



KREDIT TILSYNET
The Financial Supervisory Authority of Norway

ANNUAL report

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Why regulate and supervise the financial system?

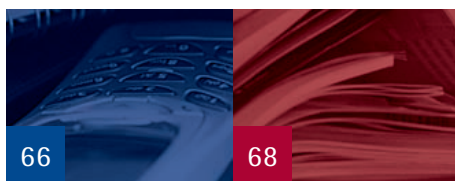
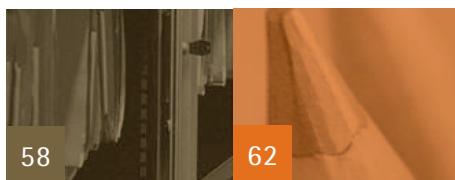
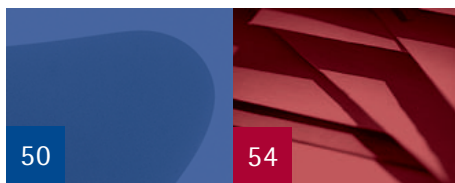
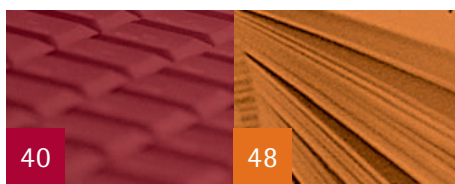
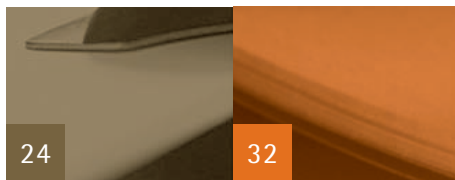
Financial market stability has received a great deal of attention in recent years. Many countries, including most of the Nordic ones, have seen serious problems in their financial sectors, with substantial costs for both the nation and the individual. The financial system redistributes capital and risk and attends to payment and settlement functions. Solid financial institutions and smoothly functioning financial and securities markets are essential if these functions are to be discharged in a satisfactory manner. Should confidence in the financial system fail, there could be substantial negative consequences for other sectors of the economy. Stability and confidence in the financial system are therefore a central aim of regulation and supervision.

Banks are key actors in the financial system, and appropriate regulation and effective supervision of banks is an important part of the effort to ensure financial stability. However, developments in share markets and other securities markets can also give rise to financial turbulence and stability problems. Regulation and supervision of market participants and their behaviour is therefore key to maintaining confidence in the financial system. Orderly and efficient securities markets can contribute to higher returns on savings and to ensuring that venture capital is available to business and industry. A sound insurance sector can make important contributions to long-term saving and capital accumulation and to curbing the risk faced by enterprises and households. Regulation and supervision of insurance is crucial to the financial system's ability to discharge its core functions.

An efficient and effective supervisory regime whose primary aim is to ensure that banks, investment firms and insurance companies comply with applicable rules and maintain adequate management and control of their business and of risk, is key to maintaining the financial system's stability. Enterprises' provision of correct and relevant information on their financial situation is likewise crucial for market actors and authorities alike. Accounting controls and effective regulation and supervision of audit companies and external accountants are at centre-stage in this context.

A further main goal of regulation and supervision is to protect consumers and other users of financial services. Financial institutions in key areas manage their clients' assets by a variety of means. Clients may be bank depositors, insurance policyholders or investors in securities markets. Much consumer protection is provided through regulation and supervision of financial institutions' solvency and activity, and through various types of public guarantee schemes, such as the one covering bank deposits.

An important aspect of consumer protection comprises regulation and supervision of intermediary functions performed by investment firms, management companies for securities funds, insurance brokers, real estate agents, debt collection agencies etc. Here the object is to prevent misuse of client assets along with any other behaviour that promotes the interests of an intermediary at the expense of clients' interests.



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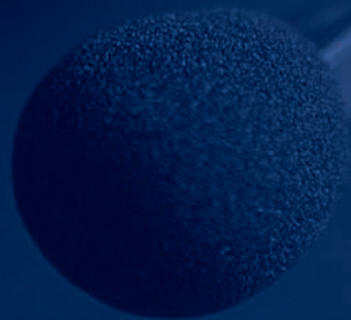
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"Kredittilsynet shall ensure that the institutions it supervises operate in an appropriate and proper manner in accordance with law and provisions issued pursuant to law and with the intentions underlying the establishment of the institution, its purpose and articles of association." (Financial Supervision Act, section 3)

Kredittilsynet is responsible for the supervision of banks, finance companies, mortgage companies, e-money companies, insurance companies, pension funds, insurance brokers, investment firms, securities fund management and market conduct in the securities market, stock exchanges and authorised market places, settlement centres and securities registers, real estate agencies, debt collection agencies, external accountants and auditors.



PR eface



2004 proved a good year for Norwegian financial institutions, featuring low losses along with satisfactory earnings and financial positions. The strong growth in household debt may however create problems - in the first instance for large borrowers, but also to some extent for institutional lenders. Kredittilsynet has advised a cautious approach on loan size relative to property value. Information from banks on the consequences of higher interest rates for borrowers is also important. To limit unfavourable consequences for the markets and to assure financial stability, it would be advisable to adjust interest rates to a more normal level on a gradual basis, without too much delay. Financial institutions should devote part of their net profit to ensuring that they have sufficient equity capital to absorb future risk.

The EU's new capital adequacy rules - based on guidelines from the Basel Committee on Banking Supervision - which will become effective in 2007, entail capital charges more in line with the various types of risk faced by financial institutions. For many institutions the statutory minimum capital requirements could leave them with a smaller cushion against unforeseen events and conditions. Ensuring that institutions remain sufficiently solvent and robust in the future will pose a challenge both for the individual financial institutions themselves and for the supervisory regime.

Non-life insurance companies have seen a positive trend in earnings and financial strength. Where life insurers are concerned, larger buffer capital is desirable to enable them to meet their long-term obligations and to ensure sound returns for policyholders and owners.

The EU is also preparing new rules in respect of solvency requirements in the insurance industry, the Solvency II framework. Although the main features of the new framework are expected to be finalised in the next two or three years, the new rules are unlikely to be adopted before 2008. Norway should have rules in place ensuring that insurance companies are able to meet various types of risk, both in insurance and in asset management, even before the new EU rules come into force.

Regulation of Norwegian financial institutions is designed to ensure their ability to fulfil important functions for society and industry, and to avoid their exposure to detrimental influence from sectional interests of certain owner groupings. This, together with general principles of good corporate governance, will provide the basis for Kredittilsynet's enforcement of the new rules governing ownership of financial institutions. Desires for greater flexibility need to be balanced against the need for orderly ownership conditions able to provide the necessary stability and predictability for the individual institution. At the same time, providing their owners with a good return is a legitimate aim for financial institutions, and is important for securing access to new capital in the future.

Kredittilsynet's work in the securities field is affected by the ambitious plans now being implemented with a view to establishing a single securities and capital market in Europe, involving the implementation of a number of new directives. In the European perspective this is viewed as an important instrument for achieving greater economic growth and employment. For Norway, implementing the European legislation will be important with a view to ensuring that Norwegian enterprises and Norwegian investors enjoy the same access to this market as their counterparts in other EEA countries. Although Norway has in several areas anticipated European developments, with the result that changes required will be minimal, in other areas the

new EU framework will introduce rules that are more detailed than is customary in Norway.

Growing internationalisation, both of markets and of market regulations, underlines the importance of proactive collaboration among supervisory authorities on a Nordic, European and global level.

Monitoring the follow-up of international accounting standards is a new and demanding task for Kredittilsynet. It brings Kredittilsynet into direct contact with all listed companies, and entails a substantial enlargement of the agency's supervisory and administrative scope. The task is also demanding since the standards in question are still being developed in a number of areas, and views may differ on how best to implement them. Kredittilsynet aims to work closely with Oslo Børs (the Oslo Stock Exchange) and Norwegian accountancy circles as well as with other countries' authorities to ensure that the international standards are successfully implemented in Norway.

Along with the many functions assigned to Kredittilsynet in the securities market, the new tasks mean that Kredittilsynet will in due course have two wide-ranging and equally significant concerns:

- financial stability - sound and solvent financial institutions
- smoothly functioning financial and securities markets

Kredittilsynet's budget has been increased in recent years in step with its expanding responsibilities. Despite this, some reduction in inspection activity has been necessary - albeit within reasonable limits - in periods when preparing and administering new rules has required sizeable resource inputs. New tasks will require substantial resources. Kredittilsynet will at the same time closely review the potentials for simplifying and streamlining the tasks performed in various areas. It may well be necessary to consider whether it would be sensible to lower the standard of administration and supervision in some areas. Given the role that branches have, and may acquire, in the Norwegian financial market, Kredittilsynet has recommended that branches should contribute to financing the supervisory effort.

Kredittilsynet endeavours to take into account the advice and views of users of the agency's services. It does so by means of regular user surveys, hearings/consultations and meetings with users and their trade organisations.

Kredittilsynet has reinforced its collaboration with the consumer authorities in recent years, particularly with a view to widening the information available about the financial market and about the potentials and risks associated with various types of investment. Examples witnessed at the interface between pyramid gaming and the financial market in the last couple of years suggest that Norwegian society, including schools, would benefit from a substantially higher level of information and knowledge about various types of investment, and the risks attending them. Kredittilsynet is intent on playing its part in such an effort, together with other authorities and affected sectors.

Oslo, 21 January 2005


Finn Hvistendahl
Chairman of the Board


Bjørn Skogstad Aamo
Director General

Functions and objectives

Kredittilsynet strives to ensure that financial institutions and markets function securely and efficiently in the best interest of society and users of financial services, and that service providers are afforded an appropriate framework for their operations.

Kredittilsynet is an independent government agency that builds on laws and decisions emanating from the Parliament (the Storting), the Government and the Ministry of Finance and on international standards for financial supervision and regulation.

Through its supervision of enterprises and markets, Kredittilsynet strives to promote financial stability and orderly market conditions and to instil confidence that financial contracts will be honoured and services performed as intended. In addition to its preventative work, Kredittilsynet must be prepared to deal with concrete problems that may arise. Kredittilsynet's premise is that Norwegian enterprises must be afforded competitive conditions which all in all are in line with those enjoyed by institutions in other EEA countries.

Tasks that need to be resolved in order for Kredittilsynet to attain its overarching goals can be summarised as follows:

Institutions

Kredittilsynet's premise is that responsibility for business operations rests with the board and management of the institutions themselves. Kredittilsynet will work to promote satisfactory capital strength, risk awareness, management and control in institutions under its supervision. Through its administration and effective enforcement of the rules, Kredittilsynet will strive to ensure that institutions and other market actors comply with laws, rules and ethical norms. Institutions of major significance for financial stability and for users are given priority for supervision purposes.

Users of financial services

In its dealings with institutions, markets and market places, Kredittilsynet will protect the interests of users of financial services. Kredittilsynet will contribute to rules and arrangements that ensure that users receive correct information - in the first instance from the institutions themselves - about the institutions, their products and the associated risks.

Markets and market places

Kredittilsynet works for efficient and effective competition and price formation in securities markets and other markets under its supervision. Settlement and payment systems and the financial infrastructure in general must function in an appropriate and satisfactory manner. Markets and market places need to be open and transparent, and market practitioners must exhibit good conduct.

Kredittilsynet's performance of its activity

Kredittilsynet intends to be an effective, flexible and independent body featuring high competence and good service. It will emphasise transparency and predictability in its activities, good communication with supervised institutions and the general public, and good collaboration with other authorities and industry associations.

Important events in 2004

Structural changes and licensing

The Ministry of Trade and Industry authorised to acquire the Government Bank Insurance Fund's stake in DnB NOR ASA

By virtue of the Storting's decision to terminate the Government Bank Investment Fund, the government's 34 per cent stake in DnB NOR ASA devolved to the Ministry of Trade and Industry. This required permission under the rules governing ownership of financial institutions, set out in the Financial Institutions Act. Kredittilsynet endorsed the transfer subject to conditions designed to ensure independent banking operations, and the Ministry of Finance authorised the acquisition in March 2004.

Conditions for the DnB NOR merger followed up

In July 2004 the Ministry of Finance approved the sale of Elcon Finans AS to the Spanish Santander Consumer Finance, and the transfer of Gjensidige NOR Fondsforsikring AS to the Danish insurer, Danica Pension. Danica Pension was also authorised to acquire the insurer Nordenfjeldske Personforsikring AS. Upon Kredittilsynet's recommendation, the Ministry of Finance granted DnB NOR ASA exemption until further notice from the ownership limitation rules in the Stock Exchange Act and the Securities Register Act to own existing shareholdings in Oslo Børs Holding ASA and Verdipapirsentralen Holding ASA.

Íslandsbanki authorised to acquire Kredittbanken

In November 2004, upon Kredittilsynet's recommendation, the Ministry of Finance approved the Icelandic bank, Íslandsbanki's, planned takeover of all shares of Kredittbanken ASA. Íslandsbanki has also issued an offer for all shares of Bolig- og Næringsbanken ASA.

Sparebanken Rana and Helgeland Sparebank merge

Following talks between Sparebanken Rana and Helgeland Sparebank, the two banks' responsible bodies decided on a merger. The merged entity will be named Helgeland Sparebank. Kredittilsynet received an application for merger on 21 December 2004, and recommended approval since it would contribute to a more solid bank for the region.

Interest grows in hybrid capital instruments

Only a few institutions applied in 2002 and 2003 for permission to issue hybrid capital. This changed radically in 2004 when Kredittilsynet received applications from 26 institutions, mostly small savings banks. All applications were granted.

Regulatory framework

EU Commission presents proposal for new capital adequacy rules/Basel II

The Basel Committee on Banking Supervision adopted in June 2004 new guidelines for calculating capital charges for banks. Shortly afterwards the EU Commission presented its proposal for changes to existing capital adequacy directives. The capital adequacy directives will be implemented in Norwegian law in the course of 2006 as part of Norway's fulfilment of EEA obligations. Kredittilsynet presented its plans for implementation in a consultative document in the autumn of 2004.

Guarantee schemes reformed

- *The Norwegian Banks' Guarantee Fund*

The Savings Banks' Guarantee Fund and the Commercial Banks' Guarantee Fund were merged in July 2004 to form the Banks' Guarantee Fund. Administration of the fund is shared between the Savings Banks' Association and the Norwegian Financial Services Association. The deposit guarantee, amounting to NOK 2 million for each depositor in each and every bank, remains unchanged.

- *Insurance guarantee schemes*

In October 2004 Kredittilsynet resubmitted to the Ministry of Finance a proposal to revise the rules for guarantee schemes in the insurance industry. If adopted, the proposal will delimit the guarantee schemes' coverage with a view to providing coverage for private individuals and small and medium-size enterprises.

