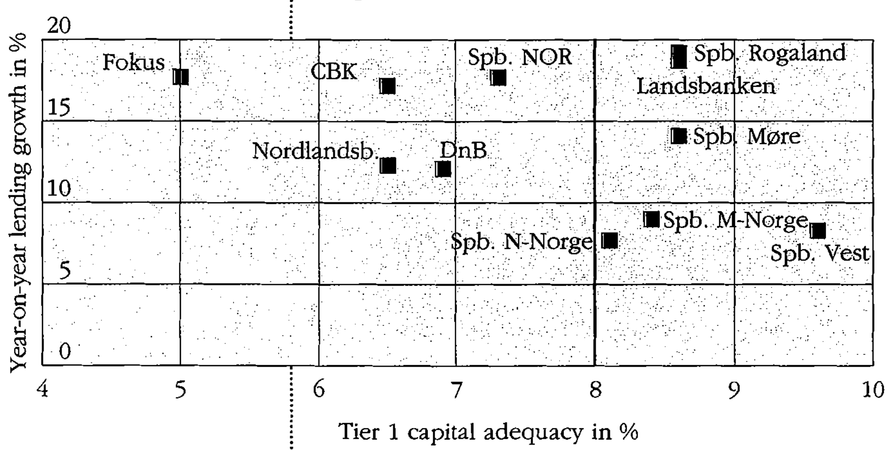


Figure 5 shows tier 1 capital adequacy and lending growth at end-September 1997 for the biggest commercial banks and savings banks. Several banks have a tier 1 capital adequacy below 8 per cent, concurrent with lending growth between 12 and 18 per cent in the period.

Against this background Kredittilsynet examined possible result paths in various groups of banks in the period 1997-99. It also examined the trend in tier 1 capital assuming, respectively, 10 and 15 per cent annual growth in lending and balance sheet items. To provide a better view of differences in the trend among various categories of banks, the banks are grouped by size of total assets: Sparebanken NOR, savings banks nos. 2 - 5, savings banks nos. 6 - 25, the 102 remaining savings banks, the three biggest commercial banks and the 11 remaining commercial banks. Note that only projections of development trends are observed here.

- Calculations of capital adequacy

Charts 6 and 7 below illustrate the calculations. If banks manage to reduce lending growth to 10 per cent and concurrently secure a sound trend (the «good alternative») in financial terms, all groups of banks will be able to maintain their current equity capital levels. Assuming 10 per cent balance sheet growth and the «poor alternative», tier 1 capital adequacy of all groups will be weaker than at the end of 1996. Only the smaller savings and commercial banks are in a position in which they can be reasonably comfortable with such a develop-

Assumptions underlying the calculations

For all groups a basis is taken in actual results for the third quarter of 1997. The current satisfactory bank results are essentially due to extremely low loss levels. This follows from the practice employed in Norway and many other countries whereby loans are assessed on the basis of the actual financial position of households and firms. Hence at a cyclical peak the position for most sectors will be good and property prices relatively high. Losses of some size must be expected to arise after a time.

Our calculations assume two alternative growth rates for the balance sheet for each of the years 1998 and 1999, viz. 10 per cent and 15 per cent. Lending and the measurement base are assumed to grow at the same rate as the total balance sheet. The annual growth assumed in the balance sheet, lending and the measurement base is identical to the 12-month growth at the end of the third quarter of 1997.

In the «good alternative» for bank finances, it is assumed that net interest income will not show a further fall and that losses will not exceed 0.2 per cent of gross loans in 1999. In the «poor alternative» losses are assumed to increase to 0.5 per cent of gross loans for savings banks and 0.6 per cent for commercial banks in 1999. With a gradual increase, losses of 0.3 per cent are expected for both groups of banks in 1998.

Although the decline in net interest income seems to have levelled off somewhat, continued downward pressure must be expected, especially for savings banks which show the largest interest margins.

In the «poor alternative» net interest income is expected to edge down by 0.6 percentage point for savings banks and 0.4 percentage point for commercial banks.

It is reasonable to expect other income and costs to increase when banks expand. These items are assumed to increase in krone terms at a rate equal to half the assumed balance sheet growth, i.e. 5 per cent and 7.5 per cent. Assumptions are also made in regard to tax costs for the various groups of banks.

Not all these scenarios are equally likely. There is reason to believe that rapidly expanding banks will experience a lower level of interest margins than banks with a moderate rate of growth. The same applies to groups of banks as a whole. Furthermore, there is reason to believe that banks which rapidly expand their lending will incur higher risk on their loan portfolios than banks with a moderate rate of lending growth. This will probably also be the case for the industry as a whole. Hence the supposition that the «good alternative» is a financially speaking more likely outturn in a situation of 10 per cent lending growth than the «poor alternative» for this result. The «poor alternative» for this result could be a more likely development path in the case of 15 per cent lending growth.

Based on the calculations of possible development paths for banks' results in the period 1997-99, the consequences for the various groups of banks' tier 1 capital adequacy were determined. The calculations are partly based on assumptions regarding payment of dividend yield on primary capital certificates and shares.

ment. In the 15 per cent lending growth scenario the biggest banks will see a substantial reduction in their tier 1 capital even on the assumption of a favourable economic path.

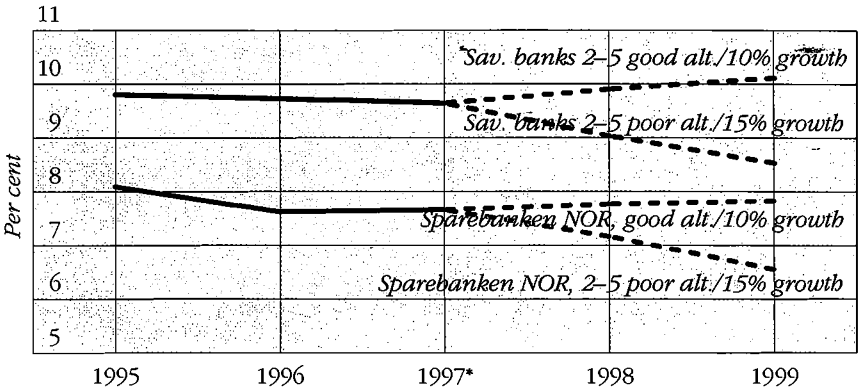
Chart 6 shows the trend in tier 1 capital adequacy in the two outermost development paths described above for Sparebanken NOR and savings banks nos. 2 - 5. With 10 per cent balance sheet growth, good earnings and low losses, capital adequacy for these banks will edge up in the period to 1999. Tier 1 capital in excess of minimum requirements will in this case be sufficient to compensate for balance sheet growth. Calculations done for the smallest savings banks show that this group of banks will achieve a relatively better result than the biggest savings banks, entailing a rise in tier 1 capital adequacy of 2.0 to 2.5 percentage points in the same period.

In the event of strong balance sheet growth, weaker earnings and higher losses, capital adequacy at Sparebanken NOR and among savings banks nos. 2 - 5 will be reduced in the period to 1999. At end-period tier 1 capital adequacy is estimated at 6.5 per cent for Sparebanken NOR and 8.5 per cent for savings banks nos. 2 - 5. The assumption of 0.6 percentage point decrease in net interest income in 1999 is a relatively stringent assumption for Sparebanken NOR. This bank has relatively lower net interest income than the other savings banks, and it would be realistic to expect the same trend in net interest income here as in the case of the commercial banks. The calculations show that the smallest savings banks will also see a weakening of their financial position up to 1999 under the «poor alternative». The decrease is far smaller than for the biggest savings banks since the smallest savings banks do not issue primary capital certificates, and all profit is added to their tier 1 capital. Moreover, this group of savings banks has relatively higher earnings in terms of net interest income entailing a bigger profit in per cent of average total assets.

Chart 7 shows the trend in tier 1 capital adequacy in the outermost cases under the various development paths for the three biggest commercial banks and the remaining commercial banks, i.e. nos. 4 - 15. Average tier 1 capital adequacy at the three biggest commercial banks will, under the «good alternative» and moderate balance sheet growth, come to 7.3 per cent at end-1999. The main portion of the decline in the tier 1 capital ratio is assumed to come at the end of 1997. Earnings and losses in 1997 are estimated on the basis of figures for the third quarter of 1997. A relatively strong decline in net interest income, and losses from 1996 to the third quarter of 1997, entail weak earnings and higher losses for this period, which in turn affects the calculation of tier 1 capital adequacy. Despite the supposition that a relatively large portion of the profit will be paid to shareholders in the form of dividend, the calculations show stable tier 1 capital adequacy in the period 1997 to 1999. The lower taxes incurred by the three biggest commercial banks compared with the other bank groups are taken into account.

As regards the remaining commercial banks, average tier 1 capital adequacy is estimated at 8.5 per cent at the end of 1999 under the «good alternative» and 10 per cent balance sheet growth. Since

Chart 6: Tier 1 capital in per cent of the measurement base for the biggest savings banks

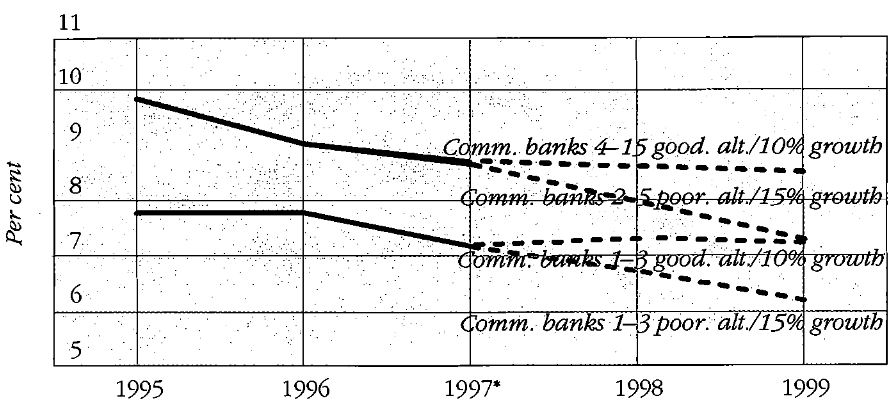


* The estimate for 31.12.97 is based on the situation as at 30.09.97.

the remaining commercial banks have relatively higher tier 1 capital ratios than the three biggest commercial banks, the financial position of this group of banks improves during the period. This group pays a larger share of its profit in taxes than the three biggest banks, but its dividend ratio is lower.

The trend in tier 1 capital ratios among commercial banks has actually shown a decline since 1995. Calculations show that with 15 per cent lending growth, poorer earnings and higher losses, tier 1 capital ratios will be further reduced in the period to 1999. The tier 1 capital ratio in this scenario is estimated at 6.1 per cent for the three biggest com-

Chart 7: Tier 1 capital in per cent of the measurement base for commercial banks



* The estimate for 31.12.97 is based on the situation as at 30.09.97.

mercial banks and 7.3 per cent for the remainder at the end of the period. Under the assumptions outlined, the calculations show that the banks

Kredittilsynet will monitor developments in variances between anticipated and actua l lending growth in 1998

In light of the quickening lending growth, Kredittilsynet was asked to consider whether tighter tier 1 cap ital requirements would be an appropriate measure for strengthening financial institutions' solidity

could see a substantial weakening of their tier 1 capital adequacy in the years ahead. They could prevent such an outturn by either reducing growth or ensuring a better performance trend. Other possibilities would be to reduce today's high dividend levels or bring in more tier 1 capital through new issues.

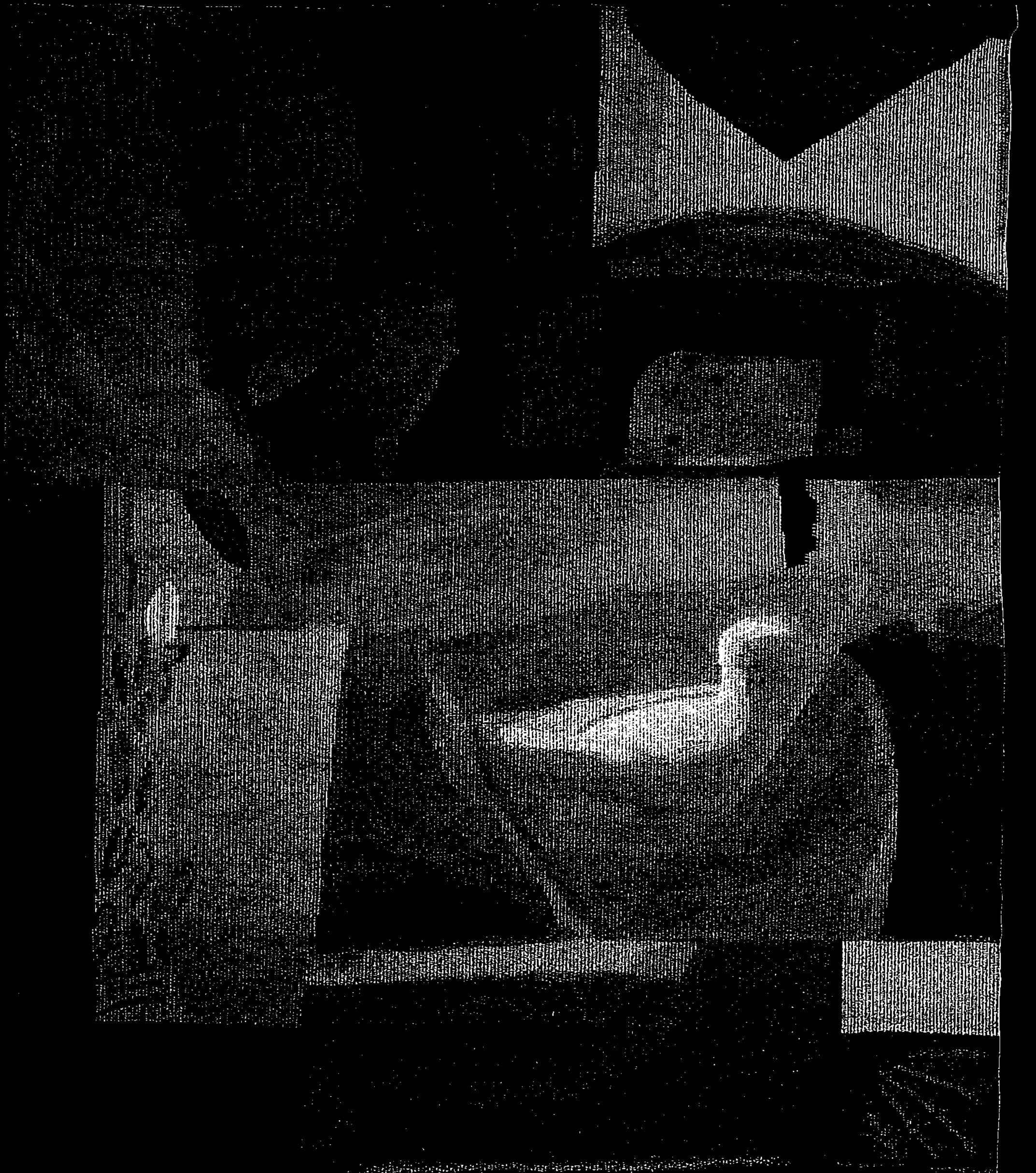
- Monitoring of individual banks

Against the background of the strong lending growth and deteriorating tier 1 capital adequacy, Kredittilsynet approached a selection of banks to assess the trend in lending and financial strength for 1998. The banks were asked to give an account of budgeted lending growth for 1998 broken down on private loans and corporate loans, and to give an account of expected tier 1 capital adequacy on the assumption that the budgeted lending growth is realised. Concurrently each bank was asked to state to what extent the reported budget variables constitute binding management objectives for the bank.