Large businesses along with some insurance classes largely drawing professional clients will not be encompassed. The proposal also clarifies the issue of guarantee scheme membership for foreign companies operating in Norway. A further proposal is to terminate the Credit Insurance Companies' Guarantee Scheme, and possibly to further delimit the coverage provided by the Non-Life Insurance Companies' Guarantee Scheme.

- *New organisation of investment firms' provision of security*

The Storting has passed amendments to the Securities Trading Act's rules governing provision of security. The reason is that the EFTA Surveillance Authority considers investment firms' right to place an upward limit on the individual security furnished was counter to EU Directive 97/9/EC. The stage is now set for a collective guarantee scheme through the Investment Firms' Guarantee Fund that replaces existing individual guarantees. Kredittilsynet has drafted supplementary regulations.

Bill on insurance mediation in preparation

The Ministry of Finance asked Kredittilsynet to draft legislative provisions to implement Directive 2002/92/EC on insurance mediation into Norwegian law. A draft act on insurance mediation and an associated consultative paper were forwarded to the Ministry of Finance on 24 March 2004, and circulated for comment. The closing date for comments was 15 June 2004. A Bill is expected to be presented early in 2005.

New life insurance legislation passed

In the autumn of 2004 the Storting passed amendments to the rules governing life insurance. The intention is to establish an integrated body of rules that assures Norwegian companies suitable framework conditions with which to meet international competition. Important aims of the act are to create clearer divide between assets of the insured and the company, a clearer distribution of risk between client and company and more transparent pricing of life insurance products.

Proposal for regulation of hedge funds and venture funds

In November 2004 Kredittilsynet sent to the Ministry of Finance a proposal for amendments to the Securities Funds Act and associated regulations. If passed, it will enable the establishment of securities funds containing high risk, illiquid investments, such as pension funds and venture funds. These funds will only be available to professional investors.

Proposal to implement the Prospectus Directive into Norwegian law forwarded to Ministry of Finance

At the end of 2003 Kredittilsynet set up a working group to study regulatory amendments needed to implement the EU Directive on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market. Following a round of consultation on the amendments recommended by the working group, changes were proposed to chapter 5 of the Securities Trading Act and to the Stock Exchange Regulations. The Ministry of Finance is expected to introduce a Bill in the spring of 2005.

New rules to prevent market abuse

On 1 March 2004 Kredittilsynet forwarded to the Ministry of Finance its consultative paper recommending how the Market Abuse Directive (2003/6/EC) can be implemented into Norwegian law. After a round of consultation, the ministry proposed a law amendment in Proposition no. 12 to the Odelsting (2004–2005) which was enacted in January 2005. The Market Abuse Directive contains rules relating to insider trading and market manipulation. The Directive also lays down rules concerning compliance supervision.

New regime for supervision of financial reporting and new accounting rules are adopted

From 2005 onwards, stock exchange listed companies are required to present consolidated accounts in accordance with international accounting standards (International Financial Reporting Standards, IFRS). For other companies, compliance with the IFRS will be optional. Special considerations may call for this option to be limited or precluded in the case of financial institutions' company accounts. In order to strengthen confidence in presented accounts, national enforcement bodies are to be established to oversee that enterprises' reporting is in compliance with IFRS. By virtue of amending act no. 81 of 10 December 2004, this role was assigned to Kredittilsynet. The law amendment was enacted in January 2005.

Right to lay down new rules on auditors' independence

In December 2003 Kredittilsynet forwarded to the Ministry of Finance a proposal to include in the Auditors Act a legal basis for regulations laying down further rules on requirements as to auditors' independence and objectivity in the context of non-audit services. Associated amendments to the Auditors Regulations were also proposed. Both the draft law and draft regulations were circulated for comment by the ministry. The law amendments were enacted in January 2005.

Amendments proposed to the External Accountants Act

In the spring of 2004 the Storting decided that the responsibility for authorisation and supervision of external accountants should remain with Kredittilsynet. In September 2004 Kredittilsynet forwarded to the Ministry of Finance a proposal for amendments to the Authorisation of External Accountants Act, primarily with a view to simplifying administrative procedures. The amendment proposal is an updated version of a proposal originally sent to the ministry in September 2001. The proposal was circulated for comment by the Ministry of Finance on 16 December 2004. The closing date for comments was 18 March 2005.

Amendments adopted in the Estate Agency Regulations

Kredittilsynet has adopted amendments to the estate agency regulations which i.a. impose clear-cut requirements on the responsibilities, obligations and presence in the enterprise of the person effectively in charge. The person in charge is responsible for ensuring that the estate agency work is of a high standard by monitoring employed estate agents and seeing to it that they are qualified to perform their work tasks.

New money laundering legislation into force

The act and regulations went into force in January 2004. The new rules significantly widen the range of entities required to report to the National Authority for Investigation and Prosecution of Economic and Environmental Crime (ØKOKRIM) if they suspect that any client or customer is engaged in money laundering. Kredittilsynet has issued a circular (no. 9/2004) providing guidance to the new legislation.

Supervision costs also to be borne by foreign branches

Kredittilsynet has drawn up a proposal to change the rules for covering Kredittilsynet's expenditure. The intention is to include branches of financial institutions and investment firms from other EEA countries in the overall levy. So far only Norwegian enterprises have paid the overall cost of supervision. The Financial Supervision Act also provides for EEA branches in Norway to cover a pro rata share of the expenditure. The proposal was circulated for comment by the Ministry of Finance. It is proposed that the amendment should come into force with effect for the levy to be paid in 2005 for the year 2004.

Supervision and regulatory compliance

Review of anti-money laundering measures

Thematic inspections of 12 financial institutions were carried out early in 2004 to ascertain institutions' compliance with the money laundering legislation. The inspections revealed wide variations in awareness of money laundering. Serious rule breaches were also brought to light at some institutions. The general conclusions drawn from the inspections were communicated to all banks, mortgage companies and finance companies.

New risk and vulnerability analysis carried out

The source base for the 2004 risk and vulnerability analysis was widened to include information on events registered abroad, and information from collaboration with other governmental bodies, national and international alike. Types of threat emerging in other countries, but so far not in Norway, were analysed. The analysis paid particular attention to organised crime combined with financial institutions' use of the internet as a distribution channel for banking services. Internet banking in particular is viewed as a vulnerable area where risk-mitigation measures may be relevant, although the report also addresses a number of other vulnerable areas.

Unlawful activity in the securities market halted

- The 5 Percent Community

The 5 Percent Community (T5PC) applied in the autumn of 2003 for permission to set up a wholly-owned investment firm named Exente Securities ASA. Kredittilsynet regarded trading in shares issued by T5PC as incompatible with the Securities Trading Act. Permission to offer investment services can only be given provided the requirements of the Act are met. In order not to allow T5PC into the regulated securities market and to compel the emergence of owners who were fit to assure good, sensible management of Exente Securities ASA, Kredittilsynet asked T5PC to reduce its stake in the investment firm to below 10 per cent. T5PC failed to comply with this demand, whereupon Kredittilsynet refused permission and stopped processing the application in June 2004. Kredittilsynet had refused a similar application concerning Eurosmart AS in the autumn of 2003. Supervision of pyramid gaming schemes falls outside Kredittilsynet's remit, however.

- Delta Management AS

In November 2004 Kredittilsynet ordered Delta Management AS to cease operations. The company's business contravened the Securities Trading Act since it was in reality a securities fund run without authorisation. Some 40 investors had contributed a total of about NOK 45 million to the company since its establishment in April 2003. Kredittilsynet alerted the police of criminal offences related to the company's business. Delta Management AS was being wound up at year-end.

NOS Clearing ASA loses NOK 55 million

NOS Clearing ASA provides the clearing function in the market for freight derivatives (Imarex). In the course of the summer NOS suffered a loss of more than NOK 55 million. The loss arose when one of its members, a Greek company, defaulted on its obligations to NOS. Since the loss was substantial in relation to

NOS's own funds, the company needed refinancing. It was also considered necessary to increase the capital base to a higher level in order to maintain the confidence enjoyed by the clearing house among existing and potential members. A significant increase in risk exposure, primarily due to large volume growth in the market for freight derivatives, was a key rationale for this assessment.

Stocknet Securities ASA in breach of the Securities Trading Act

In the spring of 2004 Stocknet Securities ASA, an investment firm, was ordered to immediately cease lending client assets, and to separate such assets from those of the firm. A controlled closure of the credit facility was then carried out to ensure that clients' invested funds would not be exposed to loss. Advance warning was also given of withdrawal of Stocknet's licence to provide the investment service "reception and transmission, on behalf of investors, of orders in relation to financial instruments, as well as the execution of such orders". Since the firm acquired new owners and underwent a major reorganisation, the business was allowed to continue. Information on the case was forwarded to ØKOKRIM for prosecution.

Drop in number of notification cases referred by Oslo Børs

Ninety-three notification cases were referred to Kredittilsynet by Oslo Børs in 2004 compared with 161 in 2003 and 326 in 2002. Even allowing for the change in procedure for registration of such cases at the end of 2002, the number of referred cases has declined in real terms. The decline is probably due to increased awareness among market players, itself a result of Oslo Børs's and Kredittilsynet's active follow-up of possible infringements. In 2004 six issuers and individuals were fined for breaches of the securities trading notification requirement.

Kredittilsynet issues first-ever order to relinquish unlawful gain

Competence to order the relinquishment of unlawful gain was transferred from ØKOKRIM to Kredittilsynet. Kredittilsynet utilised this power for the first time in November 2004. The order in question, referring to a sum of about NOK 25,000, was issued to a party other than the offender. The background to the decision was a contravention of the Securities Trading Act's prohibition against insider trading. The offender acted on the basis of a trading authorisation from the party who had achieved the gain.

Kredittilsynet criticises Morgan Stanley Capital Group Inc. in the market for electricity derivatives

In 2004 Kredittilsynet dealt with a case of possible market abuse in the electricity derivatives market at Nord Pool ASA. After investigations were carried out, Morgan Stanley Capital Group Inc. was reported to ØKOKRIM on suspicion of possible contravention of the Securities Trading Act's prohibition against price manipulation. Since ØKOKRIM had insufficient capacity to handle the case, Kredittilsynet opted to draw up a report in which it criticised the company's market conduct.

IT operations outsourced to Denmark

Terra-Gruppen (TG) decided in the first quarter of 2004 to terminate its strategic collaboration with EDB Business Partner (EDB BP) in order to establish a new collaboration with SDC Udvikling AS (formerly Sparekassernes Datacenter - SDC) in Denmark. In 2003 SDC outsourced its IT operations, including staffing, to IBM Denmark. Kredittilsynet carried out an IT inspection of the project in the first quarter of 2004 and had critical comments on the way the project had been established and managed. Since TG is in this case acting on behalf of many small savings banks that lack competence in the IT field, it is particularly important that the project is subject to relevant, documented processes and that it is implemented with an acceptable level of risk.

Follow-up of requirements on auditors' post-qualifying training

In 2004 Kredittilsynet examined auditors' post-qualifying training. The process took the form of off-site supervision and on-site inspections. Non-compliance with the requirements, in some cases substantial, was brought to light. As a result, a number of auditors were either strongly censured or were ordered to step down as statutory auditors. One auditor's licence was withdrawn. Based on the deficiencies revealed in auditors' post-qualifying training, Kredittilsynet released in the autumn of 2004 a circular to all state authorised and registered auditors (circular no. 16/2004).

Substantial increase in complaint reports regarding external accountants and auditors

Kredittilsynet noted a substantial increase in the number of complaint reports regarding authorised external accountants and auditors in 2004. Most such reports originated from the tax authorities. The increase from 2003 to 2004 was about 70 per cent for external accountants and about 30 per cent for auditors.

International cooperation

Much work delegated to the EU's supervisory committees

Kredittilsynet's work is greatly influenced by international standards and regulatory developments in the EU. 2004 saw the establishment of new EU committees for banking supervision and insurance supervision. CEBS (Committee of European Banking Supervisors) and CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) are already well under way on preparing recommendations for the regulation and supervision of the banking and insurance sector, particularly related to capital adequacy and solvency. The committees have set up several working groups in which Kredittilsynet is a participant. CESR (Committee of European Securities Regulators) faced a large increase in its workload in 2004, largely due to the new Directive on Markets in Financial Instruments (MiFID). As a consequence of the new committee structure Kredittilsynet attended 200 meetings of working groups and committees within the EU/EEA. Moreover, Kredittilsynet hosted several international meetings in 2004.



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Organisational set-up and resource use

Board of Directors

Kredittilsynet's Board of Directors has by law the overarching responsibility for the agency's activities and handles important matters in relation to regulations and licences, budget and action plans. The board has five members. Members and alternates are appointed by the King for a four-year period.

Kredittilsynet's Board, appointed on 1 March 2002, has the following members:

Mr **Finn Hvistendahl**, chartered engineer, chairman
Mr **Endre Skjørestad**, advocate, deputy chair
Ms **Eli Aas**, advocate, board member
Mr **Erling Steigum**, professor, board member
Ms **Nina Mår**, court-of-appeals judge, board member

Ms **Marianne Berg**, district court judge, first alternate
Mr **Lasse Ekeberg**, director at the Norwegian Competition Authority, second alternate

Mr **Birger Vikøren**, director at Norges Bank, attends as observer. Mr **Thorvald Grung Moe**, special adviser, is his alternate.

Two members elected by and from among the employees supplement the board when administrative matters are dealt with. Since February 2003 the employee representatives have been:

Ms **Ellen Jakobsen**, senior adviser
Ms **Lisbeth Strand**, senior adviser

Alternates: Mr **Henning Siebke**, adviser, and Ms **Linda Bruås**, adviser

Eleven ordinary board meetings were held in 2004. The board dealt with 87 administrative matters and 59 supervisory matters requiring decision. The board was also informed about 114 supervisory matters.

Priorities in 2004

Kredittilsynet's supervisory activities are based on statutory tasks, the Ministry of Finance's annual letter of allocation based on the budget adopted by the Storting and Kredittilsynet's strategy. Kredittilsynet's strategy was adopted by the Board in November 2002 and, together with signals given by the ministry, guided Kredittilsynet's priorities in 2004.

Goal achievement in 2004

The goal of financial stability was achieved to a satisfactory degree in 2004. No bank experienced serious solvency or liquidity problems. Bank losses were significantly smaller than in 2003, and all categories of banks maintained satisfactory levels of financial strength and capital adequacy. Prospects for financial stability remain bright for the period immediately ahead, although many households have significantly increased their indebtedness, making both them and the banks vulnerable to higher interest rates and falling house prices.

Non-life insurance companies showed an improved profit performance on the purely insurance front, and can point to good results and a sound financial position despite the moderate financial return posted in 2004. Life insurance companies, with continued weak buffer capital, have benefited little from the substantial upturn in Norwegian equity values. In isolation, 2004 nonetheless produced relatively good returns for the companies and their customers.

The report entitled *The Financial Market in Norway 2004: Risk Outlook* (available at www.kredittilsynet.no) takes a closer look at financial stability and other conditions in Norway's financial industry. Many features of the international and Norwegian economy affect the financial markets. Kredittilsynet's task - through drafting regulations, monitoring and inspections - is to make a proactive contribution to reducing problems in the financial sector. Again in 2004, relatively few problems were noted in the sector. Kredittilsynet aims to give a closer account of the relationship between the goals and policy instruments of financial supervision in 2005.

The goal of ensuring orderly conditions in the markets and the financial industry appears to have been largely achieved. Recent years have seen significantly fewer breaches of the notification requirement in securities trading. This is a result both of information drives and of proactive efforts by Oslo Børs, Kredittilsynet, ØKOKRIM and other police agencies to bring to light and punish violations. A number of fines and judgments were handed down in connection with insider trading and price manipulation in 2004. This will probably be instrumental in reducing such rule breaches in the future. Although Kredittilsynet's investigation of suspected violations resulted in few referrals to ØKOKRIM or other police body in 2004, caution should be shown in interpreting this as evidence that such violations no longer take place.

Very few breaches of laws and regulations by financial institutions, insurance companies, real estate agencies or debt collection agencies were noted in 2004. Even so, several inspections showed that there was room for improvement in a number of areas.

With regard to auditing and accounting, Kredittilsynet conducted thematic inspections at the leading companies. The number of reports and complaints received, especially from the tax authorities, against auditors and external accountants has risen. Kredittilsynet attaches much importance to following up these cases, several of which resulted in censure and withdrawal of licences in 2004. Kredittilsynet will continue to follow up such cases in 2005.

Kredittilsynet has essentially achieved its target as regards case processing time (see table 1, page 16). Progress made with the strategic projects has by and large been satisfactory.

Strategic projects

Kredittilsynet's strategy (2002) contains seven strategic projects. Several reached completion 2003, while others continued in 2004. An overview follows below:

1. Development of risk-based supervision

Kredittilsynet is in the process of assessing the overall consequences of new capital adequacy rules for supervision, and is preparing the transition to a more risk-based regime along international lines (see page 31).

2. Control of prospectuses and accounts: preparing and setting the stage for new tasks

Proposed new rules on the prospectus to be published when securities are offered to the public or admitted to trading on a stock exchange or authorised market place were circulated for comment in July 2004. A proposal regarding the competence of, and sanctions available to, supervisory authorities will be circulated in 2005. New tasks related to prospectus control and con-

trol of institutions' observance of international accounting standards were identified in a report in 2003, along with the consequences of new Directives concerning information disclosure and financial reporting as well as corporate acquisitions. The report, available at www.kredittilsynet.no, analyses what the new rules entail in terms of responsibilities and functions, organisation, resources and methods. In 2004 it was decided that Kredittilsynet should assume responsibility for control of financial reporting (see a separate account of this under *Financial reporting supervision - listed companies* on page 48).

3. Methods, reporting and organisation of the supervision of asset management

An in-house survey of asset management in supervised institutions showed that institutions largely outsource asset management functions to investment firms, primarily within their own group. The project report assesses the need for changes in supervisory methods, in the reporting from institutions and internal adjustments to Kredittilsynet's organisational set-up. The report

formed part of the basis for Kredittilsynet's organisation project (strategic project no. 6) and has resulted in improved methods and closer collaboration on supervision of asset management and financial institutions.

4. Changes in the pension system and consequences for the supervisory regime

A project group at Kredittilsynet has prepared an interim report proposing measures to encourage longer-term management of pension assets which was forwarded to the Ministry of Finance on 16 September 2003. The interim report was followed up with a concretised draft model for longer-term pension saving that was sent to the Ministry of Finance on 19 May 2004. The model received a thorough evaluation by the Bank Law Commission in a letter dated 5 October 2004 to the Ministry of Finance which forwarded it to the Storting's Standing Committee on Finance and Economic Affairs. The committee expressed support for the model in Recommendation No. 4 (2004–2005) to the Odelsting. The project group will consider the need for further deliberation in light of Report No. 12 (2004–2005) to the Storting, a government white paper on pension reform.

5. Measures to improve the information available to end-users in the financial market

Upon Kredittilsynet's initiative a working group drawing participants from the Consumer Council, the Consumer Ombudsman and Kredittilsynet drew up a report on the information provided to retail customers in the financial market. Several of the measures recommended for improving information provision will require law amendments, and will be followed up by the three agencies. A key recommendation is to establish an internet-based information database/portal. The Consumer Council will head the working group whose remit is to look into such a solution. The first part of the report was finalised in the autumn of 2004. The report is available at the websites of the respective agencies, or can be obtained by contacting Kredittilsynet.

IMF assesses the financial sector

In the autumn of 2004 the International Monetary Fund (IMF) visited Norwegian authorities and financial market actors to gather information about Norway's financial system. The visit formed part of the Financial Sector Assessment Program (FSAP) which is designed with a view to assessing the financial system's stability. The FSAP helps countries to identify and remedy structural deficiencies in the financial sector and in that way increase their ability to withstand macroeconomic disturbances and spill-over effects from financial instability in other countries.

FSAP examinations have been conducted in a total of 71 countries, among them Sweden, Finland and Iceland. Experience shows that FSAP examination gives government authorities fruitful practical advice on how to make the financial system

6. Adjustments to Kredittilsynet's organisation

Changes in markets along with new supervisory methodology, areas and tasks call for an assessment of possible adjustments to Kredittilsynet's organisation. In May 2004 an internal project group, assisted to some extent by an external consultant, presented a preliminary report on the need for organisational changes in light of changing conditions and in order to assure rational resource use and a good governance structure at Kredittilsynet. After further discussions with the staff and at board level, it was decided that Kredittilsynet should continue its main structure comprising three departments linked to the central supervisory areas, an administration department and a staff unit serving the Director General. In order to address new and growing tasks, a special section for accounting supervision will be established, and the supervision of auditors and external accountants will be unified in another section within the accounting and auditing supervision department. Kredittilsynet attaches importance to internal flexibility, and therefore favours fewer organisational units. In addition, an increase in the number of tasks and staff in a number of areas has strengthened the second-in-command function at the larger units. Internal coordinating and controller functions have also been reinforced (see organisation chart on page 75).

7. Electronic administration

Work on introducing an electronic case-handling system started in 2003 and continued in 2004. The system is expected to improve the quality and oversight of document production – and thereby promote efficient resource use. Supervised institutions now largely file their reports electronically. These include capital adequacy reports by banks, mortgage companies, finance companies and investment firms, and reporting of large exposures. As from 2004, information on security furnished by estate agents and debt collection agencies is also obtained electronically. Kredittilsynet has signed an agreement with Altinn for delivery of an electronic reporting system. Kredittilsynet also collaborates with the Brønnøysund Register Centre on access to the Central Coordinating Register for Legal Entities and the Register of Enterprises' Reporting Obligations. The scope of information presented on Kredittilsynet's website and the website's functionality were also further developed in 2004.

more robust and efficient, which is why Norway asked the IMF to conduct such an evaluation.

In an FSAP review, the IMF considers how Norway complies with international principles and standards for various parts of the financial sector. The IMF took a special look at Norway's compliance with principles in the fields of banking supervision, insurance supervision and payments systems. Measures against money laundering and terrorist financing will be reviewed at a later stage under the auspices of the Financial Action Task Force on Money Laundering (FATF).

The visit, lasting from 14 to 26 October, was followed up with a further visit in February 2005. A report from the evaluation is expected to be made publicly available.

Feedback from Kredittilsynet's clients

How can the supervisory regime be improved? Kredittilsynet's strategy establishes that the activity must be user-oriented, and that user surveys must be conducted at least every second year. In 2004 a comprehensive quantitative user survey was carried out which, apart from external accountants, covered all categories of supervised entities and other stakeholders.

The survey polled views on the following aspects of Kredittilsynet's activity:

- Development and simplification of rules where Kredittilsynet wields influence
- On-site supervision (inspections)
- Analyses of markets and sectors
- Reporting to Kredittilsynet
- Information from Kredittilsynet
- Kredittilsynet's competence

The results were presented in the form of a quality index from 0 to 100, where a result above 70 is considered very good. What is to be regarded as a good result nonetheless depends on the nature of the business. Here, account needs to be taken of Kredittilsynet's position as a public supervisory agency. As a rule, pure service enterprises achieve higher scores than agencies with supervisory tasks.

The survey scores *Kredittilsynet's on-site supervision* highest. Of 20 factors, 16 quality aspects of supervision achieve an index score above 68 points. *Information from Kredittilsynet* is also regarded as good, scoring from 68 to 75 points. The results are similarly positive when it comes to *Communication with Kredittilsynet*, with results varying from 62 to 76. *Information products* score between 65 and 72, and *Analyses of markets and sectors* also achieve a good score. The four factors considered here achieve index values between 69 and 72.

Areas falling in an intermediate category are *Regular reporting to Kredittilsynet*, *Kredittilsynet's web pages*, *Kredittilsynet's competence* and *Overall satisfaction with Kredittilsynet*. The index score here ranges from 63 to 71 points.

The weakest score goes to the area *Development and simplification of legislation*. Of 11 factors covering this area, ten score less than 60 points. Five factors achieve 51 points or less. The weakest factor in this area is *Kredittilsynet's will and ability to simplify rules* (47 and 45 points). Other factors considered weak are *The time it takes to implement legislation*, and *Understanding of the enterprise's practical application of the legislation*. The same applies to *Ad hoc reporting to Kredittilsynet* and *Help over the phone when completing a form*. *Case processing time* is also considered a weak aspect (54 points).

The questions are linked to specific factors, enabling improvements to be made where results are weak. Exceptions are cases where Kredittilsynet must implement EU Directives under obligations set out in the EEA agreement and other guidance from Norwegian authorities.

A small, qualitative survey targeting some of the largest supervised entities was also conducted in conjunction with the review of Kredittilsynet's organisational set-up. The results from the qualitative survey were generally more positive than those from the broader quantitative survey. TNS Gallup writes in its report that the largest institutions are generally more familiar with Kredittilsynet, and that this fact explains the differences.

TNS Gallup was commissioned by Kredittilsynet to conduct both surveys.

Administration, staff and gender equality

Kredittilsynet's Director General is appointed by the King in Council for a six-year term. Mr **Bjørn Skogstad Aamo** was appointed for a new six-year term in February 1999 with effect from April 1999.

The Director General's salary at the end of 2004 totalled NOK 922,500, and the fee to the Chairman of the Board was NOK 150,000.

Twenty-seven vacancies were advertised in 2004 compared with 16 in 2003. Eight of the advertised positions were internal compared with nine in 2003. Applicants totalled 431 compared with 458 in 2003.

At the end of 2004 Kredittilsynet had 186 permanent staff compared with 178 at the end of 2003. Forty-seven per cent of the

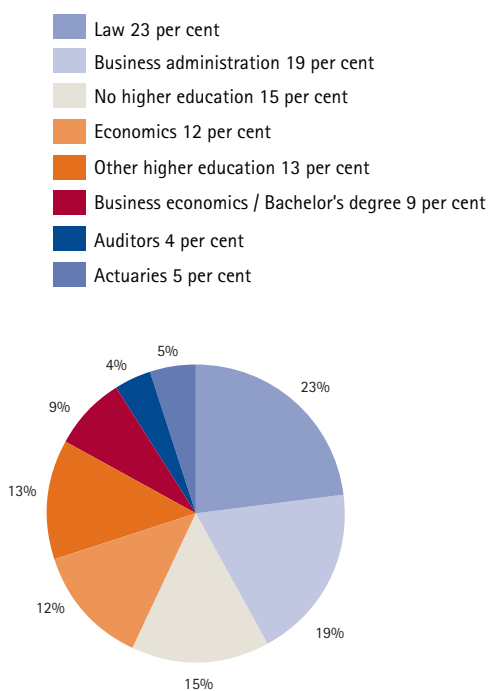
permanent staff are female. Eighty-five per cent hold a university degree or the equivalent.

Women constituted 29 per cent of Kredittilsynet's management team in 2004. Twenty-seven per cent of all managers with personnel responsibility were women. While an effort is made to recruit women to senior positions, the success of this effort depends on existing positions becoming vacant or on new senior positions being established. Kredittilsynet will attach importance to this issue when adjustments to the organisation are given effect. Women's pay measured 88.1 per cent of men's pay in 2004 compared with 87.6 per cent in 2003 (and 84.3 per cent in 1997). This development reflects the priority given to equal pay by the in-house pay policy. The gender equality effort is anchored in the work-environment and gender-equality committee. A separate elected representative for gender equality attends

meetings of the committee on a regular basis. The committee routinely reviews pay statistics for each job category and for Kredittilsynet as a whole in order to keep abreast of equal-pay developments.

Kredittilsynet attaches much importance to building up and maintaining the expertise needed to perform effective supervision, and this is reflected in its pay and personnel policy. Whereas in 1995 24 staff members had substantial experience (generally in excess of five years) from industries under supervision, by the end of 2004 the figure had reached 48. The fact that staff recruited from high-salary sectors are willing to accept a lower salary to join Kredittilsynet, and stay for some time, implies recognition of a high-quality environment offering jobs that spur personal development. Moreover, Kredittilsynet is now more successful than just a few years ago at retaining staff who have gained long supervisory experience and high expertise during their career with Kredittilsynet.

Chart 1: Staff educational background as of 31.12.2004



Kredittilsynet's staff turnover was 7 per cent in 2004 compared with 4.5 per cent in 2003, 5 per cent in 2002 and 11 per cent in 2001. The increase reflects changes in the labour market since 2001 which were particularly in evidence in the autumn of 2004. Staff turnover in 2004 is also regarded as low.

With its espousal of the government-sponsored "IE agreement" designed to promote inclusive employment, Kredittilsynet attaches importance to preventing sickness absence and to maintaining the agency's low level of sickness absence (2.8 per cent in 2004 compared with 3.3 per cent in 2003). The IE agreement is also designed to prevent discrimination of physically-challenged applicants who apply for jobs with the agency and to

increase the de facto retirement age. Collaboration with the Social Security Administration and company health service receives high priority under the IE agreement.