The survey results showed that a majority of the respondent banks anticipate lower growth in 1998 than in 1997. Banks anticipating continued buoyant growth in lending are mainly those in a sound financial position. If action is not taken to strengthen banks' solidity, the anticipated growth in lending will entail a further weakening of tier 1 capital - and of capital adequacy - for several of the respondent banks in 1998. The replies received give the impression that the banks will make a greater effort to price risk correctly, and that lending growth will be based on assessment of the quality of the borrowers. The survey shows that the banks do not perceive budget figures as binding management objectives, but that the budgets can rather be viewed as forecasts of the trend in the market for loans. Kredittilsynet will monitor the trend in variances between budgeted and actual lending growth in 1998. The survey will be followed up at ordinary meetings with a selection of banks and via on-site inspections.

- Assessment of higher tier 1 capital requirements for banks

In a letter of November 1997 the Ministry of Finance asked Kredittilsynet to assess whether tighter tier 1 capital adequacy requirements would be an appropriate means of bolstering financial institutions' capital strength, inter alia in the light of the strong lending growth. The ministry expects Kredittilsynet to address the competitive aspects of the issue. Kredittilsynet will present its report to the ministry at the turn of the month January/February 1998.



«The Enrichment», tapestry, 170 x 140, 1988.
Property of Follo Politikammer.

Kredittilsynet's operations in figures

Table 5: Number of supervised entities as at 31 December 1995, 1996 and 1997

Banks and financial institutions	**1995**	**1996**	**1997**
Savings banks	133	133	133
Commercial banks			
(of which 3 foreign-owned in 1995, 2 foreign-owned in 1996, 1 foreign-owned in 1997)	17	16[1]	13
Postbanken	1	1	1
Foreign branches of Norwegian banks	10	12	12
Norwegian branches of foreign banks[4]	3	3	7
Finance companies	40	38	36
Norwegian branches of foreign finance companies	5	8	12
Mortgage companies[4]	11	8	8
Norwegian branches of foreign mortgage companies[4]	-	1	1
Loan intermediaries	11	10	2
Insurance	**1995**	**1996**	**1997**
Life insurance companies	9	9	10
Non-life insurance companies	53	52	53
Unit-linked companies	-	-	6
Local marine insurance associations	20	19	18
Insurance brokers	22	44	40
Local fire insurance associations	38	39	39
EEA branches and general agents[4]	18	18	13
Private pension funds	135	136	136
Private pension schemes	129	114	104
Municipal pension funds	32	31	29
Holding companies	**1995**	**1996**	**1997**
Holding companies	-	-	11
Securities trading	**1995**	**1996**	**1997**
Investment firms (previously stockbroking firms)	32	34	61
Management companies for securities funds	23	22	23
Project broking undertakings[2]	13	11	-
Options trading undertakings[3]	1	1	-
Estate agency	**1995**	**1996**	**1997**
Estate agencies	318	348	381
Lawyers' practices incl. estate agency	917	918	944
Debt collection	**1995**	**1996**	**1997**
Debt collection agencies	142	127	123
Auditors	**1995**	**1996**	**1997**
Auditors	3 769	3 942	4 058
Auditing firms	413	448	468
Data processing centres			
Norwegian Options Clearing House (NOS)			
Norwegian Registry of Securities (VPS)			
Banks' Central Clearing House (BBS)			
Fellesdata			

Kredittilsynet also performs supervisory tasks in relation to the Register of Company Accounts in Brønnøysund and the Accountants Authorisation Board.

Notes:

1) 16 incl. Oslobanken.
2) Regulations on project broking undertakings were revoked at end-1996. No figures are available for this category for 1997.
3) Since 1 July 1996 options trading undertakings are included in securities funds and are no longer a separate category.
4) The number of branches in 1997 is based on reports received from foreign supervisory authorities under provisions pursuant to the EEA Agreement.

On-site inspections in 1997

Sixty-six on-site inspections were carried out in the fields of banking/finance, insurance, pension funds, insurance brokers and bank-owned data-processing centres. The number is lower than in the two preceding years, partly because resources have been transferred to the securities area. Two-thirds of the inspections are related to banks. The inspection programme designed for banks that are monitored on a continual basis was carried out as planned. These banks account for the majority of total assets in the bank sector. All major life insurance companies were inspected. Inspections were also carried out at non-life insurance companies, pension funds and insurance brokers based on individual assessment of the supervised entities in question.

On the securities side the number of on-site inspections was close to the figure for 1996. The focus is on reviewing investment firms' management and organisation.

On the estate agency and debt collection side, administrative tasks, especially the authorisation of new estate agencies, led to fewer on-site inspections in 1997 than in 1996.

On-site inspections of auditors were slightly fewer in number since substantial resources were targeted at the major auditing firms towards year-end.

Table 6: Number of on-site inspections by type of institution:

	1995	1996	1997
Banks/financial	57	50	40
Insurance	18	14	14
Insurance brokers	-	3	2
Pension funds	17	9	8
Investment firms[1]	32	15	19
Other securities institutions[2]	15	11	11
Loan & guarantee intermediaries	2	0	1
Estate agencies (excl. lawyers)	59	43	23
Debt collection agencies	41	30	10
Auditors	129	134	123
Data processing centres	-	2	2
Holding companies	-	1	0

Notes:

1) Previously stockbroking firms
2) Incl. management companies for securities funds

Table 7: Cases handled after delegation from the Ministry of Finance

	Savings-banks			Commercial-banks			Insurance-Companies			Finans-companiesf			Pension funds			in finan conglom.
	1995	1996	1997	1995	1996	1997	1995	1996	1997	1995	1996	1997	1995	1996	1997	1997
Articles	26	22	27	10	15	17	29	26	32	27	36	17	-	-	-	6
Own funds	6	8	9	8	8	11	4	3	9	10	8	8	93	42	71	5
Monitoring committee			1			1				1	1		-	-	-	-
Committee of shareholders' representatives/supervisory board			1			1	1		1	4			-	-	-	-
Organisational set-up		1	3		1	3		1	4	7			-	-	-	-

Twelve applications for registration as fund managers were approved in 1997. One undertaking has ceased this function.

Table 8: Cases in the accountancy and auditing field 1995-1997

	1995	1996	1997
Dispensation from Companies Act and Accounting Act	591	463	716
Complaints against late-filing penalty levied by Register of Company Accounts	498	758	309
Dispensation concerning auditors and audits	2	0	0
Dispensation from IT regulations	9	8	2
Appeals from applicants for authorisation as accountants	6	80	53

Increases of capital

- Banks

Four commercial banks were authorised to increase their share capital by a total of NOK 304.8 million in 1997. Increases of tier 1 capital came to NOK 270 million since one increase of capital was through retained profits. In 1996 three savings banks were authorised to increase their primary capital by NOK 247.5 million and, including premium, their tier 1 capital was increased by a total of NOK 417.5 million.

Three savings banks were authorised to increase their primary capital by up to NOK 240 million. In 1996 three savings banks were authorised to increase their primary capital by NOK 177.5 million. In 1997 six savings banks were authorised to allocate part of their profit for the year to the equalisation fund. Two such authorisations were granted in 1996.

Thirteen banks, of which six savings banks and seven commercial banks, were authorised to raise subordinated debt of up to NOK 8,124 million. In 1996 the equivalent figure was NOK 2,874 million, distributed on five savings banks and five commercial banks.

- Insurance companies

Three life insurance companies were authorised to increase their share capital by NOK 200 million. No life insurance companies increased their share capital in 1996. In 1997 two non-life insurance companies were authorised to increase their share capital by up to NOK 44 million. One unit-linked company received authorisation for a share capital increase of NOK 7.5 million. 1977 was these companies' first year of operation. In 1996 one non-life insurance company was authorised to increase its share capital by NOK 3 million.

No mutual insurance companies increased their guarantee capital in 1997 or in 1996.

Three insurance companies, all life insurance companies, raised subordinated debt worth up to NOK 1,286 million in 1997. The equivalent figure for 1996 was NOK 1,070 million distributed on one non-life and one life insurance company.

- Finance companies

In 1997 Kredittilsynet approved applications from eight finance companies to increase share capital and raise subordinated debt. The increases totalled NOK 938.8 million, comprising NOK 178.8 million in share capital increases and NOK 760 million in subordinated debt. In 1996 eight finance companies were authorised to increase their capital by NOK 325.9, of which share capital increases accounted for NOK 35.4 million.

- Parent companies in financial conglomerates

Five parent companies in financial conglomerates were authorised to expand their own funds by NOK 2,440.5 million in share capital and NOK 150 million in subordinated debt. Including premium, their tier 1 capital was increased by a total of NOK 3,042 million.

In 1996 three parent companies in financial conglomerates increased their own funds by about NOK 308 million in share capital and NOK 83 million in subordinated debt.

Establishment of branches and cross-border activities pursuant to EEA rules

In 1997 two Norwegian banks and one credit institution notified cross-border operations within the EEA. Four banks and one credit institution reported the establishment of branches in Norway. The credit institution in question is a subsidiary due for conversion in 1998. One bank is converting a representative office into a branch. Kredittilsynet received 14 new notifications from credit institutions wishing to offer cross-border services into Norway from other EEA states, three notifications of change of status and one notification of closure.

In 1997 one Norwegian non-life insurance company opened a branch in another EEA state. Three Norwegian non-life insurance companies reported cross-border activities. Four insurance companies opened branches in Norway, one of which will also provide life insurance. Moreover, 55 insurance companies announced their wish to offer cross-border services into Norway. Six of these are life-insurance companies. One non-life company notified cessation of cross-border activities in 1997.

Top: «Blue Landscape I», tapestry, 100x200, 1990-92.
Property of Royal Norwegian Air Force Academy, Stavern.

Middle: «Blue Landscape II», tapestry, 100x200, 1990-92.
Property of Royal Norwegian Air Force Academy, Stavern.

Bottom: «Blue Landscape III», tapestry, 100x200, 1990-92.
Property of Royal Norwegian Air Force Academy, Stavern.

Banking, finance and insurance

Supervision of banking, finance and insurance in Norway is three-pronged. Alongside on-site inspections and documentary supervision, Kredittilsynet performs administrative and research assignments, and also frames and interprets rules and regulations.

Continued enhancement of reporting routines for the insurance industry and credit institutions in 1997

Supervision of financial strength and profitability
Kredittilsynet monitors compliance with capital and prudential requirements on a continual basis. This includes capital adequacy requirements for all financial institutions, solvency margin requirements for insurance companies and liquidity requirements for and constraints on banks' share- and property holdings (cf. the chapter «Current trends and analyses» above).

Since 1996 work has been under way on developing an up-to-date, simplified system for insurance companies' reporting to the authorities whereby companies will only need to report to a single database. The project is a collaboration between Kredittilsynet, Statistics Norway, Norges Bank and the Association of Norwegian Insurance Companies. Regular reporting under the new system will start in the first quarter of 1998. In 1997 a substantial effort was made to achieve further efficiency gains in the reporting of data by credit institutions to the authorities. The aim is to have banks, mortgage companies and finance companies carry out the bulk of their reporting by mechanical means to a single database. Kredittilsynet is collaborating with Statistics Norway and Norges Bank to this end.

Macroeconomic surveillance
As part of its macroeconomic surveillance, Kredittilsynet focuses on the danger of stability problems throughout the financial industry or parts of it. The macro programme draws on resources from several departments at Kredittilsynet and supplements the current supervision of individual institutions. Half-year reports are submitted to Kredittilsynet's executive board and are discussed at regular meetings with Norges Bank. The macroeconomic surveillance work is also discussed with the Nordic countries' supervisory authorities. The Ministry of Finance is kept informed.

In the macro programme current indicators monitor the trend in financial vulnerability in both the financial and non-financial sectors (households and firms) in the light of the trend in the Norwegian and the international economy. Indicators to capture current trends in financial markets are being developed on a continual basis. Where future prospects are concerned, the focus is on the uncertainty of the cyclical trend and consequences for the financial industry. The programme also focuses on structural trends in the financial industry. In this connection a seminar for Nordic supervisory authorities in 1997 addressed the trend in banks' interest margins and Nordic households' saving pattern, and a closer look was taken at foreign institutional investors in the Norwegian stock market.

Supervision of financial conglomerates
The growing emergence of financial conglomerates has raised the question of whether current monitoring is keeping pace with developments. The various elements required for supervision of such conglomerates have been pinpointed and improvements considered. Supervision of financial conglomerates is organised on a team basis with an inspector responsible for the conglomerate as such and the rest of the team covering the various companies within the conglomerate. Supervision follows a plan in which all important functions are checked at regular intervals.

- Organisation of asset management in financial conglomerates
Major financial conglomerates in particular have been concerned to assemble the asset management expertise to be found in the various parts of the conglomerate in order to enhance the quality of the work done and to cut costs. This applies particularly to the management of securities, but also to loans and management of real property. The situation raises issues about the rules applying in Kredittilsynet's area of supervision. Since asset management must be regarded as part of financial institutions' core activity, it cannot be delegated to other parties without the approval of the licensing authority. This applies regardless of whether the financial institution purchases asset management services from an undertaking in the same group or from an undertaking outside the group. Kredittilsynet wants to see financial institutions retain sufficient competence to ensure proper steering and control of asset management. Moreover, persons who take on asset management assignments must be legally entitled to do so. In cases where an undertaking performing asset management assignments for other parties has clients both inside and outside the conglomerate, Kredittilsynet has sought to prevent possible conflicts of interest, and to safeguard information barriers by attaching conditions to any licences granted.