Kredittilsynet's code of ethics and guidelines – which include guidelines for securities trading and use of supervised entities' services by Kredittilsynet's employees and officers – are working well. The establishment of a controller function in the Director General's staff to monitor compliance with ethical guidelines and other internal guidelines is rooted in a wish to ensure consistent follow-up. An amendment to the Financial Supervision Act in January 2005 (proposed by Kredittilsynet) enables the introduction of regulations prohibiting or otherwise restricting trading by Kredittilsynet's staff in quoted shares etc. (Trading in shares etc. issued by supervised institutions is already prohibited.) Kredittilsynet will be drafting such regulations.

An in-house survey of the work environment was conducted in 2004 in conjunction with the organisational review (strategic project no. 6). The survey confirmed a general high level of well-being among Kredittilsynet's workforce, although some staff categories were somewhat dissatisfied with pay and career opportunities. Based on this, the management and organisations reviewed the agency's pay policy and pay trend in recent years for all employee categories. In instances where statistical data revealed a basis for dissatisfaction, this was taken into account in the in-house pay adjustments made during the year. Some changes were also made to the pay policy. Work on possible alternative options for professional and personal development and career development is under way.

Since 2003, in keeping with Kredittilsynet's strategy, specific targets have been set for the time spent on a selection of administrative cases and for supervisory reports and resulting observations. The aim is to process 90 per cent of such cases within 30 days. Where some types of complex cases are concerned, a longer period is allowed. The deadline for supervisory reports and ensuing observations varies somewhat from one area of supervision to the next. Target achievement is reported on a quarterly basis, and detailed results are published at www.kredittilsynet.no. Main figures for 2004 are as follows:

Table 1: Case processing time at Kredittilsynet as of 31.12.2004

Administrative cases	
Total no. of cases with processing-time target	2,211
No. of cases with 30-day deadline	1,575
No. of cases with longer deadline	636
Target achievement for 30-day deadlines	93.5%
Target achievement for longer deadlines	66.5%
Overall target achievement	85.2%

Supervisory reports and observations	
Supervisory reports: Total 169, 153 within deadline, i.e. 90.5% target achievement	
Supervisory comments: Total 157, 137 within deadline, i.e. 87.3% target achievement	

Table 2: Case documents registered by Kredittilsynet 1997–2004

Sector	1997	1999	2000	2001	2002	2003	2004
Administration / DG staff	480	594	686	1,116	850	1,196	1,213
Finance and insurance	8,141	6,497	7,098	6,696	6,947	7,036	6,715
Securities	3,850	3,798	4,908	6,833	7,911	5,822	5,796
Estate agency and debt collection	3,910	3,489	4,625	5,347	6,285	5,539	6,388
Accounting and auditing*	4,356	11,101	10,346	9,482	9,567	9,418	13,502
Total	20,737	25,479	27,663	29,474	31,560	29,016	33,614

* The increase as from 1999 is due to Kredittilsynet taking over the supervision of external accountants.

It should be noted that the complexity and scope of documentation in the financial and securities sector are far greater than in other areas. The increase in the number of registered documents

in accounting and auditing cases is due to a sharp increase in renewal of external accountants' licences in 2004.

Finances

Expenditure

Kredittilsynet's budget forms part of the government budget and is established by Parliament (Storting). The budget for 2004 totalled NOK 146.13 million. Including funds of NOK 2.27 million carried forward from 2003 the budget came to NOK 148.40 million. Kredittilsynet received an additional NOK 1.33 million in refunds of maternity and sickness benefits. The aggregate disposable budget accordingly came to NOK 149.72 million, while aggregate expenditure came to NOK 145.86 million, an increase of 8.2 per cent over 2003. Total salary expenditure rose by 5.5 per cent, while expenditure on goods and services rose by 14.7 per cent. Aggregate expenditure was just over NOK 3.8 million less than disposable revenues. Unutilised revenues will be carried forward to 2005.

As in the case of other government agencies included in the central government accounts, Kredittilsynet's accounts are prepared on a cash basis and, unlike in the case of private businesses, not an accruals basis. The accounts are prepared based on the central government chart of accounts which employs natural classification of revenues and expenses. Based on this chart, Kredittilsynet has classified expenditures by function. The main classification by function is shown in table 3.

The Office of the Auditor General had some comments and queries in connection with the audit of the accounts for 2003, related partly to the salaries areas and documentation of Kredittilsynet's system for apportioning supervision expenses among supervised entities. The Office of the Auditor General was satisfied with Kredittilsynet's explanations, and endorsed the accounts by letter of 29 June 2004.

Kredittilsynet's expenses have risen in recent years, the main reason being a wider sphere of responsibility resulting from new tasks and from legislative changes bringing new demands on Kredittilsynet. This particularly involves EU legislation, which Norway is obligated to implement. A pertinent example is the new capital adequacy framework and the development of risk-based supervision (see account on page 29 and page 31). Normal expansion of the securities market, of the financial industry and of the number of auditor and external accountant entities also requires an increased effort from Kredittilsynet if supervisory standards are to be maintained. Active use of tender processes has helped to keep down operating expenses.

Table 3: Kredittilsynet's expenditure 2002–2004

	2002 accounts	2003 accounts	2004 accounts
Salaries bill	85,603	94,866	100,058
Of which:			
Salaries and social costs (all positions)	83,036	91,736	95,725
Stand-ins / Substitutes	1,899	2,396	3,715
Other emoluments (directors, consultants etc. / other fees)	668	734	618
Goods and services	37,974	39,939	45,805
Of which:			
Operating expenses	15,959	16,420	16,640
Information	2,256	3,033	3,246
Service travel and meetings	3,988	4,185	6,307
Inspections and other supervision	3,520	4,615	5,509
Organisation development, leadership and competence development	4,127	4,054	4,949
IT expenditure	8,124	7,632	9,154
Total expenses	123,577	134,805	145,863

Figures in NOK 1000s
(Preliminary accounts for 2004)

Revenues

Under section 9 of the Financial Supervision Act, Kredittilsynet's expenses are covered by the institutions under its supervision at the start of the financial year. The Storting therefore adopts a revenue appropriation equal to the expenditure appropriation. The act requires the expenses to be apportioned among the various institutional groups based on the extent of the supervision, and the expenses are therefore paid in arrears.

The total amount levied for 2003 was NOK 126.52 million. The amount levied was smaller than actual expenses because a) the

levy is based on the budget appropriation, b) any amount carried forward from the previous year is deducted and c) part of the expenses are covered by the National Insurance Fund through refunds of maternity and sickpay outlays. The levy proposed by Kredittilsynet for 2003 was approved by the Ministry of Finance on 14 May 2004 after prior consultation with affected trade organisations. Supervised entities liable to pay the amount levied for 2003 number 9,792 compared with 9,296 in 2002. The apportionment of the levy among the various categories of supervised entities is shown in table 4.

Table 4: Total levy distributed on supervised groups

Supervised group	Percentage of total levy in 2002	Percentage of total levy in 2003
Banks	28.68	28.79
Insurance	24.65	24.59
Pension funds	4.46	4.60
Finance companies / Mortgage companies	3.79	3.70
Auditing firms / Auditors	4.81	6.27
External accountants	5.67	5.06
Securities market	16.89	16.97
Estate agencies	4.34	3.62
Debt collection	2.52	2.29
Holding companies	2.52	2.64
Miscellaneous	1.67	1.47
Total	100.00	100.00

Table 5: Distribution of expenditure 2000, 2002 and 2003 – as per cent of total

Supervised category	Calculation base	Per cent of calculation base		
		2000	2002	2003
Credit institutions	Total assets	0.0024	0.0024	0.0023
Insurance	Premium income	0.0432	0.0404	0.0357
Investment firms	Income from investment and ancillary services	0.1551	0.2343	0.2335
Management companies for securities funds	Total assets	0.0028	0.0047	0.0037
Estate agencies	Commission earnings	0.1736	0.1619	0.1315
Debt collection	Debt collection income	0.1674	0.1896	0.1767
Auditors	Turnover	0.2147	0.1925	0.2410

Table 5 shows the size of the levy as a per cent of the calculation base for various groups of supervised entities for the years 2000, 2002 and 2003. External accountants are omitted from the table since they pay an identical annual levy regardless of turnover. There is some variation between the groups in terms of the trend in the burden represented by the levy, due in part to conditions in the respective industries. Although Kredittilsynet's expenditure rose by 27.7 per cent from 2000 to 2003, several groups saw a decline in the levy they were required to pay.

Apportionment of Kredittilsynet's expenses – branches from EEA states

So far branches have played a minor role in Norway's financial market, although both banks and insurance companies now have branches of some size. However, several factors suggest that branches will play a more important role, and that Kredittilsynet as the host country authority will need to devote resources to supervision of these branches in the future. This also means that expenses on this supervision will have to be met by the branches and not, as is the case today, by apportioning all expenses on enterprises with their legal entity and head office in Norway. The Financial Supervision Act enables Kredittilsynet's expenses to be levied on branches of financial institutions and investment firms. Kredittilsynet sent a proposal on this subject to the Ministry of Finance in October 2004.

A survey shows that most EEA states that finance their supervisory authorities via a levy on supervised institutions also impose a levy on EEA branches. The size of the levy varies. EU rules require member states to oversee such institutions, and specify which member state is to have chief responsibility for supervision in cases where an institution is established in several jurisdictions. How the supervision is to be funded is not regulated, however.

Kredittilsynet's proposal entails a system for imposing a levy on branches that resembles the system used in the United Kingdom. In the UK, branches are included in the supervised category to which the business in question belongs, e.g. banking, finance companies or life insurance, and the same basis for

calculating levies is employed for the branch as for the supervised category. However, resources expended on branches are not comparable with resources spent on Norwegian institutions, and vary according to the type of institution. A levy could be imposed on EEA branches for the first time for the year 2004, payable in the spring of 2005. The report's recommendation will not require legislative amendments. The Financial Supervision Act provides the necessary legal basis for including EEA branches in the levy arrangement. The recommendation was circulated for comment by the Ministry of Finance with 16 November 2004 set as the closing date for comments, and is still being considered by the ministry.

Resource input by institution and function

Table 6 and 7 show an increase in resource input from 2003 to 2004 that was equivalent to about four full-time positions, i.e. four fewer than planned. The reason is that some new positions are filled later than envisaged, that vacancies have increased, and that long-term absence has risen slightly. Table 6 shows a marked increase in resource inputs in the banking and finance area. The same was true for estate agency. In both areas legislative drafting was an important explanation. The decline in the auditor area is related to an added effort made in 2003 vis-à-vis the larger firms.

Table 7 shows the distribution of resources by function. The resource input to on-site inspections rose compared with 2003. There was a slight fall in resource input to administration and enforcement of laws and regulations, while resources devoted to legislative drafting increased.

Table 6: Resource input by institution

	2002		2003		2004	
	FTEs*	Per cent	FTEs	Per cent	FTEs	Per cent
Banks	33.1	20.1	34.3	19.7	37.0	20.8
Finance companies	2.8	1.7	2.9	1.7	2.9	1.6
Mortgage companies	1.6	1.0	1.7	1.0	1.9	1.0
Insurance companies	27.6	16.8	29.5	16.9	28.9	16.2
Holding companies	3.0	1.8	3.1	1.8	3.3	1.9
Pension funds	5.6	3.4	5.6	3.2	5.9	3.3
Securities market	27.8	16.9	29.4	16.9	28.8	16.2
Estate agents	6.2	3.8	5.4	3.1	6.6	3.7
Debt collection	3.6	2.2	3.4	2.0	3.6	2.1
Auditors	5.9	3.6	8.1	4.7	7.5	4.2
Accounts in general	2.4	1.5	2.3	1.3	2.0	1.1
External accountants	5.9	3.6	6.6	3.8	6.0	3.3
Miscellaneous	0.8	0.5	0.6	0.4	0.8	0.5
Undistributed	37.9	23.1	41.1	23.6	42.8	24.0
Total	164.0	100.0	174.1	100.0	178.0	100.0

* FTEs - Full-time equivalents

Table 7: Resource input by function

	2002		2003		2004	
	FTEs	Per cent	FTEs	Per cent	FTEs	Per cent
1. On-site inspections	25.0	15.2	24.1	13.8	25.4	14.3
2. Off-site supervision	16.9	10.3	18.0	10.4	18.9	10.6
3. Monitoring the macroeconomy and other trends	4.3	2.6	4.1	2.4	4.3	2.4
4. Administering and enforcing laws and regulations	33.7	20.5	35.3	20.2	35.0	19.7
5. Legislative drafting and simplification	16.1	9.8	20.5	11.8	22.9	12.9
6. International cooperation	9.1	5.5	10.2	5.9	9.4	5.3
7. Information, communication and technology	16.7	10.2	17.7	10.2	18.1	10.2
8. Administration, leadership and organisation development	42.4	25.8	44.2	25.4	43.9	24.7
Total	164.0	100.0	174.1	100.0	178.0	100.0

Information and communication

Kredittilsynet views information and communication as a strategic instrument of supervision, especially with a view to preventing breaches of rules and standards. The information effort is directed in the first instance at institutions and sectors under supervision, and is based on the principles guiding the central government information policy. The information and communication aspect is incorporated in Kredittilsynet's strategy, and is also elaborated on in a separate communication strategy. Kredittilsynet attaches importance to contact with sectors under supervision, and holds regular meetings with trade organisations. Similar meetings are held with collaborating public authorities. Collaboration with the Consumer Council is formalised in a special agreement, and in 2004 Kredittilsynet collaborated with the Consumer Council and the Office of the Consumer Ombudsman on a joint project on the provision of information to end-users in the financial market (see account in the chapter *Money laundering and other issues*, page 66).

Kredittilsynet also participates widely in seminars for trade organisations and institutions under supervision, and numerous presentations are given on the agency's activities and tasks, as well as on rules and guidelines affecting supervised entities. In 2004 two seminars were arranged relating to securities market issues. The first was a press seminar on rule violations in the securities market, while the other, which was arranged in conjunction with Oslo Børs, dealt with the implementation of the EU Market Abuse Directive.

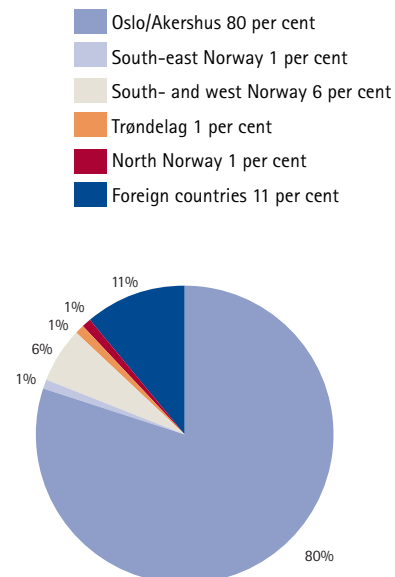
Nineteen circulars were issued in 2004 compared with 30 in 2003, and 38 press releases compared with 41 in 2003. One press conference was held.