In 1997 Kredittilsynet handled a number of major cases involving possible mergers and buy-outs of financial institutions.

- Storebrand

In the spring of 1997 RGI ASA acquired a substantial holding of preference stock in Storebrand ASA. According to Storebrand's articles of association preference shares are redeemable at a fixed price at Storebrand's ordinary general meeting in 1998 or 1999. If they are not redeemed in 1999 at the latest, they will be converted to ordinary shares. Under Storebrand's articles of association, owners of preference shares may not participate in any decision regarding their redemption, nor may they do so by voting for ordinary shares. Aker RGI questioned the validity of this provision of the articles of association. The issue centred on whether, under the articles of association, preference capital should not count as represented capital in relation to the Companies Act's requirement of a majority vote to pass amendments to the articles of association, and whether this interpretation contravenes the Companies Act.

Storebrand's articles of association are approved by Kredittilsynet. Prompted by the uncertainty that arose regarding the validity of the articles' provisions governing the redemption of preference shares, Kredittilsynet took a closer look at the provisions in question. Kredittilsynet considered that the provision of the articles that denies owners of preference shares influence in the question of redemption in relation to the Companies Act governs disqualification in connection with the decision regarding redemption. Since the Companies Act does not prohibit this type of disqualification provision, Kredittilsynet found no reason to review its decision to approve Storebrand's articles of association.

Shortly before Aker RGI acquired a substantial holding of preference shares in Storebrand, Aker RGI-'s main shareholder, Mr. Kjell Inge Røkke, acquired 10 per cent of the shares in Storebrand through two wholly-owned limited companies. Under the provisions of the Financial Institutions Act, no party may own more than 10 per cent of a financial institution. Kredittilsynet concluded that Mr. Røkke wielded decisive influence in Aker RGI, that Aker RGI's shares in Storebrand should be considered on a par with Mr. Røkke's shares, and that Mr. Røkke and Aker RGI in combination were not entitled to own more than 10 per cent of the shares in Storebrand. Storebrand was therefore instructed not to approve Aker RGI as a shareholder in the company. This was in line with the view of Storebrand's board of directors. The decision was unsuccessfully appealed to the Ministry of Finance.

As a result of the above decision Aker RGI sold its shares in Storebrand but concurrently secured a repurchase right to the shares through option agreements. After thorough consideration Kredittilsynet concluded that the option agreements ran counter to earlier decisions in the affair and ordered Aker RGI to cancel the option agreements. This order was not appealed, and Aker RGI has complied with it.

- Sparebankgruppen AS's offer to purchase all shares in Fokus Bank

On 14 April 1997 Sparebankgruppen AS launched a bid to take over all shares in Fokus Bank ASA. The time-limit for acceptance was extended three times up to 18 July 1997. Kredittilsynet did not consider the financial risk assumed by the four banks making up Sparebankgruppen to have been unreasonable. The harmful effects for Fokus Bank in the initial phase were not regarded as sufficiently serious on their own to warrant supervisory measures. However, such a long-lasting offer period and the resultant uncertainty could have prompted concern for Fokus Bank's customer relations, funding situation etc., at the same time as it gradually became clear that Sparebankgruppen had little chance of rallying sufficient support for its offer. For this reason Kredittilsynet on 16 June 1997 asked Sparebangruppen to review the situation with an eye to withdrawing its takeover bid.

Sparebankgruppen AS and this company's proprietary banks acquired about 10 per cent of the shares in Fokus Bank ASA in connection with the group's attempt to buy out Fokus Bank ASA. They also acquired American-style options entitling them to further acquisitions of Fokus shares. At the end of June 1997 Sparebankgruppen withdrew its bid to take over all shares in Fokus Bank ASA. Sparebankgruppen and the proprietary banks still held options on 11,385,174, or about 17 per cent, of Fokus shares.

Against this background Kredittilsynet took a close look at whether the option agreements were in contravention of the Financial Institutions Act, section 2-2, cf. section 2-6. Sparebankgruppen AS and the proprietary banks were notified by letter of 29 October 1997 that Kredittilsynet were considering a move to instruct option holders not to renew the option agreements beyond their expiry dates, i.e. 1 December 1997 and 24 February 1998. The background to Kredittilsynet's approach was that the group still owned 10 per cent of the shares in Fokus Bank ASA and also held long-term options which could be exercised at any point in the agreement period. The option agreements no longer formed part of an attempt to acquire all shares in Fokus Bank ASA. Sparebankgruppen AS declared on its own behalf and on behalf of the proprietary banks by letter of 5 November 1997 that neither Sparebankgruppen AS nor its owners would hold American-style options on shares in Fokus Bank ASA after 24 February 1998. Kredittilsynet took cognizance of this. In light of the above, the investigation into these option agreements was closed with no need for orders to be issued to Sparebankgruppen AS or their owners.

- Conglomerate model DnB-Vital

In line with the conditions set by the Ministry of Finance for the acquisition of Vital Forsikring, Den

Kredittilsynet handled a series of major cases involving possible mergers and buy-outs of financial institutions

New regulations on individual pension agreements (IPAs) made by Kredittilsynet in 1997 pursuant to the Tax Act

Six insurance companies applied for and received authorisation to set up unit-linked companies

norske Bank applied for approval of the conglomerate's organisational set-up. DnB wishes to continue the current conglomerate structure, i.e. with the bank as the ultimate parent company owning Vital through an intermediate holding company. Kredittilsynet dealt with the application and advised the ministry to require the DnB conglomerate to be organised on a holding model. Kredittilsynet's recommendation made special reference to statutory and supervisory factors, including considerations of financial strength. The application is being considered by the Ministry of Finance.

- DnB's acquisition of BN-bank

In May 1997 Den norske Bank applied for permission to acquire Bolig- og Næringsbanken (BN-bank). Kredittilsynet concluded that neither consideration for competitive conditions on the financial market nor structural policy factors prevented authorisation being given, and recommended the Ministry of Finance to grant a licence. In Kredittilsynet's view a licence should be conditional upon a plan being drawn up with a view to bringing DnB's tier 1 capital after acquisition up to the same level as at 31 December 1996 within a specified date. The Financial Institutions Act prevents a bank from owning another bank. However, Kredittilsynet recommended that dispensation be given for a period of one year. This period can be extended if DnB applies for authorisation to convert BN-bank to a credit institution.

New pension saving reforms

On 25 September 1997 the Ministry of Finance laid down new regulations on individual pension agreements (IPAs) pursuant to the Tax Act. The regulations are based on the Storting's treatment of the IPA scheme in June 1997. The regulations replace the earlier regulations on personal pension insurance pursuant to the Tax Act and entail extending the tax allowance pursuant to section 44, subsection 1, of the Tax Act to include specified products offered by other banks and management companies for securities funds. IPAs can be offered both as pension insurance and pension saving. Pension saving can be offered by insurance companies, banks and securities funds. Pension insurance can be offered by insurance companies, inter alia as unit-linked life insurance. Kredittilsynet assisted the ministry in framing the regulations.

- Unit linked companies

After the changes to the rules making it possible to establish unit-linked life insurance companies, Kredittilsynet in 1997 asked life insurance companies wishing to establish such special-purpose companies to submit applications early enough to enable them to be dealt with and presented to the Ministry of Finance collectedly. It is not possible to offer these products other than through establishing special companies for the purpose. Six companies submitted applications to establish such unit-linked companies, all of which were granted. During the autumn Kredittilsynet closely monitored the establishment of these companies, approved their articles of association and examined their product statements etc.

Table 9: Companies which applied for and received authorisation to set up unit-linked companies

Applicant's name	Name of new company
Christiania Forsikring AS	K-Fondsforsikring AS
David Livsforsikring AS	SpareBank 1 Fondsforsikring AS
Gjensidige Livsforsikring	Gjensidige Investeringsvalg Forsikring AS
Samvirkegruppen AS (now Landsbanken Samvirkegruppen AS)	Samvirke Fondsforsikring AS
Storebrand ASA	Storebrand Fondsforsikring AS
Vital Forsikring Holding AS	Vital Fondsforsikring AS

Technological challenges - IT supervision

Separate IT supervision was carried out at some of the biggest institutions. The supervision concept, which focuses on administration, development, operation, and maintenance of the central systems, was introduced in 1996 and further developed in 1997. A standardised programme for monitoring the IT area in medium-sized and small institutions was also devised. This programme will be initiated as part of the ordinary supervision as from 1998.

In view of the rapid technological development in the financial sector, which is of consequence for both product design and distribution, Kredittilsynet's resources in the IT field have been strengthened. Risk assessments and surveillance of technological infrastructure in the financial market will be given priority, in parallel with the development and administration of rules in this area.

Supervision of market risk

Capital adequacy rules for market risk (the «CAD» regulations, based on the Capital Adequacy Directive) were adopted on 17 July 1996. Institutions whose portfolio is above a certain size are required, based on detailed technical rules, to calculate capital requirements to cover risk of loss due to value changes in the portfolio. As from the fourth quarter of 1996 institutions have reported to the authorities in conformity with the new CAD regulations, while credit institutions with relatively small trading portfolios can still report in conformity with the earlier capital adequacy regulations. All institutions are required to report currency position risk for their entire operations in conformity with the rules of the CAD regulations.

The reporting shows that credit institutions' market risk is very moderate measured in relation to the credit risk inherent in the institutions' other activities.

About 80 per cent of commercial banks reported their activity in the trading portfolio in conformity with the CAD regulations. For these banks position risk linked to debt instruments accounts for more than half of the measurement base for the trading portfolio (incl. foreign exchange risk), while counterparty risk, mainly in connection with OTC derivatives, accounts for the bulk of remaining market risk.

Only about 15 per cent of savings banks reported their activity in the trading portfolio in conformity with the CAD regulations, although this group accounts for about 70 per cent of savings banks' aggregate measurement base. Savings banks' measurement base for the trading portfolio (incl. foreign exchange risk) accounts for an even smaller share of the total measurement base than it does in the case of commercial banks; for savings banks position risk on equity capital and debt instruments is about equally large and together constitute the most important elements for the trading portfolio.

To obtain a picture of what consequences the new rules have had for capital adequacy, nine of the biggest banks were asked to calculate their capital adequacy ratios for the second quarter of 1997 according to both the current and the earlier rules. The nine banks' capital adequacy averaged 11.0 per cent under the current rules, compared with 11.2 per cent under the earlier rules. In other words the introduction of the CAD requirements obliges banks to strengthen their capital ratios by 0.2 per cent in order to maintain the same level in relation to the minimum requirements.

In order to obtain better statistics of various groups of supervised entities' operations in derivatives markets, Kredittilsynet is working on a programme for reporting outstanding derivative positions for credit institutions, investment firms, insurance companies and pension funds. The reporting will be largely based on a joint recommendation from the Basle Committee on Banking Supervision and the technical committee of the International Organisation for Securities Commissions (IOSCO), and will be introduced in the first half of 1998.

Administration of regulations and framing regulations

The Act on Guarantee Schemes for Banks and Public Administration etc., of Financial Institutions went into force on 1 January 1997. The Act protects all deposits with Norwegian banks up to NOK 2 million per investor per bank. The Act enables branches of foreign banks to join the scheme on a voluntary basis. The arrangement involving two separate funds for savings banks and commercial banks respectively is retained. The banks pay premiums to the guarantee funds based on their risk-weighted total assets, total deposits and tier 1 capital adequacy. Kredittilsynet has assisted the Ministry of Finance in framing regulations on commencement, transitional rules and charges etc. Articles of association for both guarantee funds have now been drawn up and approved.

Regulations on supervision and control of credit institutions' and securities funds' major loans etc., were laid down on 23 April 1997. Kredittilsynet's draft regulations were submitted to the Ministry of Finance on 19 April 1994. The regulations state that institutions may not lend in excess of 25 per cent of their own funds to any one customer. The regulations also contain limits to institutions' aggregate holding of major loans. A loan is defined as major if it constitutes 10 per cent or more of own funds. In September Kredittilsynet circulated a draft reporting form for major loans to relevant trade organisations for comment. The reporting form was concurrently sent to the biggest commercial banks, savings banks, finance companies, mortgage companies and investment firms with a view to test reporting for the fourth quarter of 1997. Regulations on reporting credit institutions' and investment firms' major loans were laid down on 10 December 1997. All institutions encompassed by the regulations report as from the fourth quarter of 1997.

Less stringent rules were introduced for loans to companies in the same conglomerate. Limits on loans between parent companies and subsidiaries have in reality been lifted. The regulations were not given effect for insurance companies. Kredittilsynet called attention on several occasions to the detrimental nature of these circumstances and warned against the solutions ultimately chosen by the Ministry of Finance.

The amendments of June 1997 to the Securities Trading Act created the legal clarification necessary to give netting agreements effect for the purpose of calculating capital adequacy requirements for financial institutions and investment firms. Against the background of the law amendments Kredittilsynet proposed an amendment to the capital adequacy rules entailing implementation of the so-called netting directive. Netting agreements reduce credit risk incurred in trading in OTC derivatives, and the proposed amendments to the capital adequacy rules take account of this reduced risk by requiring the capital charge to be calculated on the basis of the net asset position vis-à-vis the counterparty.

The regulations of 18 September 1995 on division of insurance into classes for licensing purposes divide insurance into a specified number of classes. The regulations have been adapted to EU Council Directive 79/267/EEC, article 1 and the annex. In 1997 Kredittilsynet completed the implementation of the regulations for insurance companies. In the course of the year Kredittilsynet also brought life insurance companies' licences into line with the classification set out in the council directive, cf. regulations of 18 September 1995 on division into insurance classes, section 2. Since existing licences were assumed to be in life insurance class I, companies had to apply for new licences for all other insurance classes. Initially it was only necessary for companies to apply for licences for class V - management of pension funds' resources. During 1997 Kredittilsynet adopted guidelines for dealing with these cases. Kredittilsynet also dealt with seven applications for licences for class VI - capitalisation products.

The Act on Guarantee Schemes for Banks and Public Administration etc., of Financial Institutions went into force on 1 January 1997. The Act protects all deposits with Norwegian banks up to NOK 2 million per investor per bank

Kredittilsynet continued work on a supervisory programme for insurance brokers' firms in 1997

In 1997 Norway implemented the final parts of the third generation directives for both non-life and life insurance. In other words the requirements of EU rules on the insurance side are now fully implemented in Norwegian legislation in this area. On 23 April 1997 the Ministry of Finance laid down new regulations on insurance companies' asset management. Kredittilsynet sent its recommendations to the ministry on 13 June 1994. The new regulations incorporate adjustments to EU rules. Kredittilsynet worked on certain matters of interpretation and drew up a draft circular in this connection which will be circulated early in 1998.

On 15 September 1997 the Ministry of Finance laid down new regulations on premiums and legal reserves in life insurance. Kredittilsynet's recommendations were sent to the ministry on 13 June 1994. These regulations replace earlier regulations on premiums in life insurance and formalise the requirements imposed by EU's life insurance directives as regards premium fixing as well as technical provisions in life insurance.

Regulations on insurance companies' asset management set a ceiling of 20 per cent of insurance companies' technical provisions (in the wide sense) that can be invested in shares. A proposal from the Ministry of Finance to review this rule was circulated for comment in the autumn of 1997 with 1 January as the deadline for submissions. Kredittilsynet recommends raising the ceiling to 35 per cent.

In 1997 Kredittilsynet continued work on a supervisory programme for insurance brokers' firms. A large number of cases were dealt with in connection with regulations of 24 November 1995 on insurance broking.

Kredittilsynet also devoted substantial resources to monitoring and analysing the major non-life insurance companies' technical provisions and own funds in 1997.

The technical reporting committee in non-life insurance continued its work in 1997 in accordance with its mandate. The committee was especially concerned with further developing methods for calculating minimum requirements as to technical provisions for occupational injury insurances. In this connection the committee was assigned the specific task of devising a system for distinguishing between occupational injuries and occupational diseases for accounting and provisions purposes and to assess the possibilities for improving the method used to calculate refunds to the National Insurance Administration.

In March 1997 Kredittilsynet organised the final meeting of the Müller Group, appointed by the EU Conference of Insurance Supervisory Authorities. The group, charged with putting forward proposals for updating/modernising the EU solvency margin rules, presented its final report at the Dublin Conference of Insurance Supervisory Authorities in April 1997. An expert group under the EU Commission has continued this work and is expected to present proposals for revising the solvency margin rules in the spring of 1998.

In 1997 Kredittilsynet also dealt with a large number of cases coming under regulations of 28 June 1968 on private service pension schemes pursuant to the Tax Act. In 1997 three pension schemes (including one municipal pension scheme) and seven pension funds were terminated.

In 1996 the Municipality of Oslo approached the Ministry of Finance to enquire whether the Oslo Municipal Pension Scheme was a pension scheme in accordance with the Insurance Activity Act and therefore subject to the pension scheme regulations. Oslo Municipality contended that the pension scheme is not subject to the Insurance Activity Act, and that the municipality was therefore free to decide whether to build up the pension scheme for municipal employees on an insurance-technical basis.

After thorough assessment of Oslo Municipal Pension Scheme, Kredittilsynet informed the Ministry of Finance that the scheme, like all other municipal pension schemes, has to be regarded as a pension scheme under the provisions of the Insurance Activity Act.

The so-called «transfer» regulations in life insurance state that the time-limit for transferring funds is from two to eight months, depending on the amount of funds to be transferred. Moreover, transfer shall take place upon expiry of the insurance at the earliest. The question has been raised of whether a life insurance company can set a different time-limit for transfers than that set out in the regulations. The background is that pension schemes run by KLP forsikring (a mutual life insurance company for the public sector) are entitled to give one year's notice of termination of an insurance agreement prior to termination at the end of the calendar year. Kredittilsynet took up with the Ministry of Finance the question of whether the intention behind policyholders' right to transfer funds calls for harmonisation of the rules governing notice in the Insurance Agreement Act with the rules on settlement deadlines in the «transfer» regulations. An amendment to the «transfer» regulations has been proposed to prohibit notice of termination set out in insurance terms or insurance agreements exceeding that set in the regulations. The proposal was circulated for comment in September 1997.

- Act on Company Pensions

Kredittilsynet's board chairman, Mr. Erling Selvig, professor and doctor at law, heads a government-appointed committee charged with framing a new act on company pensions. Kredittilsynet is also represented by two members and a secretary. The act will replace regulations of 28 June 1968 on private service pension schemes pursuant to the Tax Act. The committee was originally due to present its recommendations in February 1997. However, the issues proved more numerous and more complex than first thought and the committee is now expected to present its recommendations in February 1998.

- Regulations on calculating the taxable portion of life annuities

Unit-linked companies have essentially utilised their licences to offer annuity insurances in accordance with regulations of 21 December 1990 on calculation of the taxable portion of life annuities. This, in addition to increased sales of annuity insurance by established life insurance companies, has accentuated the need for a review of products offered in the market with a view to verifying whether they comply with the regulations and on that basis qualify for favourable tax treatment pursuant to section 42, seventh paragraph, of the Tax Act. In 1997 Kredittilsynet had extensive correspondence with individual companies on such matters, and was moreover asked by the Ministry of Finance to review the regulations and products on a broad basis.

- Costs in life insurance

On 14 February 1997 Kredittilsynet forwarded an extensive report on costs in Norwegian life insurance to the Ministry of Finance. The report, initiated by the ministry in 1995, was broad-based but focuses on the need to review the requirement that all establishment costs should be paid upon entry into the contract (cf. regulations to section 7-5 of the Insurance Activity Act). The justification is partly to avoid detrimental cross-subsidisation, partly to increase the attractiveness of long-term saving in life insurance.

- New legislation on guarantee schemes

In September 1997 Kredittilsynet sent a proposal for new rules for guarantee schemes in insurance to the Ministry of Finance. The recommendation restricts the scope of the scheme compared with the Bank Law Commission's study of guarantee schemes. Kredittilsynet's proposal recommends restricting the scheme to insurances contracted by private individuals and smaller and medium-size companies.

- Non-life and credit insurance companies' guarantee schemes

Kredittilsynet acts as secretariat to the boards of the Non-life Insurance Companies' Guarantee Scheme and the Credit Insurance Companies' Guarantee Scheme. In 1997 the Supreme Court found in favour of the contention of the Non-life Insurance Companies' Guarantee Scheme that reinsurance claims should not have priority on a par with direct insurance claims.

«Tecum principium», tapestry, 150 x 100, 1983.
In a private collection.

Accounting

Kredittilsynet is responsible for framing and updating accounting rules for banking and insurance since these institutions are excepted from certain provisions of the Accounting Act. Supplementary guidelines for accounting are also drawn up for other entities under Kredittilsynet's supervision as and when required. Moreover, Kredittilsynet performs a number of other administrative tasks within the general field of accounting, including the granting of dispensation from the Accounting Act and the loose-leaf regulations.

The obligation to investigate and report suspicious transactions was extended in 1997, resulting in a steep increase in reports

In 1997 Kredittilsynet continued its work on accounting procedures in regard to financial derivatives. As a result of this work a report was produced on existing rules in this area in Norway and internationally. The report comments on current developments and on Norway's position in the international picture. In March a seminar was held attended by, among others, representatives of the FASB (Financial Accounting Standards Board, USA), the ASB (Accounting Standards Board, UK) and the IASC (International Accounting Standards Committee). The report is available as an offprint.

The study of accounting treatment of loan losses is due to be completed in 1998. It will serve as a basis for discussion of the loss regulations and alternative principles. Norwegian rules in this area are in conformity with accepted accounting standards and no amendments of significance are anticipated. However, this field is under debate both at home and abroad and it is important for Kredittilsynet to keep abreast of developments.

The accounting principles for banking and insurance differ in some areas, for instance in regard to valuation rules and presentation. This leads to uncertainties in regard to closing of accounts in conglomerates containing both types of institution. In light of the trend towards mixed financial groups Kredittilsynet is working on a new body of rules for such groups. This also has a bearing on Kredittilsynet's work on changes in the accounting rules in the financial sector in general that can be expected as a result of a new accounting act.

Kredittilsynet has noted a marked increase in the number of applications for dispensation from provisions of the Accounting Act. This has to do with increased internationalisation and technological developments, and refers above all to applications to have accounting carried out abroad or in foreign currency, and to safekeeping of accounting documentation. Kredittilsynet also received a growing number of enquiries about the lawfulness of new electronic accounting systems.

In its capacity as supervisory body for the Accountants Authorisation Board, Kredittilsynet levelled criticism in 1996 against the authorisation scheme and associated administrative functions. In 1997 Kredittilsynet concluded that several aspects of the scheme had shown improvement, but noted that a permanent solution had still not been found for important aspects related to the register of accountants, and that a supervisory scheme for accountants was still not in place. Fifty-three appeals against decisions of the Board were processed in 1997. Four appeals were successful.

Based on a consultation memorandum from the Ministry of Finance, Kredittilsynet submitted a lengthy consideration of the future of the authorisation scheme.

Since 1990 penalties have been imposed on board chairmen of companies for late filing of accounts with the Register of Company Accounts. In 1997 Kredittilsynet handled 309 complaints against the Register's decisions to impose late-fining penalties. Kredittilsynet reversed the Register's decision in 17 cases. Kredittilsynet recommended that newacounting legislation should allow wider scope for exercise of judgement when processing applications for remission of late-filing penalties.

Money laundering

On 1 January 1997 the obligation to investigate and report suspicious transactions to ØKOKRIM (the National Authority for Investigation and Prosecution of Economic and Environmental Crime) was extended to Norges Bank, Postbanken, management companies for securities funds, investment firms, insurance brokers, project brokers, currency brokers and a number of other undertakings. The reporting requirement was also extended to suspicious transactions related to proceeds of all criminal acts unless there was reason to believe that the proceeds derived from one or more acts which by law could not attract a severer penalty than six months' imprisonment. In 1997 institutions filed 727 reports of suspicious transactions with ØKOKRIM. This was an increase of 563 reports on the 164 reports filed in 1996. The increase is related to the extension of the reporting requirement and to the increase in the number of institutions subject to the requirement in 1997. A relatively large number of reports are filed by commercial banks. Some institutions were summoned to Kredittilsynet to explain their routines for reporting suspicious transactions. Kredittilsynet wishes to place a greater focus on dissimilar reporting routines among institutions reporting to Kredittilsynet.

«La mento di Olympia», tapestry, 150 x 1OO, 1983.
Property of Telemobil, Oslo.

Auditing

Auditor supervision entails supervision of registered and state-authorised auditors, as well as auditing firms, listed in the register of auditors. Supervision includes verifying that auditing activity is in conformity with the requirements of law, regulations and adopted auditing standards. Kredittilsynet is also responsible for auditor authorisation and for the register of auditors.

Draft for new auditors act presented in January 1997

As in previous years, Kredittilsynet performed all-round supervision of auditors and auditing activity. In addition to relatively extensive supervision of auditor categories where auditing is generally found to be of poor quality, supervision formed part of the processing of complaints against individual auditors. Although the number of complaints against auditors rose from 16 in 1996 to 29 in 1997 complaints are still at a far lower level than a few years ago. Kredittilsynet also initiated a large-scale general supervision of the biggest auditing firms. These firms operate a broad range of activities and are playing an increasingly important role in the economy. This particular project is expected to be completed in the course of 1998.

Statistics on disciplinary measures are shown in table 10. It may be noted that measures targeted at registered auditors mainly refer to auditors on a transitional scheme. It is still the case that a relatively large number of auditors opt to hand in their licence after receiving notice of inspection. This is in turn related to the priority given to supervision of the weakest auditor groups.

Documentary supervision was introduced. The purpose of this type of supervision is to establish a basis for organising and implementing on-site inspections and to provide a basis for apportioning Kredittilsynet's expenditure on supervised entities. It also provides useful information on the Norwegian auditing profession and the nature of the activities carried out, including organisational set-ups and ownership structure.

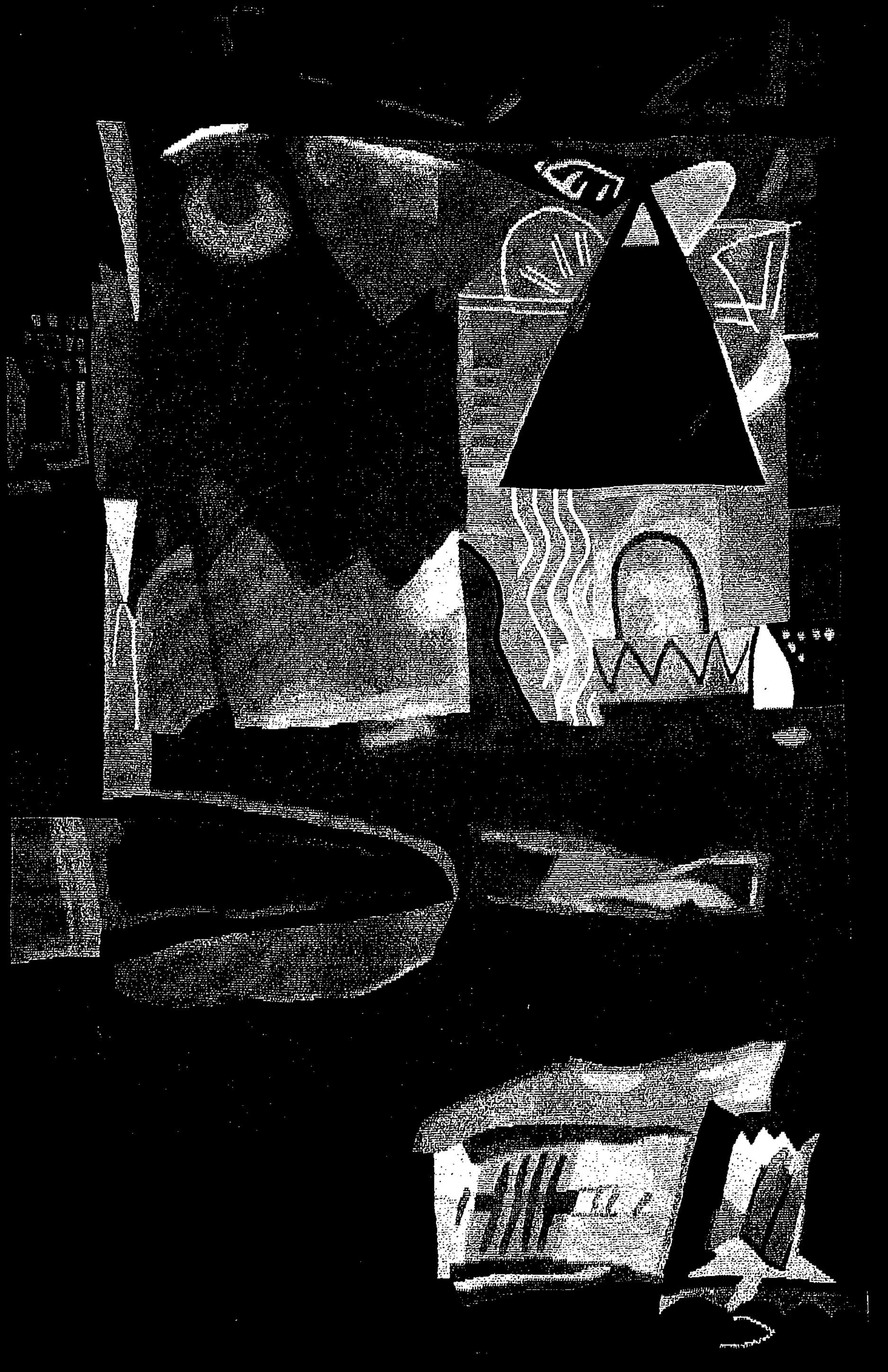
A draft auditors act was introduced in January. Kredittilsynet submitted a lengthy consultative statement in which it recommended removing the two chapters on supervision of auditors from the new act, leaving the Act on the Supervision of Credit Institutions, Insurance Companies and Securities Trading as the sole legal basis for supervision of auditors.