Kredittilsynet's website, a key channel for information from Kredittilsynet, was further developed in 2004. Among other things it now features the agency's public postal journal. An automated system for subscribing to press releases, circulars etc. was also developed.

Kredittilsynet has wide-ranging contacts. Each year Kredittilsynet's management and other staff meet a large number of representatives of supervised institutions, trade organisations, collaborating authorities and international contacts. Kredittilsynet's officers meet many of these contacts in the field. Kredittilsynet received 1,932 visitors in 2004 compared with 1,980 in 2003. Eighty-one per cent of the visitors were from south-east Norway including Oslo.

A steadily increasing number of visits are made to Kredittilsynet's website. Just over 92,000 unique visitors came by the website in 2004, accounting for a total of 270,000 page views. "Unique visitors" means IP-logged PCs that have visited the site. A visit is defined as the number of files requested by a unique visitor in a 30 minute interval.

Chart 2: Visitors to Kredittilsynet as of 31.12.2004





NOTA	15.02	12 JR. 3. 3	750.00
YVF	20 ⁵ / ₁₆	10 ³ / ₈ + ³ / ₁₆	285.00
ASS	21.12	5.02 JR. 5. 3	210.00
YF	19 ³ / ₁₆	16 ³ / ₁₆ - ¹ / ₁₆	105.50
ANK	08.03	1.53 JR. 6. 6	165.25
ANK	29.03	2.16 JR. 10. 12	

Key figures and data on supervisory activities

Table 8: Figures for supervised entities as of 31 December 1999–2004

	1999	2000	2001	2002	2003	2004
Banks and financial institutions						
Savings banks	131	130	129	129	129	127
Commercial banks	13	13	15	16	15	13
Foreign branches of commercial banks	12	12	10	10	9	10
Norwegian branches of foreign banks	8	9	8	8	8	8
Finance companies	35	35	35	33	29	28
Foreign branches of Norwegian finance companies	-	-	2	2	2	2
Norwegian branches of foreign finance companies	13	18	21	21	21	22
Mortgage companies	9	11	10	10	10	11
Norwegian branches of foreign mortgage companies	1	1	1	1	1	1
E-money institutions						
E-money institutions					4	5
Insurance						
Life insurance companies	9	8	8	7	7	6
Unit Linked companies	6	6	8	6	6	6
Non-life insurance companies	51	52	53	52	46	47
Local marine insurance associations	15	14	14	14	13	13
Local fire insurance associations	22	21	20	20	20	20
EEA branches and foreign companies' general agents	21	29	29	29	30	30
Insurance brokers	41	44	49	50	50	49
Private pension funds	132	130	122	120	107	93
Pension schemes	84	80	70	65	50	38
Municipal pension funds	26	30	29	29	30	31
Holding companies						
Holding companies	12	13	12	13	8	8
Securities markets						
Investment firms	88	93	93	92	87	78
Management companies for securities funds	27	29	28	24	23	21
Clearing houses	1	1	1	2	2	2
The Norwegian Central Securities Depository	1	1	1	1	1	1
Stock exchanges	-	-	1	2	2	2
Authorised market places	-	-	-	2	1	1
Estate agency						
Estate agencies	428	479	507	528	542	578
Lawyers' practices incl. estate agencies	928	961	1,016	1,018	1,094	1,178
Cooperative building associations	-	77	67	55	47	41
Debt collection						
Debt collection agencies	117	115	113	113	123	114
Debt purchase businesses	-	-	-	8	10	10
Auditors						
Auditors	4,454	4,640	4,824	5,006	5,154	5,358
Auditing firms	489	507	514	507	514	518
External accounting firms						
External accountants	6,961	5,544	5,856	6,201	6,598	6,724
External accounting firms	2,325	2,138	2,377	2,415	2,566	2,542

The Banks' Payment and Central Clearing House (BBS AS) and EDB Business Partner ASA are not under direct supervision of Kredittilsynet, but are relevant for Kredittilsynet's supervisory activity as providers of technical solutions to Norwegian financial institutions.

Table 9: Number of on-site inspections by type of institution 1999-2004

	1999	2000	2001	2002	2003	2004
Banks/finance ¹	43	42	51	55	53	57 ¹
Holding companies	0	0	2	2	0	4
Insurance ¹	12	17	12	16	19	11 ¹
Insurance brokers	4	3	6	4	6	3
Pension funds	13	12	5	8	5	4
Investment firms	23	25	20	20	23	18
Other institutions in the securities market (incl. management companies for securities funds)	14	2	10	9	13	7
Estate agencies	68	62	60	71	12	19
Debt collection agencies	7	6	5	6	12	26
Auditors	128	80	73	32	19	65
External accountants	47	147	62	41	35	29
Data processing centres	3	0	1	2	2	2

IT supervision is included in the figures from 1999-2004.

Thematic inspections were carried out at 12 financial institutions in 2004 related to money laundering.

¹ Of these, four were on-site inspections of banking groups and one of an insurance group that were conducted under the auspices of the Swedish Financial Supervisory Authority with participants from Kredittilsynet.

Table 10: Number of IT inspections by type of institution

	2002	2003	2004
Banks/finance	4	6	4
Holding companies	2	0	2
Insurance	2	1	2
Insurance brokers	-	-	-
Pension funds	8	-	-
Investment firms	1	4	4
Other institutions in the securities market (incl. management companies for securities funds)	5	4	4
Estate agencies	-	-	1
Debt collection firms	-	-	1
Auditors	-	-	-
External accountants	-	4	1
Data processing centres / IT providers	2	2	2
Other	-	-	1

IT inspections are often conducted in conjunction with ordinary inspections. The number of IT inspections in table 10 is also included in table 9.

Table 11: Cases handled after the delegation from the Ministry of Finance 1999-2004

	1999	2000	2001	2002	2003	2004
Cases pursuant to Savings Banks Act (No. 1 of 24 May 1961)	45	48	28	50	46	69
Cases pursuant to Commercial Banks Act (No. 2 of 24 May 1961)	45	29	13	12	21	32
Cases pursuant to Financial Institutions Act (No. 40 of 10 June 1988)	81	69	64	59	53	130
Cases pursuant to Insurance Activity Act (No. 39 of 10 June 1988)	74	37	37	36	74	45
Cases pursuant to Tax Act, delegated by Ministry of Health and Social Affairs, under rules on occupational pensions	3	19	1	-	0	0
Cases pursuant to the Guarantee Schemes Act (No. 75 of 6 December 1996)	-	2	0	-	0	0



Banking and finance

Supervision of banking and finance is intended to ensure satisfactory financial strength, risk awareness, management and control of institutions and to promote financial stability and orderly market conditions. It comprises on-site supervision, off-site supervision and macroeconomic surveillance. In addition, Kredittilsynet is assigned administrative and consultative tasks as well as responsibility for drafting regulations.



Financial stability

In its macroeconomic surveillance Kredittilsynet monitors trends in the Norwegian and international economy that may affect financial market stability, and collates these aggregated trends with conditions among financial institutions brought to light via inspections. Based on its findings, Kredittilsynet forwards half-yearly confidential reports to the Ministry of Finance and Norges

Bank. Kredittilsynet's yearly report entitled *The Financial Market in Norway: Risk Outlook* provides a synopsis of the state of the Norwegian financial industry. Kredittilsynet and Norges Bank collaborate on monitoring financial stability on a systematic basis.

Analyses

Macroeconomic surveillance in 2004 focused above all on the rapid growth in bank lending to households. More than 70 per cent of aggregate bank lending to the non-financial private sector goes to households, mostly in the form of home mortgage loans. Hence bank risks largely refer to the housing market, and the trend in this market was followed closely. In conjunction with Statistics Norway, a study was made of households' sensitivity to possible interest rate increases to gain a better overview of the most exposed segments of the household sector. Persistent low rate interest rates ahead may encourage continued rapid lending growth which is likely to heighten banks' risk exposure to the household sector in the medium term. An interest rate hike, when it materialises, may prompt households to reduce their consumption. This could have repercussions for parts of the enterprise sector, thereby further increasing banks' risk exposure.

Regular analyses of credit institutions' profitability, financial strength and risks are prepared as well as ad hoc analyses of topical problems. Quarterly press releases on financial institutions' results and financial strength are published, together with Kredittilsynet's reports, on the agency's website. Key results from analyses of topical issues are also presented here.

Banks' results in 2004 were good, thanks mainly to low lending losses. The overall sector's financial position was satisfactory. Low interest rates have brought banks' net interest margins under added pressure, and net interest revenues fell further in 2004.

Surveys of banks' credit and liquidity risk were conducted in 2004. In Kredittilsynet's annual home loan survey, a selection of banks submit reports covering the total market for loans secured on housing property. The information obtained included banks' routines for assessing borrowers' ability to pay and data on collateral furnished. The survey of September 2004 showed that while the share of new home loans in excess of 80 per cent of property value was somewhat lower than 12 months previously, it was still high at 40 per cent. In about one in ten cases the loan exceeded 100 per cent of property value. Compared with the previous year's survey, the 2004 survey showed more loans for house purchase and fewer for refinancing. Other surveys were conducted to ascertain the degree to which borrowers received, and understood, information from banks on possible

consequences of borrowing on their personal finances. The great majority of customers were satisfied with the information they received from their bank. However, as much as 55 per cent of customers participating in the survey believed they had not been made aware of the consequences of an interest rate increase.

One survey focused specifically on banks' exposure to selected sectors and the risk picture this entailed. According to banks' own assessments, risk levels vis-à-vis selected sectors were somewhat lower than one year previously. The scale of bank lending secured on securities was also investigated in 2004, and was found to be low for the bank sector as a whole. The various analyses of credit institutions provide a basis for Kredittilsynet's assessment of the situation in the financial industry on a general basis, and for the on-site inspections performed at institutions. The report entitled *The Financial Market in Norway 2004: Risk Outlook* provides further information on these surveys.

Surveillance and analysis of the financial market is partly based on reporting by financial institutions. In conjunction with Statistics Norway and Norges Bank, Kredittilsynet devotes substantial resources to maintaining and refining systems used by credit institutions and insurance companies to report data to the three authorities.

Oversight of compliance with statutory requirements

Off-site and on-site supervision entails overseeing financial institutions' compliance with statutory requirements - including those related to capital adequacy, liquidity and large exposures. Compliance with most of these statutory requirements can for the most part be monitored by checking the financial reports regularly submitted to Kredittilsynet.

Oversight of annual accounts

Reviews in 2004 of the annual reports of the largest financial institutions focused on financial statements' compliance with laws and regulations, and were confined to specific themes. This work prompted follow-up in the form of clarifications explained either in circulars or in letters directly to the institutions involved. Kredittilsynet's reviews did not bring to light significant deficiencies in the institutions' financial statements in the areas investigated.

On-site inspection

The main aim of on-site inspections in the financial industry is to see to it that institutions have the requisite financial strength and risk awareness, and that their management and control systems ensure satisfactory risk management.

Fifty inspections were carried out in 2004 at commercial banks and savings banks, and seven inspections at finance companies and mortgage companies. Substantial resources were devoted to developing and testing new methods of risk-based supervision.

Banks' credit risk

The historically low level of nominal interest rates reduced banks' credit risk in 2003 and 2004. The scale of defaults has subsided, and loss provisioning volumes have been reduced.

The two largest banks increased the share of low-risk loans in their corporate portfolios in 2004, as measured by the banks' own risk classification systems. The share of medium- and high-risk loans were both concurrently reduced.

Strong growth in lending to retail customers combined with low credit demand from the business sector has shifted portfolio composition from the corporate market to the retail market. A shift in portfolio mix towards retail lending is normally considered to dampen risk. Inspections have shown that growth in retail lending essentially takes place outside banks' core region. Moreover, some banks have been confronted with the home loan surveys' finding that a high proportion of their home mortgage loans carried exposure in excess of 80 per cent.

A number of small banks are inspected each year based on developments in lending growth, defaults, losses, financing and tier 1 capital. Not all small banks are equally adept at managing lending. Moreover, small banks are in general more exposed to concentration risk linked to individual exposures and industries than are large institutions.

As a step in monitoring credit risk, Kredittilsynet analyses some large and medium-size banks' corporate portfolios using Norges Bank's credit risk model (Sebra). The analyses carried out in 2004 showed, for most small banks, little change in expected gross losses in the course of 2004. In the case of inspections conducted after the 2003 accounts became available, the accounting data reduced the losses expected. Most of the surveyed banks appear to carry a somewhat higher credit risk than the average for the overall enterprise sector in Norway. Moreover, the analyses suggest that banks are still unable to apply sufficiently differentiated risk pricing in their loan portfolios. Even so, the impression left by the inspections conducted in 2004 was that small and medium-size banks are also paying greater attention to risk pricing than previously.

In August 2004, the Ministry of Finance asked Kredittilsynet to look into banks' credit practice and information given to retail customers about interest rate increases. At the on-site inspections conducted in the second half-year, the banks were accordingly asked to give an account of the information they provided

to borrowers about the consequences of possible interest rate increases. In addition, loans and loan offer letters relating to a sample of home mortgage loans with a high loan to value ratio in relation to household income were scrutinised. The survey reveals that several banks lack exhaustive guidelines for when and how to inform retail customers of the consequences of interest rate increases. Kredittilsynet has raised the issue with both banking associations of how to improve the information given to bank customers.

Banks' liquidity risk

In 2004 liquidity risk was a main theme of inspections carried out at eleven small and medium-size banks. The general impression gained was that liquidity risk has been reduced in relation to previous years. Kredittilsynet's liquidity indicator shows that fewer banks have a weak funding structure. Small banks which previously experienced funding problems now report improved long-term funding opportunities.

Continued rapid credit growth and slower growth in bank deposits will increase banks' need for funding from other sources. In such a situation higher lending losses could well trigger liquidity problems for some banks.

Banks' market risk

The book value of a bank's shareholdings must not exceed 4 per cent of its total assets. Due to the positive share price trend on Oslo Børs, banks' overall exposure to equities rose in the course of 2004. Market risk levels are nonetheless low. Hence only two inspections focusing on market risk were conducted. One was a step in Kredittilsynet's testing of new methodology for risk-based supervision in the market risk area. This inspection revealed that the bank in question was very heavily exposed to a single company. The bank was criticised because its management board had not been provided with thoroughgoing risk analyses prior to deciding to sharply increase its equity exposure.