Kredittilsynet's submission otherwise comes out against the notion that Kredittilsynet should be responsible for dealing with complaints from users of auditing services inasmuch as monitoring the auditor profession should remain a supervisory task pure and simple. Kredittilsynet is also opposed to the establishment of an independent auditor committee since the Ministry of Finance should in principle be the paramount authority and complaints instance in this connection. In all other respects Kredittilsynet endorses the study presented together with the draft auditors act.

Table 10: Disciplinary measures etc., in 1995-1997 distributed on state-authorised (SA) and registered (RA) auditors

	Licence withdrawn		Stern reprimand		Reprimand criticism		Total		Satisfactory/		Grand total
	SA	RA	SA	RA	SA	RA	SA	RA	SA	RA	
1995	0	6	5	20	7	12	12	38	31	27	108
1996	0	3	5	20	17	31	22	54	18	35	129
1997	0	9	4	18	13	33	17	60	15	9	101

* Note that Kredittilsynet's critical remarks resulting from supervision are included in the column shown since such remarks are not to be regarded as a sanction. This entails a change in relation to earlier presentation of statistics.



«Historical», tapestry, 280 x 130, 1985.
Property of Østfold County Municipality.

Securities trading

Supervision of the securities market comprises supervision of institutions, their financial position and market behaviour, and of market players' compliance with other market rules.

Main priorities
Work in the securities area was strengthened in 1997 through the establishment of four new posts at senior level and in-house redeployment of expertise. The new posts are assigned particular responsibility for monitoring on-site supervision, documentary supervision, administrative tasks and supervision of compliance with insider-trading and price-manipulation rules, as well as certain other market rules. The new posts were established to ensure that all Kredittilsynet's tasks in the securities area receive adequate priority and attention, also in periods of heavy pressure of work.

Investment firms:
New legislation with regulations, including experience with recent years' rule changes

- New licensing rules
Amendments to the Securities Trading Act were passed by the Storting on 7 June 1996. The amendments entailed a new set of framework conditions for banks' operations in foreign-exchange and interest-rate derivatives and the activities of the earlier stockbrokers' firms. A transitional version of the new rules went into force on 31 December 1996.

The amendments required all existing firms to apply for a licence for the business they wished to pursue. The processing of applications from these firms was completed in the spring of 1997. A further 32 undertakings were licensed as investment firms during 1997. Five investment firms closed down in the course of the year.

- Business rules
The Act's business rules went into force on 31 December 1996. The amendments entailed that firms licensed as investment firms were given:

- Greater opportunity for own-account trading
- The opportunity to sell short
- he opportunity to borrow/lend financial instruments
- The opportunity to engage in lending up to certain limits

This liberalisation is largely matched by the following statutory requirements:

- As to capital
- As to the fitness of directors, management and substantial shareholders
- As to routines and internal organisation
- As to promoting investors' best interests

A new Securities Trading Act was passed by the Storting on 19 June 1997. The act went into force on 1 December 1997. Regulations with transitional provisions were laid down by the Ministry of Finance on 7 November 1997.

The act embodies the amendments implemented in 1996 and brings further changes to the rules on insider trading, notification duty, disclosure duty, prospectus requirements, derivatives trading and supervision, as well as new rules on market manipulation and netting of certain types of derivative contracts.

Amendments to Securities Trading Act adopted on 7 June 1996; a transitional version of the act's business rules took effect on 31 december 1996

Regulations laid down in 1997 pursuant to the Securities Trading Act

18 March 1997
Regulations on quarterly returns for investment firms (made by Kredittilsynet)

23 April 1997
Regulations on supervision and control of credit institutions' and investment firms' major loans etc., (made by Kredittilsynet)

11 June 1997
Regulations on minimum requirements as to internal rules for investment firms, financial institutions etc., on own-account trading in financial instruments for certain employees (made by Kredittilsynet)

In addition, regulations on clarification of control responsibility, documentation and confirmation of internal control were extended to investment firms and management companies for securities funds.

Work on own-account trading rules
Against the background of the circumstances brought to light in connection with R.S. Platou Securities AS's lead-manager assignment for the Norwegian Applied Technology (NAT) issue, the Ministry of Finance asked Kredittilsynet by letter of 27 February 1997 to review the need both for short-term and longer-term measures in relation to employees' own-account trading including interest conflicts, advantages conferred by one's position and misuse of information received by virtue of one's position.

Against the background of the NAT case, the Ministry of Finance asked Kredittilsynet to review the need for short-term and longer-term measures in relation to employees' own-account trading

As regards short-term measures Kredittilsynet framed two draft regulations restricting employees' right to engage in own-account trading. Regulations on own-account trading in financial instruments by employees in management companies for securities funds were laid down by Kredittilsynet on 6 June 1997, while regulations on minimum requirements as to internal rules for investment firms, financial institutions etc., on own-account trading in financial instruments by certain employees were laid down by the Ministry of Finance on 11 June 1997.

Kredittilsynet also carried out a preliminary legislative study which resulted in a proposal for more permanent measures. The study was transmitted to the Ministry of Finance on 3 April 1997. The proposal largely embodies the underlying approach upon which the draft regulations are based. The study concludes by recommending a series of selective and situation-specific trading prohibitions for employees who are engaged in securities trading in two or more institutions, in order to avoid conflicts of interest and unreasonable advantages. The Ministry of Finance circulated the legislative study for comment on 28 April 1997 setting 1 August as the closing date for submissions.

Noka Securities AS

Noka Securities AS went into receivership on 24 April 1997. The failure resulted from unauthorised own-account trading on the part of the erstwhile managing director. The affair came to Kredittilsynet's attention after an inspection in February 1997. Kredittilsynet asked the auditor to closely examine a number of customer trades. This led to the discovery of other concealed own-account trading which proved to have inflicted heavy losses on the firm. The former managing director was sentenced on 1 October 1997 in Oslo High Court for gross fraud, gross embezzlement, company fraud and forgery.

Because of its handling of the Norwegian Applied Technology (NAT) issue, R.S. Platou Securities A.S' authorisation to lead manage security issues was withdrawn by Kredittilsynet

NAT issue

In August 1996 R.S. Platou Securities AS agreed to lead-manage a public issue for the technology company NAT combined with a universal sale and a placing with NAT employees. The issue was heavily oversubscribed.

Against the background of the firm's statement to the Oslo Stock Exchange regarding allocation of the shares in NAT, Kredittilsynet made further investigations at R.S. Platou Securities AS and subscribers. Kredittilsynet brought to light a series of breaches of the Securities Trading Act and the Securities Funds Act. The violations involved tactical subscribing by employees, allocation of shares to employees and employees' close associates to the detriment of other subscribers, allocation to portfolio managers and their close associates with major customers of the firm to the detriment of the manager's's principals, and alteration of subscription forms, partly on the basis of selective information given to certain customers about the subscription process, partly without a prior order from the customer.

Against the background of the above, Kredittilsynet passed a resolution to withdraw R.S. Platou Securities AS' authorisation under the Securities Trading Act, section 3-1, first paragraph, subparagraph 4, *«underwriting in respect of issues or corresponding acquisition of financial instruments or the placing of such issues»*. The firm opted to cease all operations. Kredittilsynet's decision was appealed to the Ministry of Finance. The ministry found no reason to act on the appeal and confirmed Kredittilsynet's decision by letter of 1 December 1997.

Two cases affecting other firms were forwarded to ØKOKRIM with a request for investigation and possible prosecution. In both cases fines were handed down and accepted.

Active portfolio management

In the first half of December 1997, Bergen Fondsmeglerforretning AS's and Tekan Aktiv Forvaltning AS's licences to engage in portfolio management were withdrawn. Bergen Fondsmeglerforretning AS had delegated investment decisions (to among others Tekan Aktiv Forvaltning AS), thereby breaching the conditions of their licence. Tekan Aktiv Forvaltning AS's licence, which had yet to become operative, was withdrawn because they had engaged in unlawful portfolio management - i.e. taken investment decisions. Norse Securities AS opted against the background of the same circumstance as that brought to light in the case of Bergen Fondsmeglerforretning AS to hand in its licence to Kredittilsynet.

On-site inspection

With the introduction of new rules in the Securities Trading Act, on-site inspections focused more closely on overseeing the quality of firms' managerial staff and organisation as opposed to detailed supervision of compliance with rules.

Kredittilsynet carried out 19 on-site inspections of investment firms in 1997.

Documentary supervision

Documentary supervision in the securities field was given greater priority in 1997. Some central reports in this connection are briefly mentioned below:

- Reporting of capital adequacy for market risk etc., by credit institutions and investment firms (CAD)

The CAD regulations, which impose requirements as to investment firms' own funds based on their calculated risk exposure, went into force at the turn of the year 1996/97. The regulations and reporting in accordance with special rules are fairly complicated.

In general it can be said that much remains to be done at many investment firms before internal quality assurance of investment firms' calculations and reporting under the CAD regulations become satisfactory.

Some aggregates (and averages) reported by nonbank investment firms are shown on the next page.

- Quarterly returns by investment firms

As from the second quarter of 1997 Kredittilsynet switched from monthly reporting from investment firms to quarterly reporting. Firms are still experiencing start-up problems with the new regime.

- Reporting of employees' own-account trading
This reporting is scrutinised by Kredittilsynet using random checks.

Securities funds
In 1997 securities funds achieved strong growth of total assets. By the end of the third quarter total assets had grown to NOK 92.8 billion, i.e. an increase of NOK 27.9 billion. A large portion of the increase derives from return on invested capital. Net new subscription in securities funds in the first three quarters of the year came to NOK 13.7 billion.

Low interest on traditional bank deposits combined with recent years' high return in the securities market have prompted households and firms to increasingly channel their financial savings into securities funds. Channelling savings into securities funds enables the investor to benefit from share market growth, and resources have chiefly been placed in unit trusts.

The large number of new participants in the market for securities funds also requires management companies to assure the quality of information passed to investors. Kredittilsynet is particularly concerned that investors should be made aware of the risks inherent in investing in securities funds compared with ordinary bank saving.

At year-end 23 firms were authorised to manage a total of 224 securities funds. Moreover a large number of foreign managers reported cross-border activity. Hence a very large number of funds are available in the Norwegian market.

Upon the commencement of the Securities Trading Act of 19 June 1997, the right to market and mediate units in funds to management companies pursuant to special authorisation from Kredittilsynet was revoked. As a consequence the sales arms of securities funds can no longer actively market fund units since such activity requires a licence under the provisions of the Securities Trading Act. Firms may however continue to transmit orders for units in securities funds to management companies for such funds, provided no settlement is involved. Such activity does not require Kredittilsynet's authorisation.

Quarterly returns from management companies for securities funds
Reporting by management companies provides a basis for monitoring compliance with some of the requirements set out in the Securities Funds Act. Certain violations of the investment limits set out in the act were drawn attention to by Kredittilsynet over the year.

Overall figures for management companies are given in table 12:

Table 11: CAD reporting by investment firms as at 30.09.97

		30.09.1997
		(in thousands of kroner)
Own funds		1 228 386
Capital adequacy (weighted average)		27,5%
Measurement base		4 462 620
Including	-counterparty risk	709 296
	-settlement risk	135 514
	-position risk, debt instruments	484 420
	-foreign exchange risk	89 006
	-position risk, equity capital instruments	2 393 303

Source: Kredittilsynet

On-site supervision - management companies for securities funds
A total of 11 inspections were carried out at management companies for securities funds in 1997. Special emphasis was given to:

- strategy
- the directors' responsibility for operations
- the companies' handling of the strong growth in the number of unit-holders and invested funds
- compliance with investment limits

In the period ahead Kredittilsynet will continue to focus on the directors' role in management companies, especially in relation to internal control. Kredittilsynet will also scrutinise preparedness in the event of a sharp price fall in the market.

Transaction supervision
Kredittilsynet makes routine checks of transactions in the securities market ahead of and at the time of the publication of events which may be assumed to have a crucial effect on the pricing of securities. Investigations will typically be made upon suspicion of illegal insider trading, trading in «red periods», and suspicion of price manipulation.

In 1997 several cases of suspected illegal insider trading were investigated without being referred to ØKOKRIM. One case in which attempts at price manipulation were suspected was referred to ØKOKRIM in the autumn of 1997.

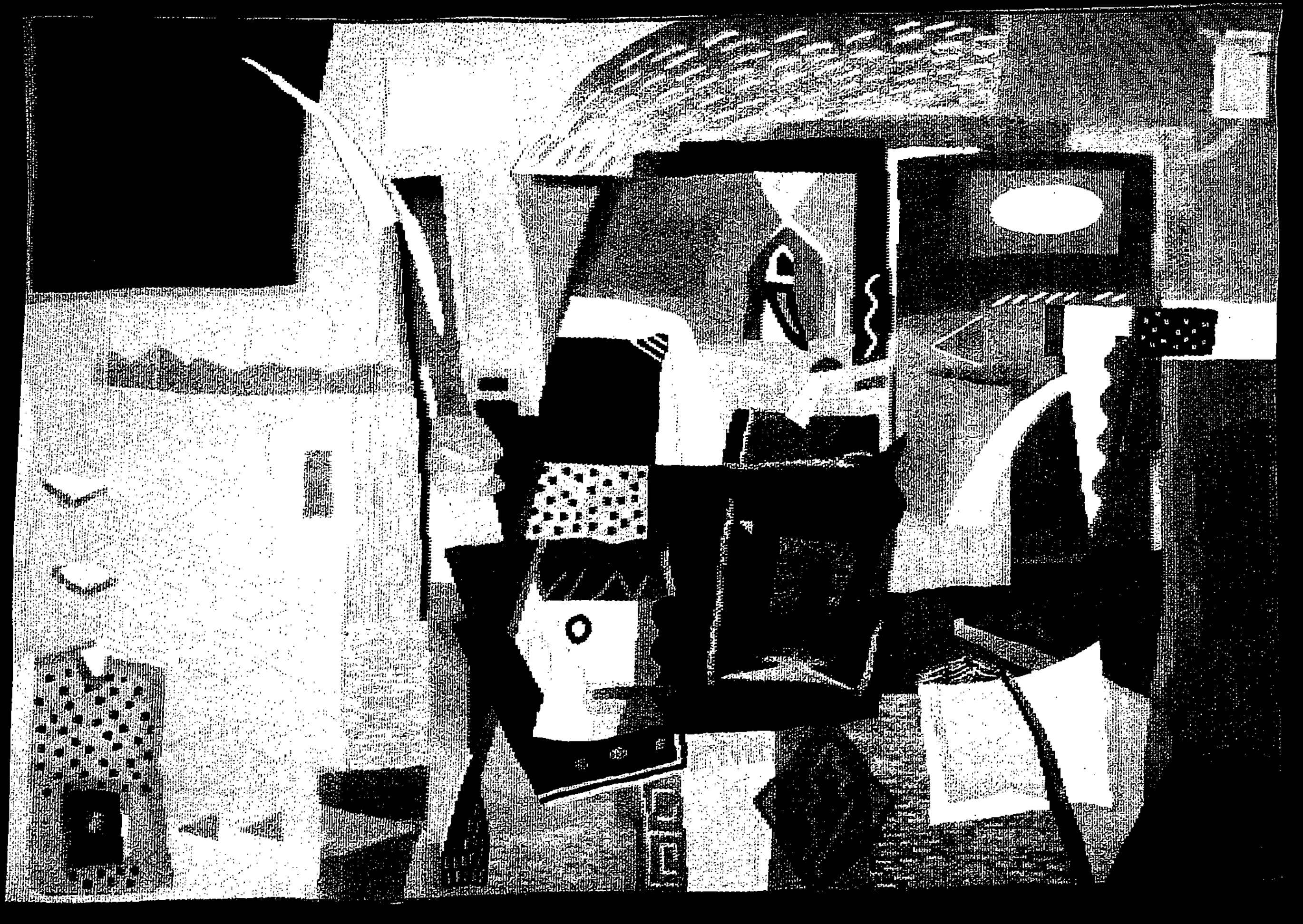
Table 12: Results of management companies for securities funds

	1995	1996	Pr. 30.09.97
Operating income	510 000	753 000	940 184
Operating profit	38 000	165 000	355 388
Operating profit in % of income	7%	22%	38%

Source: Kredittilsynet

Low interest on traditional bank deposits prompted households to channel their savings into securities funds

Kredittilsynet is particularly concerned that investors should be made aware of the risks inherent in investing in securities funds compared with ordinary bank saving



«Unity black and yellow», tapestry, 140 x 200, 1984.
Property of Norwegian Broadcasting.

Estate agency

Supervision of estate agents comprises institutional supervision and supervision of purchases/sales mediated by institutions under supervision. Institutional supervision encompasses the activities of firms licensed to practise estate agency and lawyers whose estate agency is ancillary to their principal business. Firms' and lawyers' compliance with the requirements of law and regulations, and with good agency practices, is scrutinised.

Recent years' high activity levels in the property market continued in 1997

The high activity levels in evidence in the property market in recent years continued in 1997. The market features an ample supply of properties and a substantial increase in average prices. This, together with free pricing of estate agency services, makes setting up an estate agency business an attractive proposition.

Many new estate agencies established in the past three years

About 50 new agencies have been established annually in the past three years (57 in 1997), while 18 agencies ceased estate agency activities. At end-1997 384 firms were licensed to provide estate agency services. Moreover, 128 estate agency branches were in operation at year-end. In addition 939 lawyers provide estate agency services after furnishing the necessary security.

Most estate agency start-ups are in large towns or their vicinity, notably Greater Oslo. There has also been a clear increase in the number of firms specialising in commercial property.

Of properties sold/rented via an estate agent, about one-third (in value terms) are mediated by the 10 biggest estate agencies, and about one-quarter of these were accounted for by bank-owned estate agencies. Several of the biggest market practitioners can be regarded as chains.

In view of the emergence of chains in the sector and the fact that a substantial share of the market is in the hands of chain-owned estate agencies, businesses and branches run by chains were targeted for inspection in 1997. These inspections were fairly extensive and resource-demanding. However, estate agency activities are normally based on a chain-wide concept enabling inspections to be carried out in an efficient manner. Flaws and defects pointed out by inspectors at one broker's office are communicated to all other brokers in the chain and rectified wherever they occur.

Twenty-eight on-site inspections were carried out during 1997, of which five were at premises of lawyers engaged in estate agency.

Although earnings in the trade are generally good, about 8 per cent of estate agencies, mostly recent start-ups, were in a negative equity capital position at year-end. This was mainly due to insufficient starting capital in relation to the costs that can normally be expected to accrue when starting up. The businesses in question are specially monitored through written communication and on-site inspections.

Estate agencies have to meet capital adequacy requirements in order to keep their licence. In 1997 two businesses had their licence withdrawn after ceasing to meet the requirements. The draft legislation introduced by Kredittilsynet recommends replacing the current capital adequacy requirement with a requirement as to positive equity capital. The Ministry of Finance circulated the draft to relevant bodies for comment in 1997.

«Moonlit night», tapestry, 185 x 175, 1987.
In a private collection.

Debt collection

Supervision of debt collection agencies embraces their financial position and those services that are provided on the basis of personal debt collection licences. Collection of own claims and lawyers' debt collection activities lie outside the scope of Kredittilsynet's supervision. Documentary and on-site inspections check agencies' compliance with requirements set out in laws and regulations, including the requirement as to good debt collection practices.

Improvements in debtors' finances and ability to pay have prompted a steady expansion of the debt collection industry's product range. Debt collection agencies are currently seeking new markets and products in which to compete. Competition in the market remains intense, leading in a number of cases to new contractual terms between agencies and principals. The industry features a minority of big agencies and a range of smaller and medium-size players. The big agencies are steadily increasing in size as a result of portfolio acquisitions or mergers with other debt collection agencies.

Kredittilsynet's on-site inspections in 1997 focused on:

- agencies' financial strength
- treatment of recovered funds
- accounting routines and routines for dealing with debtors and principals

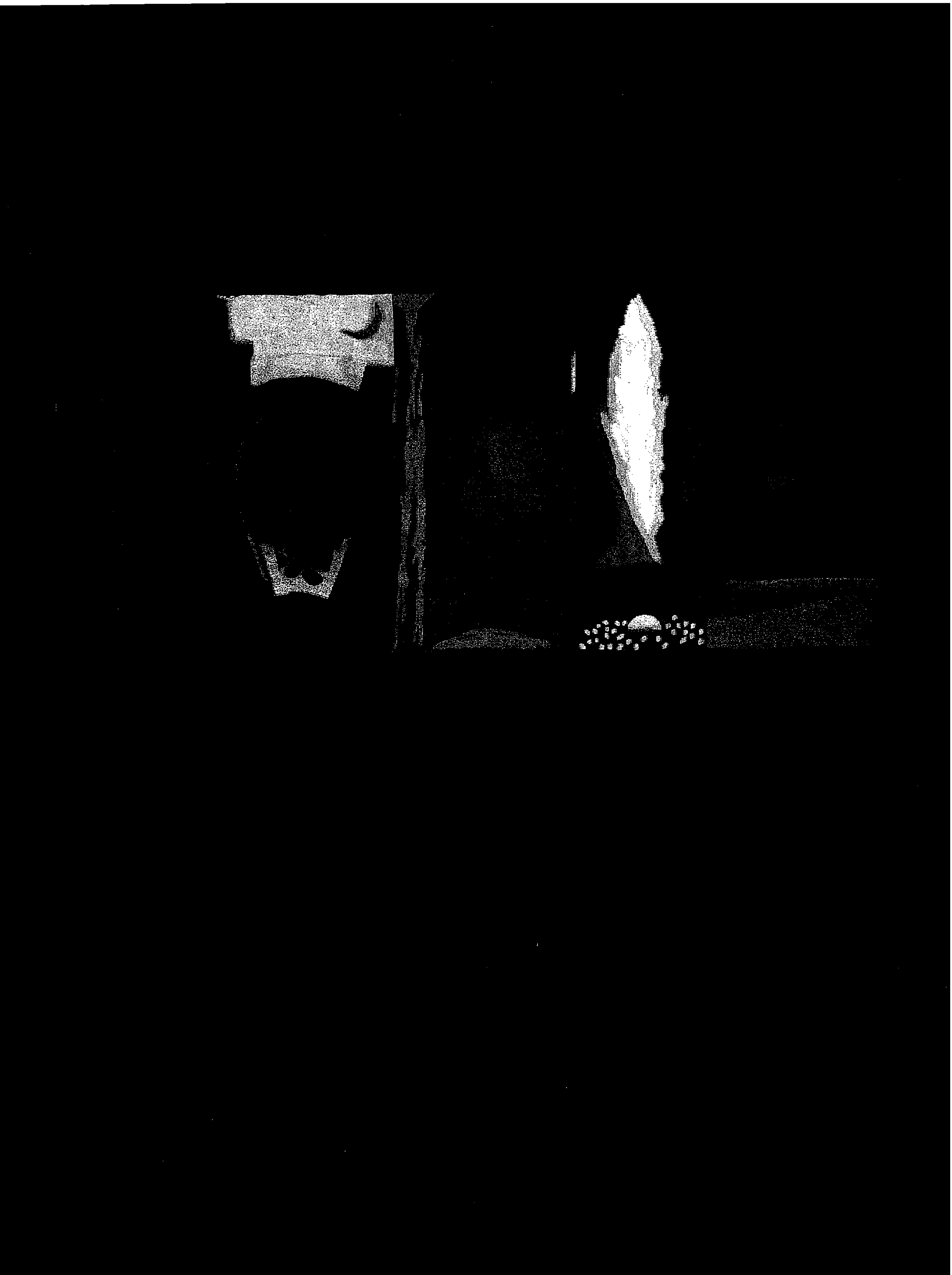
Emphasis was also placed on examining the product range offered by each agency and its internal control system. Experience from inspections shows that most debt collection agencies have no problems in complying with the statutory requirements governing their activities.

At the start of 1997, 123 debt collecting agencies were under supervision, of which 10 were housing cooperatives. Six new agencies were registered during the year, while eight agencies discontinued debt collecting in the same period. At year-end a total of 121 agencies carried on debt collection on the basis of personal debt collection licences from Kredittilsynet. Forty-two new, personal licences were issued during the year, and one was withdrawn.

Reports from debt collection agencies for the period May-August 1997 show a continued increase in incoming and completed debt collection assignments compared with the same period of the 1996. The same is true of the number of debt collection cases in process and the volume of claims due for collection. Compared with the previous four-month period, however, there was only a moderate increase in the debt collection market for these items. There are several possible explanations for this. One is that aggressive marketing on the part of agencies means that cases which would not have been referred for collection a few years ago are more likely to be referred today. The economic recovery and the associated improvement in households' financial position means that principals are more likely to recover their claims. Since the price of debt collection services has concurrently declined as a result of market competition, small claims are also referred to debt collection agencies. Another possible explanation is that higher turnovers and trading produce more debt collection cases. Credit sales to consumers have probably played a major role together with haphazard control of individuals' creditworthiness. A third possible explanation may lie in the general tendency for businesses to turn to debt-collection agencies at an earlier stage, which probably increases the ratio of cases with a successful outcome.

Reports by debt collection agencies show a continued increase in the number of incoming and completed assignments compared with previous years

The Debt Collection Act requires agencies to maintain a positive equity capital position in order to engage in debt collection. Documentary supervision has shown that some smaller agencies have had problems complying with this requirement. Three agencies were ordered to meet the requirement by a specific date, and did so through bringing in new share capital or higher earnings.



«Composition in Blue», tapestry, 140 x 310, 1989.
Property of Vinmonopolet A/S.

International activities

Internasjonaliseringen av finansmarkedene krever stadig mer samarbeid og koordinering mellom tilsynsmyndighetene. Kredittilsynet har etterhvert etablert et meget godt kontaktnett gjennom sin deltagelse i internasjonal virksombet.

At the Nordic level Kredittilsynet hosted the annual meeting of Nordic supervisors in Lofoten in June 1997, one of whose themes was a review of the respective supervisory authorities' organisational setup. Collaboration with other Nordic supervisory authorities remains a key medium for trading practical experience gained. Annual Nordic meetings are also held in the banking, insurance and securities fields as well as ad hoc meetings and seminars on specific supervision issues.

International cooperation outside the European Union and the European Economic Area

Kredittilsynet endorses the Core Principles for Banking Supervision formulated by the Basle Committee[2] and adopted in 1997. Although not a member, Kredittilsynet collaborates with the Basle Committee and participates in a number of its activities. Kredittilsynet receives relevant documents from the committee and is invited to comment on them. The Basle Committee plans to initiate a survey of the supervisory regimes in the various countries in relation to the new principles for banking supervision. Kredittilsynet considers the Norwegian regime to satisfy the core principles.

A standard for insurance supervision was adopted by the IAIS (International Association of Insurance Supervisors) at its annual meeting in Sydney, Australia, in the autumn of 1997. Before the annual meeting in 1998 member countries will be asked to report on whether their supervisory regimes meet the IAIS standard. A permanent IAIS secretariat was set up in Basle, Switzerland, on 5 January 1998. Norway is a member of the IAIS's Technical Committee and the sub-committees dealing with insurance law, regulations, practices and standards, and supervision of conglomerates. The Technical Committee decided to establish a subcommittee to prepare standards for solvency and solvency assessment for insurance companies which will be headed by Kredittilsynet.

In the securities field Kredittilsynet attended the annual conference of the International Organisation of Securities Commissions (IOSCO) in Taipei, and the meetings of the European regional committee.