Operational risk

Under the new capital standard (Basel II) to be introduced with effect from 2007, operational risk will be included in the basis for calculating capital requirements. Operational risk is therefore one of the modules employed in Kredittilsynet's risk-based supervision. Alongside ICT risk, this module incorporates organisation, leadership and internal control. The first version of the module was tested in the second half of 2004. Evaluation of the test result and possible adjustments to the module will continue in 2005.

Operational risk associated with the use and operation of ICT systems is a substantial risk factor for the Norwegian financial industry. Norwegian financial institutions have largely outsourced their ICT solutions and operation of the latter to, among others, EDB Business Partner ASA and IBM in the Nordic region (in effect Sweden and Denmark). Reports on ICT inspections carried out in 2004 drew attention to problems associated with inadequate testing of catastrophe and back-up solutions and inadequate execution of risk and vulnerability analyses. The inspections

also brought to light inadequate control when implementing major ICT projects and problems in adhering to change management procedures.

Work was also done to improve the notification requirement for payment service systems. A new arrangement was introduced by Kredittilsynet's circular no. 17/2004.

In the first half of 2004 Kredittilsynet reviewed the annual reports for 2003 of listed Norwegian financial institutions. The survey was designed to identify the degree to which the institutions complied with Oslo Børs's new recommendation to include an account of corporate governance – presented in "Draft Norwegian recommendation on corporate governance". The survey showed that twelve of the twenty annual accounts contained a chapter specifically dealing with corporate governance, while eight listed companies made no reference whatsoever to the recommendation or to corporate governance.

Following an amendment to the internal control regulations, large financial institutions were required to establish an internal audit by 1 January 2004. Internal audit functions at large institutions will be subject to supervision in 2005.

Anti-money laundering measures

As part of its ordinary inspections Kredittilsynet examines banks' formal guidelines for preventing the laundering of proceeds of crime. Often, spot checks are also made of how institutions verify the ID of new customers. Checks continue to reveal errors and deficiencies at some institutions.

In order to identify the degree to which institutions comply with the money laundering legislation, thematic inspections were carried out at twelve financial institutions early in 2004. The inspections showed wide variations in institutional awareness of anti-money laundering measures. They also showed a failure by several institutions to comply with the requirement to appoint a compliance officer at senior management level to follow up the reporting obligation and to implement training programmes. There also turned out to be substantial deficiencies in institutions' ID verification procedures and in their documentation of prospective borrowers' debt servicing ability. General observations resulting from the survey were communicated to all banks, mortgage companies and finance companies together with a call for them to check their compliance with the legislation.

Individual cases

Helgeland Sparebank

Heavy loan losses compelled Helgeland Sparebank, a savings bank, to record a pre-tax loss of NOK 90 million in 2003. The loss reduced capital adequacy at end-2003 to 8.1 per cent, and the bank had to write down the value of its primary capital certificates and obtain new capital in the spring of 2004. Kredittilsynet made it clear in a letter of March 2004 that according to the banking legislation the bank's management board and managing director bore the main responsibility for the bank's unfavourable situation, and pointed to the effect of the bank's ill-advised strategy of expanding beyond its home district and opening new offices. In May the supervisory board appointed a new board chairman and two new board members, and in June the managing director stepped down.

Merger of Sparebanken Rana and Helgeland Sparebank

Following talks between Sparebanken Rana and Helgeland Sparebank, the two banks' responsible bodies decided on a merger. The merged entity will be named Helgeland Sparebank. It will have assets totalling about NOK 12.5 billion, a total capital ratio of about 13.2 per cent and a tier 1 ratio of about 11.25 per cent. Its office address will be in Mo i Rana, while head office functions will be divided between Mo i Rana and Mosjøen. Kredittilsynet received a merger application on 21 December 2004, and recommended approval since it would contribute to a more solid bank for the region.

Bonus schemes identified

Early in 2004 steps were taken to identify bonus schemes for board members and senior employees at Norwegian financial institutions. The aim was to gain an overview of the scale and design of such schemes. The conclusion drawn was that bonus schemes at Norwegian financial institutions are broadly speaking of moderate proportions and have been properly dealt with the institutions' governing bodies.

Nordic supervisory collaboration

Nordea

The cooperation agreement in effect between the Nordic supervisory authorities on supervision of the Nordea Group was updated in 2004 to take account of changes in the group's legal structure. Nordea Bank Norway is now owned by Nordea Bank AB (publ) on a par with Nordea Bank Finland and Nordea Bank Denmark. The parent company is the result of a merger between Nordea AB (publ) and Nordea Bank Sweden. Norwegian authorities have given their approval for ownership of Nordea Bank Norway to be transferred from Nordea Bank Finland to Nordea Bank AB.

The Swedish Financial Supervisory Authority is responsible for supervisory follow-up of each individual risk area and of the Nordea Group as a whole. Collaboration between the Nordic supervisory authorities is coordinated by the Nordea Supervisory Group in which the four Nordic countries involved are represented.

The collaboration is organised in working groups for various risks and processes, and draws participants from each country.

Five Nordic group-wide inspections were conducted in 2004 at Nordea. The inspections included credit risk, market risk, operational risks, anti-money laundering measures and the group's life insurance business. In addition, the supervisory authorities prepared a joint, overall risk assessment.

A Nordic working group, appointed by the Nordea Supervisory Group, has studied the supervisory consequences of Nordea's decision in principle to convert the subsidiaries into branches of a European Company (SE). The conversion will require permission in each country involved, including Norway. Assuming the conversion to branches is carried through, a new cooperation agreement will be drafted by the supervisory authorities.

Licensing and regulatory compliance

Sale of Elcon Finans AS

In connection with the merger between DnB and Gjensidige NOR in 2003, the Competition Authority made it a condition that Elcon Finans AS should be sold off. The merged entity DnB NOR Bank ASA and the Spanish Santander Consumer Finance signed in 2004 an agreement concerning the latter's acquisition of 100 per cent of the shares of Elcon Finans AS. Acting on Kredittilsynet's recommendation, the Ministry of Finance approved Santander Consumer Finance as Elcon's new owner. The Spanish company signed an agreement with the French Société Générale Group, transferring to it parts of the business of Elcon Finans AS.

Santander is to hive off the factoring and equipment leasing businesses to a recently established Norwegian limited company, SG Finans AS. SG Finans AS will be owned by Deufin Beteiligungsgesellschaft mbH., an indirect subsidiary owned by Société Générale SA. The hiving off and establishment, and acquisition by the new company, will be completed by 30 June 2005. SG Finans AS was granted permission to engage in financing activity on 22 December 2004.

Deufin Beteiligungsgesellschaft mbH. applied for approval to own 100 per cent of the shares of SG Finans AS and for permission to form a financial group. Kredittilsynet endorsed the application, and the Ministry of Finance duly approved Deufin Beteiligungsgesellschaft mbH. as the new owner by letter of 20 December 2004.

Íslandsbanki's acquisition of Kredittbanken

Kredittilsynet advised the Ministry of Finance to permit the Icelandic bank, Íslandsbanki, to take over all the shares of Kredittbanken. Kredittilsynet assigned particular importance to the fact that Kredittbanken had for some time sought a structural

partner with a view to resolving its financial problems. The Ministry of Finance granted authorisation on 29 November 2004.

Growing interest in hybrid capital instruments

Hybrid capital instruments are a type of bond sharing clear similarities with both equity instruments and debt instruments. Since 2002 financial institutions, subject to the requisite permission, have been entitled to employ hybrid capital instruments as tier 1 capital and upper tier 2 capital. The few applications received in 2002 and 2003 were all from large institutions. This changed radically in 2004 when Kredittilsynet received applications from 26 institutions, mostly small savings banks. All applications were granted.

Merger between Holla Sparebank and Lunde Sparebank

The Ministry of Finance authorised a merger between Holla Sparebank and Lunde Sparebank, in line with Kredittilsynet's recommendation. The new bank is named Holla og Lunde Sparebank.

Merger between Den norske Bank and Gjensidige NOR

Acting on Kredittilsynet's recommendation, the Ministry of Finance in November 2003 granted permission for DnB Holding ASA and Gjensidige NOR ASA to merge. Permission also covered a merger of the two banks. Conditions were imposed by the Ministry of Finance and the Competition Authority which the DnB NOR Group duly complied with in the course of 2004, including conditions related to disposal of companies and offices with a view to ensuring continued competition and to reducing owner interests in companies in which DnB NOR would otherwise have become an excessively dominant owner. One condition set

by the Ministry of Finance referred to use of brand names, including "Postbanken" which is part of DnB NOR Bank ASA. The group is to prepare a general standard for using brand names etc. which will require Kredittilsynet's approval.

Supervision of ownership of financial institutions – individual cases

New rules on supervision of ownership of financial institutions in the Financial Institutions Act came into force on 1 January 2004. The new rules are detailed in Kredittilsynet's Annual Report for 2003 page 30. The following authorisations were granted in 2004:

- The Government Bank Investment Fund's acquisition in DnB NOR ASA - up to 34 per cent
- Landkreditt's acquisition in Landbruksforsikring AS - up to 40 per cent
- Government's stake in DnB NOR ASA through the Ministry of Trade and Industry - up to 34 per cent (after closure of the Government Bank Investment Fund)
- Cavell Insurance Company Ltd.'s acquisition of Cirrus Re-insurance Company Ltd. AS (resolution adopted by the Ministry of Finance acting on Kredittilsynet's recommendation)
- Sparebanken Øst's acquisition in Bolig- og Næringsbanken - up to 20 per cent
- IKANO S.A.'s acquisition of IKANO Finans AS (resolution adopted by the Ministry of Finance acting on Kredittilsynet's recommendation)
- Kværner Holding AS's acquisition of Kværner Insurance AS (now Aker Insurance AS)
- The insurer Danica Skadeforsikringsaktieselskap af 1999's acquisition of Nordenfjeldske Personforsikring AS (resolution adopted by the Ministry of Finance acting on Kredittilsynet's recommendation)
- The insurer Danica Skadeforsikringsaktieselskap af 1999's acquisition of Gjensidige NOR Fondsforsikring AS (resolution adopted by the Ministry of Finance acting on Kredittilsynet's recommendation)
- Santander Consumer Finance S.A.'s acquisition of Elcon Finans AS (resolution adopted by the Ministry of Finance acting on Kredittilsynet's recommendation)
- Landkreditt's ownership of Landkreditt Bank AS through the holding company Centralkassen For Bøndernes Driftskreditt AS (resolution adopted by the Ministry of Finance acting on Kredittilsynet's recommendation)
- Finaref Group AB's acquisition of Finaref AS (formerly Ellos Finans AS)

Ownership testing was employed by Kredittilsynet when processing some licence applications. This applied to an application for enlarged authorisation for Møller Bilfinans AS and to applications for authorisation for the following finance companies: EuroConex Technologies Nordic AS, SG Finans AS, Lindorff Capital AS and GE Equipment Finance AS.

Regulatory amendments and consultations

New capital adequacy rules for banks

The Basel Committee on Banking Supervision adopted on 26 June 2004 a revised international capital framework for banks. Shortly afterwards, on 14 July 2004, the EU Commission presented its final proposal for changes to the existing capital adequacy Directives. The EU Commission's proposal is largely based on the Basel Committee's work on a new capital adequacy framework. A significant difference between the Basel Committee's guidelines and the proposal from the EU Commission is that the Basel Committee's guidelines only apply to banks, whereas the new EU Directives will apply to all credit institutions and investment firms in the European Economic Area.

The EU Commission's proposal is being considered by the European Parliament and the European Council. A final decision is expected in the autumn of 2005 before the Directives enter into force on 1 January 2007. The Directives will be implemented in Norwegian law as part of Norway's fulfilment of EEA obligations in the course of 2006.

Although the Directive enters into force on 1 January 2007, the most advanced methods will not apply until 1 January 2008.

The new Directives on capital adequacy will impose substantial demands on institutions, requiring them to start preparations at

an early stage. This will particularly apply to institutions intending to utilise the more advanced methods for computing minimum capital requirements. In September 2004 Kredittilsynet published a document concerning the new capital adequacy rules. This document is designed to obtain views from the industry and other interested parties on Kredittilsynet's preliminary assessments of parts of the framework that are regarded as important in relation to institutional preparations. Kredittilsynet has opted to prioritise the rules governing institutions' use of an internal rating-based (IRB) approach to computing minimum capital charges for credit risk. The document also contains assessments relating to the standard method for measuring credit risk, and to the various methods for computing capital charges for operational risk.

Some uncertainty still attaches to the details of the final framework. Although the main features of the framework are assumed to stand firm, the possibility that the political treatment of the Directives within the EU may bring changes with consequences for the final design of the framework cannot be ruled out. Implementation of the Directives will also be subject to political consideration in Norway, where laws and regulations will be adopted by the Storting and the Ministry of Finance respectively.

Implementation of the new capital adequacy rules in Norway will also depend on how the rules are implemented in other European countries, including the other Nordic countries. Kredittilsynet points out that work is under way under CEBS auspices that will touch on a number of issues with possible consequences for implementation in Norway.

The Nordic supervisory authorities have established a collaborative arrangement related to capital adequacy in order to ensure that implementation of the new capital framework across the Nordic area is as uniform as possible.

As part of the preparations for the new framework, Kredittilsynet has established a reference group together with affected trade organisations and Norges Bank. This will enable Kredittilsynet to gauge the views of the financial industry and identify practical issues that need to be clarified before the Directive is implemented.

Kredittilsynet will continue its work on implementing the capital adequacy framework in Norway in 2005. Key tasks will include preparing the legislative process, as well as further clarifying the application and approval process for institutions intending to utilise more advanced methods to compute capital adequacy.

Act on European Companies (SE)

The Ministry of Justice circulated draft legislation on European Companies for comment. The Bill entails i.a. that banks and other financial institutions holding a licence from Norwegian authorities will be entitled to have their headquarters in another EEA state, either as the result of a merger or relocation. In its submission, Kredittilsynet emphasised that any such merger or relocation taking place under the SE Act will need to undergo an approval process to ensure that the general good and customer interests are protected. This particularly applies to information on established guarantee schemes in respect of customer claims against the company in question. The Ministry of Justice has taken due account of this point in its work on the Bill, cf. Proposition No. 17 (2004–2005) to the Odelsting.

Deposit guarantee schemes

The Savings Banks' Guarantee Fund and the Commercial Banks' Guarantee Fund were merged to form the Norwegian Banks' Guarantee Fund on 1 July 2004. The administration of the new fund is split between the Savings Banks' Association and the Norwegian Financial Services Association. The fund has its own secretariat. The deposit guarantee remains unchanged, such that each and every depositor is protected up to an amount of NOK 2 million per bank. The rules governing calculation of the minimum required size of the fund and members' fees have been changed. Savings banks have concurrently been given exemption from fee payment for a three-year period to compensate for the difference in capitalisation between the two funds.

A working group drawing members from the two original guarantee funds, Norges Bank and Kredittilsynet presented in the autumn of 2004 a report recommending clarification of a series of unresolved issues related to the scope of the deposit guarantee. The report can be a useful tool for the banks in providing information to their customers.

The cover afforded by membership of the Norwegian Banks' Guarantee Fund is significantly higher than the cover available in most European countries. According to the EU Deposit-Guarantee Schemes Directive, banks operating branches in another EEA state are covered by the home country's deposit guarantee scheme. Foreign banks' branches might wish to join the Norwegian Banks' Guarantee Fund on a voluntary basis in order to compensate for the difference between the home country guarantee and the cover offered in Norway, so-called "topping up". Kredittilsynet sent draft regulations regarding this matter to the Ministry of Finance in the summer of 2004. The proposal entails that Kredittilsynet will be charged with quality-assuring the information needed by the guarantee fund in order to ensure correct payment to depositors. According to the proposal the establishment of satisfactory cooperation agreements between the guarantee funds is a prerequisite.

Supervision of financial conglomerates

The EU Financial Conglomerates Directive must be implemented in Norway by January 2005. In the summer of 2004 Kredittilsynet forwarded to the Ministry of Finance a proposal concerning changes to Norwegian legislation to transpose the Directive. A financial conglomerate is defined as a group of companies carrying on banking and/or securities business in addition to insurance. Kredittilsynet recommends the introduction of common rules for financial groups, irrespective of whether they engage in business in one or more segments of a financial sector. The need for regulatory amendments in Norway is relatively small, since the financial legislation has envisaged that supervision will be conducted on a group-wide basis, and that all solvency and prudential requirements will be met on a consolidated basis. One important change will apply to supervision of conglomerates that have companies located in several EEA states. The Directive requires a greater degree of supervisory coordination, and provides for direct reporting by a subsidiary to a foreign supervisor.

Kredittilsynet's guidance to new money laundering legislation

The Act on measures to combat the laundering of proceeds of crime etc. (Money Laundering Act) and associated regulations went into force on 1 January 2004. The new legislation is largely an implementation of the EU's second money laundering Directive (2001/97/EC) and of certain international standards in this area, especially the FATF's (Financial Action Task Force on Money Laundering) special recommendations on terrorist financing. The legislation significantly widens the range of persons and undertakings obliged to report to ØKOKRIM any suspicion that a client or customer is engaged in money laundering. Entities with a reporting obligation now include auditors, external accountants, real estate agents, lawyers and dealers in valuable objects, in addition to banks and other financial institutions that are already subject to such rules. Kredittilsynet's circular no. 9/2004 addresses all groups of supervised entities with a reporting obligation. The circular reviews the money laundering legislation, focusing particularly on practical situations, for example identity verification. The trade organisations provided input to the circular.

Amendments to the regulations on primary capital certificates (PCCs)

Kredittilsynet considered and recommended approval of a proposal from the Savings Banks Association to amend the PCC regulations such that hybrid capital instruments, like subordinated loan capital, are excluded from the PCC-holder fraction employed to distribute profit for the year. Kredittilsynet also recommended that the provision governing order of priority be amended to take account of hybrid capital instruments. Kredittilsynet further recommended including a new provision in the PCC regulations enabling Kredittilsynet to issue further rules concerning implementation and scope of the regulations. This involves rules governing distribution of the equity capital effect in connection with full transition to new EU-approved accounting standards and upon transition to new IAS/IFRS-adapted legislation.

Bank card regulations – access point commission

The Federation of Norwegian Commercial and Service Enterprises, the Norwegian Hospitality Association and Oslo Commercial Association called on the Ministry of Finance to put into effect section 3 of the Bank Card Regulations (no. 1025 of 5 October 1989). This section sets a maximum limit of 1 per cent of the purchase sum for access point commission that international credit card companies are entitled to charge user access points (shops, restaurants etc.). The Ministry of Finance asked the Competition Authority, Kredittilsynet and Norges Bank to jointly report on the competitive situation in the market for international payment cards/credit cards. On 2 November 2004 Kredittilsynet sent its recommendations to the Ministry of Finance, based on the report from the appointed reporting group. The market for international payment cards in Norway features strong concentration and a price level at the upper end of the price range compared with other countries. However,

significant changes are under way which are likely to result in keener competition and lower prices. Kredittilsynet has therefore recommended a two-year observation period before any steps are taken to promote competition. Kredittilsynet does not recommend the Ministry of Finance to put section 3 of the credit card regulations into effect. The Ministry of Finance circulated the above report for comment, mainly to actors and interest groups in the credit card industry.

Risk-based supervision

Kredittilsynet is analysing the overall consequences of the new capital adequacy framework for financial supervision and is preparing for the transition to more risk-based supervision along international lines. The transition to more risk-based supervision is proceeding according to plan, and the modules for credit risk, market risk and liquidity risk have now been brought into play. The module for operational risk has been tested and will be put into operation in 2005 after further evaluation. The modules for insurance risk, life insurance and non-life insurance will be finalised in 2005.

In the autumn of 2005 an overall risk assessment will be prepared for each of the largest financial conglomerates. This will put into place one of the basic elements of supervision under the new capital adequacy regime. Together with follow-up of the institutions' own assessments of risk factors and need for own funds, the overall risk assessment will provide a basis for possible supervisory measures. The new capital adequacy framework is expected to be introduced as from 2007.



Insurance

Supervision of the insurance industry aims to ensure satisfactory solvency, risk awareness, management and control of institutions and to promote financial stability and orderly market conditions. It comprises on-site supervision, off-site supervision and macroeconomic surveillance. In addition, Kredittilsynet is assigned administrative and consultative tasks as well as responsibility for drafting regulations.

Financial stability

Kredittilsynet's macroeconomic surveillance involves following developments in the Norwegian and international economy of significance for financial stability. Given the prominence of mixed groups in the Norwegian financial market, there is an ever greater need to include insurance companies in this surveillance. Moreover, insurance companies are central participants in the

Norwegian securities market. Half-yearly confidential reports are forwarded to the Ministry of Finance and Norges Bank, and a yearly public report – entitled *The Financial Market in Norway: Risk Outlook* – provides a synoptic assessment of the state of the Norwegian financial industry.

Analyses

Insurance companies' results essentially reflect the trend in securities markets. Recent years have seen major changes in the composition of life insurers' investments, featuring a substantial reduction in the proportion of total assets invested in shares and an increase in holdings of fixed-income securities. Macroeconomic analysis of the insurance industry in 2004 focused on insurers' profitability and solvency in light of their asset composition and continued low interest rates. See also the report entitled *The Financial Market in Norway 2004: Risk Outlook* for a separate analysis of the impact of potential interest rate movements on insurers' profitability ahead.

Analyses of insurance companies' profitability, solvency and risk are prepared on a regular basis, along with ad hoc analyses of topics of current interest. Quarterly reports on insurers' results and solvency are published on Kredittilsynet's website, and quarterly press releases illuminate the main trends.

A low share component, a large proportion which is invested in foreign shares, meant that life insurers benefited little from the upturn on Oslo Børs. At the same time low interest rates left

weak returns on fixed-income securities. Overall premium revenues (adjusted for transfers) rose substantially in 2004. Part of the increase in premium revenues is attributable to a reduction – from 4 to 3 per cent – in the minimum guaranteed interest rate on existing insurance contracts. Much emphasis was given to the use of stress tests to gauge insurers' vulnerability to falls in interest rates and share values.

Several years' increase in non-life insurers' premium revenues accompanied by a stable trend in claims and expenses have improved this segment's technical results. However, as in the case of life insurers, low share components meant that non-life insurers benefited little from the share market recovery which thus made little contribution to profits.

Pension funds performed somewhat less well in 2004 than in 2003. Municipal pension funds in particular saw a decline in profits. Private pension funds, with their higher equity exposure, fared better.

On-site supervision

A main aim of on-site supervision of insurance companies is to see to it that they have the requisite solvency and risk awareness, and that their management and control systems ensure satisfactory risk management.

Non-life insurance

Inspections were conducted at eight non-life insurance companies in 2004.

The improvement seen in non-marine insurance businesses' operating results in 2003 strengthened in 2004. At end-2004 all major companies reported a combined ratio below 100 per cent. Reduced financial revenues due to lower interest rates and a moderate trend for international equity capital instruments pulled in the opposite direction. Given the likelihood of continued low interest rates and the uncertain trend on international stock exchanges, non-life insurers will need to withstand pressures on premiums that can be expected in the wake of their positive

results. Inspectors have consequently given increased attention to non-life insurers' management and control, in particular their compliance with the internal control regulations.

In the case of marine insurance the picture is less favourable. Although premiums have shown a rising tendency over the past two years, positive technical results are still some way off. Moreover, premium levels now seem to have stabilised, and signals from the market suggest that a further increase in premiums will be difficult to achieve. A further factor is that reinsurers have tightened their reins after several deficit years, compelling marine insurers to bear a larger share of loss incurred.

Reinsurance

After good results in 2003 and the first half of 2004, the reinsurance market suffered a serious setback in the third quarter of 2004 due to the storms that hit parts of the West Indies and the southeast coast of the USA. The reinsurance market is therefore

likely to remain tight in the years immediately ahead, with repercussions for companies that are dependent on this market. In Norway this particularly applies to marine insurers. Where the tsunami disaster in Southeast Asia is concerned, the market's immediate judgement is that it will not significantly exacerbate the situation, due to low insurance coverage in the affected areas.

Life insurance companies

Inspections were conducted at three life insurance companies in 2004.

Strategic asset management and overall risk management are central themes of on-site inspections at life insurers. With a basis in the asset management regulations' emphasis on stress testing and continual assessment of risk capital utilisation, particular importance is attached to the capacity of life insurers' buffer capital to cushion against value falls in securities markets. The likelihood that interest rates will remain low suggests that increased emphasis should be given to insurers' ability to honour their guarantee obligations in the longer term.

Since life insurers have outsourced much of their asset management to investment firms and asset management companies, they exert less direct control over the operational risk involved. In light of this, Kredittilsynet considers it imperative for companies to maintain an updated management agreement that clearly describes the management mandate. Management agreements must also contain reporting requirements enabling the outsourcer to keep track of risk and return. Moreover, the outsourcer should retain sufficient competence and resources to ensure his ability to attend to investment strategy on an independent basis and his ability to assess the quality of the asset manager's performance.

Pension funds

Inspections were conducted at one municipal and three private pension funds in 2004. Errors in annual accounts and failure to implement the internal control regulations were drawn attention to at several pension funds. Moreover, several funds had failed to update management agreements and other agreements with external providers and had omitted to prepare data security guidelines as required by the ICT regulations which became effective on 1 January 2003.

Where asset management is concerned, one fund lacked an asset management strategy adopted by the management board and the strategy documents of two other funds were deficient. Moreover, several pension funds were shown to have deficient routines for reporting to the management board in the asset management field. The deficiencies related i.a. to reporting of risk limit utilisation.

Insurance brokers

Inspections were conducted at three insurance brokerages in 2004.

The inspection reports drew attention to deficient routines in general and to the absence of routines for reconciling trade debtors and commission receivables in particular. Poor follow-up of audit reports was also censured.

Insurance brokerages have yet to be brought within the scope of the internal control regulations. With reference to the Private Limited Companies Act section 6-12 on the board's management responsibilities, Kredittilsynet nonetheless recommends brokerages to adhere to the principles of the internal control regulations.

Individual cases

Order to cease insurance activity

The Norwegian Oil and Petrochemical Workers' Union (NOPEF), the Federation of Offshore Workers' Trade Unions and the Norwegian Organization for Managers and Supervisors have established a scheme to compensate members of these organisations who lose their health certificate. The scheme is administered by NOPEF. In Kredittilsynet's view, the scheme is licensable insurance activity. Since none of the parties to the agreement are licensed to engage in insurance, Kredittilsynet ordered NOPEF to terminate the scheme. NOPEF appealed against the order, and the appeal was forwarded to the Ministry of Finance accompanied by a recommendation that it uphold Kredittilsynet's order.

Danica Pension – Acquisition of Norwegian insurance companies

Kredittilsynet received in the spring of 2004 an application from the Danish company Danica Skadeforsikringsaktieselskab af 1999 (Danica Pension) for permission to acquire up to 100 per cent of the shares of Nordenfjeldske Personforsikring AS. The shareholdings in question were owned by the Danish insurer Codan A/S

(51 per cent) and Fokus Bank ASA (39 per cent). Nordlandsbanken owned the remaining 10 per cent of the shares. Like Danica, Fokus Bank ASA is wholly owned by Danske Bank A/S.

Kredittilsynet subsequently received an application from Danica Pension for permission to acquire 100 per cent of the shares of Gjensidige NOR Fondsforsikring AS, a subsidiary in the DnB NOR Group. The Competition Authority had ordered this company to be sold off as a condition for the merger of the two financial groups DnB and Gjensidige NOR.

Kredittilsynet recommended approval of both applications, and permission for acquisition was subsequently given by the Ministry of Finance. Danica Pension also has a branch in Norway. Norwegian authorities were informed that steps will be taken to coordinate the three businesses at a later stage.

Nordic supervisory collaboration

If Skadeförsäkring Holding group and the controlling company Sampo Abp.

In 2004 Storebrand ASA, Skandia/Skandia Liv and the Finnish insurer Varma sold their interests in If Skadeförsäkring Holding AS to Sampo Abp. If Skadeförsäkring Holding AB is now wholly owned by Sampo Abp.

The agreement between the Swedish Financial Supervisory Authority, the Finnish Insurance Supervisory Authority and Kredittilsynet concerning supervision of If Skadeförsäkring remains in effect. The agreement entitles Kredittilsynet to attend important meetings that the Swedish FSA holds with If and to take part in on-site inspections. The Swedish FSA again prepared a risk evaluation of the If Group in 2004, assisted by the Finnish Insurance Supervisory Authority and Kredittilsynet.

In 2004 the Finnish Financial Supervision Authority, the Finnish Insurance Supervisory Authority, the Swedish FSA and Kredittilsynet signed an agreement concerning supervision of the

Sampo Group. The Finnish Financial Supervision Authority is responsible for supervision of the Sampo Group, while the Swedish FSA is responsible for supervision of If Skadeförsäkring Holding AB's insurance business under the continued supervisory agreement for the If Group. A supervisory team has also been set up for the Sampo Group, drawing participants from the three countries' supervisory agencies.