The Joint Forum, established in 1996 and comprising representatives from the IAIS, the IOSCO and the Basle Committee on Banking Supervision, is making good progress in developing reporting routines and guidelines for the supervision of conglomerates. Kredittilsynet is kept informed and consulted on a regular basis.

As regards the OECD Kredittilsynet regularly attend meetings of the Capital Markets Committee and Insurance Committee. The basic aim is increased liberalisation of financial markets. In addition the GATS talks have resulted in increased international contact and harmonisation.

Where measures to combat money laundering are concerned, Kredittilsynet continues to participate in the work of the FATF (Financial Action Task Force against Money Laundering) which exchanges information on and develops common international standards for anti-money-laundering measures. In 1997 an expert group from the FATF undertook a new examination of Norway's anti-money-laundering measures in relation to the FATF's recommendations in this field.

Cooperation within the European Union and the European Economic Area

Kredittilsynet considers it important to play its part in the development of rules within the European Union to the extent possible under the terms of the EEA Agreement. The EU Commission's activity on the financial front in 1997 was substantial and a large number of expert meetings were attended by Norway and the other EFTA/EEA countries.

In the summer of 1997 the EU member states decided to invite EFTA/EEA members to attend meetings of the Banking Advisory Committee (BAC) and the Insurance Committee (IC) as observers. The previous arrangement had entailed consultation meetings with representatives from the Commission in advance of the BAC and IC meetings. Participation is restricted to one representative from each EEA/EFTA member country. The Ministry of Finance and Kredittilsynet will alternate in representing Norway on these committees. Kredit-

Kredittilsynet attended a large number of international meetings and specialist fora within and outside the EU/EEA system in 1997

Noter:

2) The Basle Committee was set up by the Group of Ten Countries in 1974, has its secretariat at the bank for International Settlements in Basle, and comprises representatives of the banking supervision authorities and central banks of the following countries: Belgium, Canada, France, Italy, Japan, Luxembourg, Netherlands, United Kingdom, Switzerland, Sweden, Germany and the United States.

tilsynet takes a positive view of Norway being invited to play a more active role in important EU committees and being given an opportunity to exert direct influence.

Kredittilsynet attends meetings of the liaison bodies Groupe de Contact (banking supervision) and the EU Conference of Insurance Supervisory Authorities as an observer. At the meeting of the latter body in Sienna, Italy, in October 1997, a revised version of the protocol relating to the collaboration of the supervisory authorities of EU member states was adopted. Kredittilsynet participated in the work of revising the protocol, and Norway, Iceland and Liechtenstein are formally included in the revised protocol.

In March 1997 Kredittilsynet hosted the final meeting of the Müller Group, appointed by the EU Conference of Insurance Supervisory Authorities to examine the solvency margin provisions of the EU directives with a view to revising insurance companies' capital adequacy requirements. The Müller Group presented its final report at the Dublin Conference of Insurance Supervisory Authorities in April 1997. Its work has been taken forward by a working group under the EU's Insurance Committee in which Kredittilsynet is a participant.

Kredittilsynet also attended meetings of the High Level Securities Supervisors Committee, an informal committee under the EU Commission. In 1997 the Informal Group of Chairmen of EU Securities Commissions decided to set up a formal joint forum for securities supervisors within the EEA. The statutes of the new organisation (FESCO - Forum of European Securities Commissions) were established in December 1997.

On the banking and securities front collaboration among supervisory authorities is organised through bilateral agreements or Memorandums of Understanding (MoUs). MoUs have been signed with the supervisory authorities in all Nordic countries as well as the United Kingdom, France, Luxembourg, Germany and the Netherlands. In 1997 Kredittilsynet held bilateral meetings with the United Kingdom and Luxembourg.

Kredittilsynet wishes to develop cooperation with the European Monetary Institute (EMI), and held liaison meetings to this end with EMI representatives in 1997. Such cooperation is an important element in the macroeconomic surveillance of financial markets.

Maintaining and further developing bilateral collaboration with EU member states will be an important task in 1998 as in 1997.

Table 13: EU- and EEA-related meetings attended by Kredittilsynet:

	No. of meetings in 1996	**No. of meetings in 1997**
Permanent supervisory bodies	8	8
Consultation meetings prior to BAC and IC	6	4
BAC and IC (as observer)	0	2
Committees in securities sector	3	3
Working and expert groups under EU/EEA	28	31
Other liaison meetings, seminars etc.	5	6
Bilateral meetings	8	4
Total EU- and EEA-related meetings	58	58

Table 14: Participation in international organisations and EU- and EEA-related committees:

Banking/Finance
International Conference of Banking Supervisors
OECD's Capital Markets Committee
EU's Banking Advisory Committee (BAC)
Groupe de Contact (EEA)
Nordic supervisors' meetings

Insurance
IAIS (International Association of Insurance Supervisors)
OECD's Insurance Committee
EU's Insurance Committee (IC)
Conference of Insurance Supervisory Authorities of the Member States of the European Union (EEA)
Conference of European Insurance Supervisory Services (Pan-european conference)
Nordic supervisors' meetings

Securities trading
IOSCO (International Organisation of Securities Commissions)
Enlarged Contact Group on Supervision of Collective Investments Funds
Informal Group of Chairmen of EU Securities Commissions (as from 1998: Forum of European Securities Commissions - FESCO)
High Level Securities Supervisors Committee
Nordic meetings

Accounting and Auditing
IIA (Institute of Internal Auditors)
ECIIA (The European Confederation of Institutes of Internal Auditing)
Nordic meetings

Money laundering
Financial Action Task Force against Money Laundering (FATF)
Other international conferences and seminars

Kredittilsynet's organisational set-up

The Board
Kredittilsynet is headed by a board of five members. Members and alternates are appointed by the King for a four-year term.

At the start of 1997 the board was composed as follows:

Mr. Erling Selvig, professor, dr.juris., chairman
Ms. Else Bugge Fougner, supreme court justice, deputy chair
Mr. Asbjørn Rødseth, professor
Ms. Eli Aas, lawyer
Mr. Ingebrigt Børsheim, managing director

Alternates:
Ms. Turid Hundstad, director
Mr. Steinar Undrum, director

Mr. Steinar Undrum took up a new post and played no part in the work of the Board in the second half-year.

Mr. Harald Bøhn, Director at Norges Bank, was appointed observer to the Board with Mr. Trond Eklund, Assistant Director at Norges Bank, as his alternate.

Two members elected by and from among the employees supplement the Board when administrative matters are dealt with. Employee representatives in 1997 were:

Ms. Kjersti Elvestad, adviser
Mr. Erik Johansen, adviser

The Board met 14 times in 1997. In addition some matters were dealt with by circulation to board members.

Administration and staff
Kredittilsynet currently has a total of 140 posts. At year-end the permanent staff numbered 134 compared with 129 at the end of 1996. Of these, 53 per cent were women.

Forty vacancies were advertised in 1997, including nine internally. Applicants totalled 522.

Kredittilsynet has a satisfactory supply of highly qualified applicants with recently completed university training or the equivalent. Kredittilsynet also considers it important to recruit staff with broad experience from and knowledge of sectors and trades under its supervision. At end-1997, 27 staff members had such experience. Eighty per cent of the staff have higher education.

Chart 8: Staff educational background, 31 December 1997

Training	Percentage
Actuarial science	5%
Law degree (master's level)	21%
Economics degree (master's level)	12%
Degree in business administration	21%
Government authorised auditor's qualification	8%
Business economics degree/Bachelor's degree	6%
Other higher education	7%
No higher education	20%
Total	100%

Organisational set-up and competence
Kredittilsynet's competence is developed with a basis in the following objectives:

- To ensure effective use of the organisations's human and financial resources and organisational competence by facilitating the exploitation of synergies within the organisation
- To ensure a high level of specialised competence and sound individual competence on a par with the competence in supervised entities in areas of significance for our operations
- To reduce turnover in the organisation by ensuring that all staff members receive necessary skills upgrading as a basis for career development within the organisation

Today great demands are made of the organisation's flexibility and multidisciplinary qualities. These can be fostered by, for example, extended use of projects as a work form. In order to ensure enhanced competence in project work, courses in project management and project work have been planned and implemented as an adjunct to concrete projects. Language training for staff members was again given priority in 1997 as a result of increased international cooperation.

Public relations
Providing information, formulating premises and dialogue are important elements of Kredittilsynet's strategy. Information activity is defined as a strategic tool on a par with other instruments of supervision and is utilised in various forms in the work of prevention. Kredittilsynet communicates both via the media and directly with the sectors under supervision. The object of public relations activity is to ensure that information is provided accurately, rapidly and timely in a professional and readily comprehensible manner. A central element in this

work is ongoing contact with the press. Kredittilsynet maintains a policy of accessibility and openness in its dealings with the media.

Kredittilsynet's treatment of several major cases in the early months of 1997 brought it sharply into the public eye. The number of news stories in which Kredittilsynet was mentioned rose from 398 in the first half of 1996 to 1,078 in the first half of 1997. The high level of attention, which remained more or less stable to year-end, was extraordinary compared with a «normal year». Three press conferences/briefings were held compared with one in 1996. Forty-one circulars were issued compared with 42 in 1996, and 46 press releases compared with 26 in 1996.

Information technology (IT)
Kredittilsynet's internal IT systems are constantly evolving to adapt to developments in information technology in the community in general and the financial sector in particular. Active use of inform ation technology is a prerequisite for effective utilisation of resources for supervision and analysis purposes. A new IT strategy was adopted early in 1996, and implementing this strategy was a key feature of 1997.

Work on facilitating communication among various internal databases through conversion to a new database platform was completed, and new modules linked to the internal systems are developed on a continual basis. External E-mail access was made available to all staff. A comprehensive risk and vulnerability analysis was carried out. The introduction of more and more applications and the growing use made of them makes heavy demands on the IT infrastructure in terms of performance and stability. A comprehensive upgrading of the IT infrastructure is under way. A central goal in 1997 was to maintain and develop the quality of internal services. Thanks to increased efforts in this field service quality is now at a uniform high level.

Finances:
- Expenditure
Kredittilsynet's budget for 1997 totalled NOK 80.7 million. Total expenditure came to NOK 78.5 million, i.e. an increase of 6.4 per cent on 1996. Salaries and salary-related costs amounted to NOK 51.3 million (65.3 per cent of total expenditure). Expenditure on operation, travel, competence development, consultancy services and organisation development came to NOK 22.7 million (28.9 per cent of the total). IT outlays totalled NOK 4.5 million or 4.5 per cent of overall expenditure.

An overview of the growth in Kredittilsynet's expenditure in recent years is given below. The growth is mainly due to staff increases. The increase in the number of posts is a result of the plan to progressively expand Kredittilsynet's resources that was drawn up after the Storting's decision in 1992 to retain Kredittilsynet as an independent and stronger institution. The increased resources have enhanced Kredittilsynet's capacity and competence, thereby raising the quality of its operations.

Table 15: Kredittilsynet's expenditure 1992 - 1997

Year	Final accounts NOKm	Change from prev. yr. in %
1992	49,0	9,6
1993	54,6	11,4
1994	65,7	20,3
1995	69,0	5,0
1996	73,8	7,0
1997	78,5	6,4

Expenditure on the investigating committee (NOK 13.8m in the period 1992-1996) is not included.

- Revenues
Under section 9 of the Act on Supervision of Credit Institutions, Insurance Companies and Securities Trading, etc., Kredittilsynet's expenses are covered by the institutions under its supervision at the start of the financial year. The expenses are apportioned among the various institutional groups based on the extent of the supervision, and are payable the year after they are incurred. The total amount levied for 1996, i.e. NOK 73.0 million, was approved by the Ministry of Finance on 1 July 1997. Supervised entities liable to pay the amount levied for 1996 numbered 5,766. The percentage distribution of the levy among the various categories of supervised entities is shown in Table 16.

Table 16: Cost of supervision distributed on supervised groups

Supervised group	Percentage of total levy in 1995	Percentage of total levy in 1996
Banks	37,85	32,62
Insurance companies	26,82	26,35
Pension funds	5,95	5,63
Finance companies, mortgage companies	5,18	5,53
Auditing firms/auditors	5,79	4,78
Securities trading	9,27	12,98
Estate agencies	4,87	5,93
Debt collection	3,43	2,61
Miscellaneous	0,84	3,57
Total	100,00	100,00

«Arise», tapestry, 140 x 320, 1996.
Property of the Oslo Courthouse.

Kredittilsynet's operations in a four-year perspective – implemeting the strategy adopted in 1994

In the spring of 1994 Kredittilsynet drew up a new strategic plan for its activity. This strategy has been normative for Kredittilsynet's work and priorities in the four-year period 1994-1997.

Background
Prior to the start of the strategy period Kredittilsynet had undergone an unusual and demanding period. The far-reaching crisis in Norway's financial industry had made heavy demands on Kredittilsynet's work capacity. The organisation's effort essentially focused on dampening the harmful effects of the crisis in order to minimise its impact on the economy and on financial institutions' customers. Individual institutions and their problems were therefore targeted. At this time work on the new rules prompted by the changes in financial markets in the eighties also laid claim to a large portion of Kredittilsynet's resources. Opportunities to take on long-term development work were therefore limited. Moreover, Kredittilsynet, which was only established in 1986, was a very «young» and somewhat raw organisation at the start of the banking crisis - which made managing the crisis a particularly demanding task.

In conjunction with the banking crisis the Storting debated in 1992 the way the supervision of the financial industry was organised. A merger of Kredittilsynet and Norges Bank was an option being considered. The Storting concluded that Kredittilsynet should remain an independent institution and have its competence and resources strengthened. In December 1992 Kredittilsynet accordingly forwarded a plan to the Ministry of Finance recommending an additional 35 posts in the period 1993-1995. Kredittilsynet was allocated 14 posts in 1993, bringing its authorised posts to 117 by the start of 1994. A further 14 posts were added in 1994 and four more in each of the years 1995 and 1996. At the start of 1997 Kredittilsynet had a total of 139 authorised posts.

Kredittilsynet was thus in an excellent position at the start of the strategy period:

The situation in the financial industry was returning to normal. Kredittilsynet could concentrate its resources on problems other than crisis management and could apply a longer time perspective to its operations. Concurrently the organisation was given the wherewithal to strengthen its competence and capacity. With purposeful strategic management it would therefore be possible to build up a competent organisation able to implement a preventive approach and tackle demanding supervisory challenges.

Challenges and choice of strategy

- Challenges at the start of the strategy period, spring 1994
The following points from the strategy plan show how Kredittilsynet viewed the societal challenges facing it in the spring of 1994:

- *«Economic developments ahead are highly uncertain. The Norwegian economy may show moderate growth, low inflation and low but stable interest rates. International conditions could easily affect a small, open economy like Norway's. Macroeconomic conditions of significance to financial institutions and financial markets need to be monitored on a regular basis.*
- *Increased internationalisation of financial markets entails a growing need for updated international competence and international collaboration in order to develop appropriate rules and a satisfactory supervisory regime.*
- *Blurring of sectoral barriers, formation of conglomerates and squeezed margins call for reorganisation of financial institutions. Requirements as to a competent watchdog able to oversee conglomerates and tackle rapid changes are increasing.*
- *Developments in the field of information technology will greatly affect financial institutions and financial markets, and will call for new supervisory methods and competence.*
- *High ethical standards will be needed among players in financial markets and financial institutions if confidence and respect are to be maintained. Concurrently there is a risk that financial crime will escalate. This puts a heavy onus on surveillance, rules and guidelines employed by the supervisory authorities».*

The assessments made in 1994 have not been borne out by events in all respects. The path of economic development has proved to be smoother and more favourable than many expected. In those areas where the trend has gone in the direction expected, developments have been more rapid and vigorous than anticipated.

Choice of strategy
External and internal challenges resulted in the following choice of strategy:

«Kredittilsynet shall enhance its ability to foresee trends of material significance for the conditions

within which financial institutions operate, and give priority to implementing preventive measures to counter possible threats to a healthy, stable development in the financial industry. In view of its broad impact area and the growing complexity of the market, Kredittilsynet must exploit potential synergies in its organisation - across departmental divides, dissimilar supervisory tasks and professions.
(.....)
By combining its knowledge of supervised entities with a reinforced ability to capture important national and international trends, Kredittilsynet will be in a position to perform supervision at least equal to that provided by today's regime, even in the face of growing challenges and tasks».

The challenges facing Kredittilsynet called for a choice of strategy with a greater focus on totality and relationships within the financial system and greater emphasis on prevention to avoid a systemic crisis.

Objectives and priority measures
The four main objectives guiding Kredittilsynet during the strategy period, and examples of steps taken to achieve these objectives, are described below.

Main objective 1: Satisfactory capital strength, risk awareness, management and control in institutions under supervision
Institutions' financial strength was a central concern for Kredittilsynet in the period, and was therefore a key element of on-site inspections. In recent years the focus of on-site inspections has switched from problem loans to asset management, internal control, credit practices, administration, operation and development of technology and other themes of significance for long-term, prudent development of institutions. In view of their central role in the financial market and significance for the stability of Norway's financial industry, effort has been expended on further developing and strengthening supervision of conglomerates - both the constituent institutions of the conglomerate and the conglomerate as a whole.

Throughout the period Kredittilsynet brought home the necessity - to individual institutions, trade organisations and the Ministry of Finance alike - of ample capital adequacy to secure a buffer against hard times. This meant limiting the dividend paid to shareholders where necessary. In regard to mergers, it was stressed that the merged unit should have a satisfactory capital base, i.e. tier 1 capital should exceed the statutory minimum. Moreover, when dealing with Den norske Bank's takeover of Vital, Kredittilsynet supported a buyout since it could strengthen Den norske Bank's overall market power in competition with foreign financial institutions.

As a step in its work on prevention, Kredittilsynet framed new regulations on internal control for banks entailing clear requirements to establish and monitor routines for internal management and control. The regulations were followed up with several seminars at which the object and content of the regulations were presented to a large number of Norwegian banks. Corresponding regulations were introduced for the insurance industry in 1996. In 1997 the regulations were extended to investment firms and management companies for securities funds. Overseeing that internal management functions as intended is now a central element of on-site inspections. Alongside sufficient equity capital and other provisions, sound internal management and control are crucial to securing stability in the individual institution.

Main objective 2: Preparedness and systems designed to pre-empt situations that may threaten the stability of the financial system
In 1994 Kredittilsynet in conjunction with Norges Bank and Statistics Norway developed a macroeconomic surveillance programme to aid the analysis of central indicators of significance for the stability of the financial system. Under the programme two reports are drawn up each year, and themes are discussed at meetings held on a regular basis between Kredittilsynet and Norges Bank. The Ministry of Finance is kept informed. Work on developing methods for macroeconomic surveillance has laid a basis for fruitful contacts with other country's supervisory authorities and for dialogue with Norway's financial industry.

In the strategy period Kredittilsynet continued to monitor the trend in financial institutions' performance with the aid of key figures and ratios based on the institutions' own reporting. This provides a current overview of the performance trend in various categories of banks and insurance companies. The trend in key figures and ratios is also an important basis for on-site inspections.

In 1994, 1995, 1996 and 1997 Kredittilsynet carried out home loan surveys to pinpoint banks' home loan practices, partly with a focus on debt:finance ratios, risk assessments, loans for other purposes (but secured in mortgage on property) etc. The survey findings prompted Kredittilsynet to give clear warnings to the banks to avoid excessive debt:finance ratios and overly optimistic assessments of customers' debt-servicing ability.

In 1996 Kredittilsynet, with the assistance of the Banks' Central Clearing House, carried out a study of new IT-based payment services and distribution channels. The analysis showed that payments transmission is fairly costly for banks, although payment services are gradually becoming less costly. It also established that Kredittilsynet faces new challenges in terms of keeping abreast of payments services developed by banks and by new players who do not traditionally offer this type of service.

The analyses and studies referred to have been important in achieving the strategy's aim of a greater focus on totality and relations in the financial system. They are an aid to obtaining at the earliest possible stage an overview of factors which may threaten the stability of the financial system, thereby enabling preventive measures to be put in place.

Main objective 3: Orderly conditions, compliance with laws and regulations and a high ethical standard among operators in the financial market

Overseeing compliance with the rules in force is an integral part of supervision of the overall financial industry. Enforcing the ownership restriction rules occupied centre-stage in the latter half of the strategy period. Kredittilsynet's reinforced supervision of pension funds' compliance with the legislation should also be mentioned. After a series of inspections, Kredittilsynet drew up recommendations in the form of circulars for handling particular problem areas in this field. Kredittilsynet also drew up recommendations for financial institutions' trade in derivatives.

It has proved important for Kredittilsynet itself to have the capacity needed to monitor rule breaches at financial institutions. In order to exercise effective supervision able to prevent crises in financial institutions and reduce the extent of harm resulting from possible crises, rules are needed that make it easier for Kredittilsynet to intervene in censurable circumstances at an early stage. The sanctions available under the Criminal Code are inadequate to deal with rule breaches in the financial field. This was a lesson learned from the work of the Wiker Committee. The committee was appointed by Kredittilsynet in 1990 to carry out investigations at certain financial institutions which had suffered heavy losses with a view to bringing to light possible criminal conduct in these institutions. The committee completed its work in 1995. Several cases were referred to ØKOKRIM for possible prosecution, without charges being preferred.

In 1995 Kredittilsynet established a group to oversee transactions in the securities market. The group, which is not part of the institutional supervision, ensures that Kredittilsynet has the capacity and competence needed to uncover and follow up on cases where there is a suspicion of insider dealing and market manipulation. Its work has a clear-cut preventive effect since market players are aware that Kredittilsynet is able to monitor suspicious circumstances. Kredittilsynet also supervises institutions in the securities field in the normal way to check that they observe game rules and standards of good conduct in the market.

Collaboration with ØKOKRIM was developed and systematised in the period. The responsibility for this work rests with a member of the Director-General's staff who also assists in special investigations etc.

By drawing up ethical guidelines and making oral presentations and media initiatives, Kredittilsynet has also brought ethical issues in the financial industry into public focus on frequent occasions.

Main objective 4: ***An up-to-date and appropriate regulatory framework that fosters smoothly functioning markets, both for supervised institutions and the users of their services***

Throughout the period work was done on further developing the legislation to achieve an appropriate regulatory framework for the financial industry.

Kredittilsynet participated in drawing up new laws in several areas of supervision, among them a new Securities Trading Act, a new Accounting Act and a new Auditing Act. New laws were followed up with regulations and draft regulations - including several regulations in pursuance of the new Securities Trading Act. Kredittilsynet also actively contributed both content to and comments on the interim reports of the Bank Law Commission.

The work of adapting Norwegian rules in the financial area to the EEA rules and other international bodies of rules was a demanding and important task for Kredittilsynet throughout the period. A central aim of this work was to ensure a level playing field for the Norwegian financial industry.

In the period 1994-1997 a large number of new regulations were proposed to the Ministry of Finance with a view to adapting Norwegian rules to EU and EEA rules. One example is the new capital adequacy regulations which set requirements as to institutions' current measurement of market risk. Kredittilsynet also laid down several new regulations of its own. In some areas, including insurance, the combination of Norwegian and European rules has resulted in a more complicated body of rules.

Framing rules is a continual process in a society whose financial industry's regulatory setting is constantly changing and where simplifications are still required. The rules in the insurance field remain particularly extensive and detailed.

Strategies and areas of operation representing a new orientation and upgrading of priorities

Alongside international activities (see page xx), the following areas in particular have been assigned higher priority:

- Formulating premises, public relations and dialogue

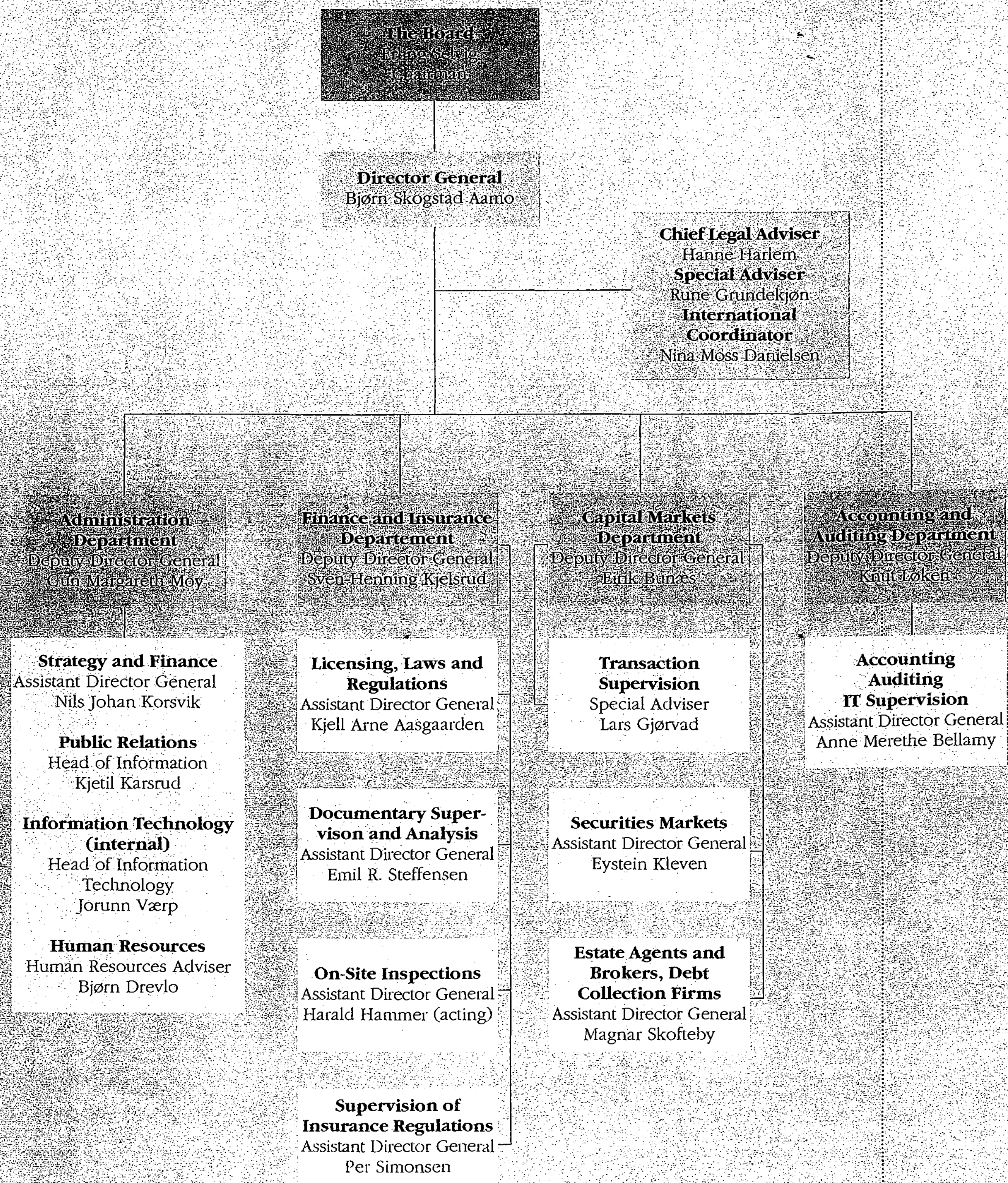
Work on formulating premises and public relations now has higher priority than previously. Kredittilsynet attached great importance to dialogue with individual institutions and operators, trade organisations and collaborative organisations with a view to building an understanding of Kredittilsynet's attitudes and an awareness of new regulations in the market. This was done through meetings and seminars, presentations and articles, as well as a proactive policy with regard to the media.

In 1994 public relations activity was given increased priority through the establishment of a new post, i.e. Head of Public Relations. Key tasks for this post entail facilitating dialogue with the media and other target groups, as well as good in-house communication. Work was also done on giving Kredittilsynet a better overall profile by upgrading office premises, improving the telephone service and introducing a new visual profile.

Public relations has to an increasing extent been employed by Kredittilsynet as a central instrument in its preventive approach, partly by putting central problems on the agenda and stimulating debate in the financial industry, in public and political circles and in the community in general. Media coverage of issues and events also has a preventive effect in that it brings the sanctions available to Kredittilsynet to the awareness of the market, which is why ongoing contact with the press and the media has been given greater priority. Kredittilsynet is accordingly regarded as an important formulator of premises in the public debate and as an institution whose views are taken notice of in the financial industry.

- Studies and economic analysis

Greater priority was also given to study and analysis activity described under the second main objective above. The macroeconomic surveillance programme in particular represents a new step for Kredittilsynet. The production of new knowledge through studies and analyses in combination with the transmission of knowledge through pro-active public relations were an important and to some extent new tool for Kredittilsynet in the period under review.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