Nordea Liv in the Nordic region

The Danish FSA, the Swedish FSA, the Finnish Insurance Supervisory Authority and Kredittilsynet collaborate on supervising Nordea's life insurance business in the Nordic region via the Insurance Supervision Group for Nordea. The group reports to the Supervisory Group for Nordea (see page 28 in the chapter *Banking and finance*), and has special responsibility for conducting supervision of groups as required by the Insurance Group Directive. In addition to internal meetings between the supervisory authorities, a meeting was held with Nordea Liv's group management in Denmark in 2004.

Licensing and regulatory compliance

Requirements on the content of risk in life insurance

Life insurers' product notices for account-based endowment insurance in 2004 contained a minimal risk element and consequently begged the question of how far the mortality and disability element of such insurances can be reduced without the products coming into conflict with the Insurance Activity Act section 7-1 which states that an insurance company can only engage in insurance, or with the banks' monopoly on deposits under the banking legislation.

Kredittilsynet has refrained from commenting on product notices describing a minimum mortality risk cover of 30 per cent of the paid-in savings. Some life insurers reported a substantial increase in sales of account-based endowment insurances in 2004 due to highly competitive returns compared with other short-term savings mediums. The latent risk of paid-in funds being transferred in the event of return ceasing to be competitive could have cash-flow consequences which suggest that insurers should adopt a shorter-term approach to investment. However, this would conflict with the interests of other customer groups with a longer-term perspective on their insurance contracts.

Interest rate guarantees in life insurance

Regulations on premiums and insurance funds in life insurance (no. 1005 of 15 September 1997) require Kredittilsynet to set a maximum interest rate below 3 per cent in life insurance should 60 per cent of the effective yield on long-term government bonds fall below 3 per cent. Any such reduction in the maximum rate must be established by 1 December prior to the calendar year it takes effect. This provision implements the corresponding EU rule into Norwegian legislation.

After making an overall assessment in November 2004, Kredittilsynet decided not to reduce the current maximum interest rate guarantee. In its assessment Kredittilsynet pointed out that any change in the interest rate would need to be on a lasting basis, and that adjustments made by other European countries to the situation had to be taken into account. Moreover, it was only a year since the interest rate guarantee on established contracts in group pension insurance had been reduced from 4 per cent to 3 per cent. Kredittilsynet pointed out that the authorities only set the maximum rate. Within the limits laid down by relevant legislation, insurers have an independent responsibility to assess the level of interest rate guarantees, and they are entirely at liberty to stipulate a lower rate than the maximum permitted. Since shortly before year-end Kredittilsynet has sought to induce life insurers to strengthen their buffer capital to put them in a better position to meet their long-term obligations and ensure good returns for policyholders and owners. A closer account of the situation in the insurance industry is given in the report *The Financial Market in Norway 2004: Risk Outlook*.

Gender as a factor in premium calculation

In March 2003 the Gender Equality Ombud decided that employing gender as a factor in calculating premiums in non-life and health insurance amounted to direct discrimination in contravention of the Gender Equality Act section 3. The Gender Equality Ombud's decision was appealed to the Norwegian Financial Services Association (FNH) and a number of non-life insurers in April 2003. In January 2004 the Board of Appeals for gender equality ruled that employing gender as a factor in calculating premiums in non-life and health insurance contravened the prohibition against direct discrimination set out in the Gender Equality Act section 3, and had to cease. The industry

was given a deadline of two years to comply. In response to a request from the Ministry of Finance, Kredittilsynet has considered whether the Insurance Activity Act section 7-6 requires insurers to employ gender as a factor in premium calculation, or whether the intentions behind the provision can be fulfilled by employing other factors. In Kredittilsynet's view, the Insurance Activity Act requires insurers to employ gender as a factor in premium calculation in cases where sufficient statistics are available showing that risk differs significantly for women and men, and employing alternative factors would not result in correct calculation of premiums. However, even if correct premium calculation is possible using alternative factors, the expediency of employing alternative factors as a substitute for gender may be questioned. In Kredittilsynet's view, insurers should be entitled to employ gender as a premium calculation factor in these cases too. This would appear to be commensurate with the EU Commission's revised proposal of 24 September 2004 for a Directive on gender equality. The proposal opens the way for member countries to allow gender to be employed as a factor in calculating premiums provided reliably updated and publicly available statistical data justify the existence of risk differentials between men and women.

The actuarial regulations' provisions governing pay/compensation to the responsible actuary

In the spring of 2004 Kredittilsynet contacted all insurers to ascertain how they complied with the Actuarial Regulations' requirement regarding the financial independence of responsible actuaries. The insurers were asked to describe what steps they had taken to implement the regulations' provisions on (1) incentive arrangements, bonus arrangements or the like, and (2) other types of compensation intended in principle to include all staff.

Based on the replies to this inquiry, Kredittilsynet issued a new letter to the insurers (with a copy to pension funds) detailing how the actuarial regulations' provisions in regard to the responsible actuary's financial independence are to be interpreted.

In Kredittilsynet's view, any prior agreed bonus arrangement or variable pay agreement for the responsible actuary would be counter to the provisions in question. Tying in bonus arrangements for the responsible actuary with tasks other than those set out in the actuarial regulations would also be counter to the regulations. The actuarial regulations do not, however, prevent a responsible actuary from owning shares or interests in companies for which he/she is the responsible actuary. The same applies to shares or interests in the group or conglomerate of which the insurer forms part.

Occupational injury insurance and the sectoral account

In the years immediately prior to and including 2002, insurers engaged in occupational injury insurance saw substantially improved results in this segment. The sectoral account for occupational injury insurance drawn up by Kredittilsynet as of end-2003 shows a sharp reversal of this trend in 2003, bringing substantial deficits that year, especially in the sub-segment occupational disease insurance. The reason is to be found in the substantial upward adjustment of claims estimates for earlier claims years in this sub-segment, as a result of which claims provisions for all years in the period 1991-2002 were inadequate. Contributory factors include a large increase from 1997 onwards in the number of cases of allergy and pulmonary diseases, assumed to be related to Chronic Obstructive Pulmonary Disease (COPD). COPD is largely the result of smoking, but can also be triggered by air pollutants such as dust and gas in the workplace.

Occupational injury insurance premiums, both in the aggregate and per insured, have risen markedly in recent years (including from 2003 to 2004). It is, however, difficult to foresee whether higher premiums will suffice to offset the rising claims expenses now in evidence, especially where occupational diseases are concerned.

Regulatory changes and submissions

NOU 2004: 1 Modernising the National Insurance Scheme – Sustainable Pensions for the Future

On 28 June 2004 Kredittilsynet presented a comprehensive submission on the Pension Commission's recommendation (NOU 2004: 1 *Modernising the National Insurance Scheme – Sustainable Pensions for the Future*).

Kredittilsynet took a positive view of the Pension Commission's recommendation that pension schemes should be funded. However, Kredittilsynet favoured going a step further in the same direction, possibly by requiring all new accumulation of pension rights to be fully funded on an actuarial basis from a given date.

Kredittilsynet supported the basic thrust of the Pension Commission's recommendations for flexible retirement. Where the recommended introduction of a "life expectancy adjustment ratio" is concerned, Kredittilsynet stated that closer consider-

ation should be given to whether the State/national insurance scheme should assume part of the responsibility for the economic effects of increased longevity among retirees with a view to offsetting the reduction in annual pension that would result from the Pension Commission's model. Kredittilsynet supported the recommended introduction of flexible retirement in private as well as public occupation pension schemes along the lines of the national insurance scheme. Kredittilsynet opposed the introduction of a life expectancy adjustment ratio in private and public occupational pension schemes since it would violate significant principles of existing pension and insurance legislation, thereby blurring the distribution of responsibilities between the pension fund, policyholder and insured. Moreover, Kredittilsynet supported conversion of public-sector benefits to net pensions, chiefly because current "gross benefits" will provide public sector employees with virtually automatic protection against changes in the national insurance scheme, which could appear unreasonable in terms of the interests of other groups. Like the Pension

Commission, Kredittilsynet accepts that this issue must be dealt with both in the legislative context and through negotiations between the social partners.

New life insurance legislation and Kredittilsynet's alternative model

The Ministry of Finance introduced a Bill proposing new life insurance legislation (Proposition No. 24 (2003–2004) to the Odelsting) on 28 May 2004. The Bill became law on 10 December 2004. Different parts of the Act will become effective at different times. The new legislation, based on Report No. 7 from the Bank Law Commission, lifts the earlier requirement confining unit linked insurance to separate companies. Under the new Act life insurers set prices and take premium payments in advance. Prices must contain a profit element, and insurers will not be entitled to take a share of the net profit at a subsequent point, as they can at present. In the case of paid-up policies and similar insurance agreements, the insurer is entitled to take up to 20 per cent of the profit on client assets. The rules on supplementary provisions are broadly continued, but are tied more closely to the individual contract. The limit on the size of insurers' supplementary provisions is raised, and the stage is set for regulations allowing flexible accumulation of supplementary provisions for the individual contract.

The Ministry of Finance forwarded Kredittilsynet's recommendation for "Defined benefit pension insurance with a long-term investment profile on pension assets" to the Bank Law Commission at the time that it introduced the new life insurance legislation. The Bank Law Commission's view was that a pension product based on the model recommended by Kredittilsynet can be developed and utilised without altering the framework set for life insurance business by the new legislation. However, it pointed out that Kredittilsynet's recommendation will require changes in the Defined Benefit Pensions Act and the rules of the Tax Act governing the application of premium fund assets as well as changes in the Insurance Activity Act's rules governing surrender deadlines. While the Commission envisages no pension-related problems in extending the use made of premium fund assets, it does not take a position on the tax aspects. A minority of the Commission's members called for an option to extend surrender deadlines. The Ministry of Finance forwarded the Bank Law Commission's assessments to the Parliament's Standing Committee on Finance and Economic Affairs on 8 October 2004. The Commission members from the Confederation of Norwegian Business and Industry, the Norwegian Confederation of Trade Unions and the Norwegian Pension Fund Association thereafter made a joint approach to the Parliament's Standing Committee on Finance and Economic Affairs requesting parliament to prepare for implementation of the main features of Kredittilsynet's model, including changes in the rules governing surrender deadlines and in the above tax rules. The request was not acted upon.

NOU 2004: 24 Pension fund legislation. A consolidated insurance act

The Bank Law Commission forwarded draft legislation on pension funds and on a consolidated insurance act to the Ministry of Finance on 11 November 2004. The first part of the document contains a Bill implementing the EU Pension Funds Directive

(2003/41/EC) into Norwegian law. It enables pension funds to operate on the same playing field as life insurers, cf. Recommendation No. 4 (2004–2005) to the Odelsting. It also enables the establishment of inter-municipal pension funds and the establishment of pension funds offering defined contribution pension schemes with no insurance element. The second part of the document recommends an editorial clean-up of the Insurance Activity Act. The document was circulated for comment on 12 November 2004.

Kredittilsynet's submission of 5 January 2005 broadly endorses the main features of the proposed new pension fund legislation, but calls for a broader debate on issues related to cross-border operations.

Kredittilsynet participates in a working group established by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) whose main objective is to secure uniform implementation of the Pension Fund Directive across the European Economic Area.

Changes in the Defined Benefit Pensions Act

In September 2004 the Ministry of Finance appointed a working group drawn from the Ministry of Finance, the Ministry of Labour and Social Affairs and Kredittilsynet to consider amendments to the Defined Benefit Pensions Act and the Defined Contribution Pensions Act. It did so in response to initiatives from the Norwegian Financial Services Association and the life insurers. The working group's main focus was on general financing of administration reserves and on the topping up of inadequate premium reserves when defined benefit schemes are wound up and converted to defined contribution schemes. A consultative document was circulated for comment early in 2005.

Employee contributions to pension schemes under the Defined Contribution Pensions Act

At the request of the Ministry of Finance, Kredittilsynet drafted amendments to the Defined Contribution Pensions Act recommending that employers should be entitled to contribute up to one half of the overall contribution to defined-contribution occupational pension schemes. Splitting the overall contribution between employer and employees could, in Kredittilsynet's view, make it less burdensome for employers to establish and maintain pension schemes, thereby encouraging the spread of this type of pension saving. Enabling employees to pay part of the overall contribution is also likely to boost their awareness of the merits of personal saving for retirement.

The proposal recommends calculating each employee's contribution on the basis of his/her wage. Since it is the enterprise that has assumed the pension obligation and not the employee, Kredittilsynet recommends capping the employee's contribution at 4 per cent of his/her wage, and at 50 per cent of the total contribution to the pension scheme. The proposal was circulated for comment with a closing date for replies set at 30 June 2004, and is under consideration by the Ministry of Finance.

Regulations on the use of derivatives

In December 2003 Kredittilsynet forwarded to the Ministry of Finance draft regulations on the use of derivatives in unit linked

pension schemes enjoying tax concessions. Kredittilsynet concurrently forwarded draft rules on the use of derivatives in unit linked insurance in general. The recommendations were circulated for comment with a closing date for replies set at 13 April 2004, and are under consideration by the Ministry of Finance.

Maintaining membership for personnel stationed abroad

Both the Defined Benefit Pensions Act and the Defined Contribution Pensions Act contain clauses enabling mandatory membership of the National Insurance Fund to be waived by regulations issued by the Ministry of Finance. Kredittilsynet prepared a submission and a joint set of regulations to the two acts which it forwarded to the Ministry of Finance on 9 May 2003. The ministry subsequently delegated authority to issue the regulations to Kredittilsynet. Kredittilsynet circulated the draft regulations for comment on 22 December 2004, setting 1 April 2005 as the closing date for replies.

Paid-up policy register

On 19 November 2003 the Ministry of Finance circulated for comment draft regulations concerning a register of paid-up policies. The draft was prepared by a working group drawn from the Ministry of Finance and Kredittilsynet. According to the working group's proposal, the register will contain information on paid-up policies and statements of accumulated pension rights issued under the defined-benefit and defined-contribution legislation. The working group recommended that Kredittilsynet should oversee the register. Kredittilsynet delivered its submission on 20 January 2004.

The establishment of a paid-up policy register was considered in a White Paper entitled Report No. 37 (2003-2004) to the Storting: *Kredittmeldinga 2003*, chapter 3. The ministry states that before a final decision is taken on the issue, consideration should be given to whether pension rights deriving from private and public occupational pension schemes and from the national insurance scheme should be included in a single register. In its follow-up to NOU 2004: 1 *Modernising the National Insurance Scheme - Sustainable Pensions for the Future*, the ministry has examined how information on pension rights deriving from the above schemes might suitably be organised. This particularly applies to whether information on pension from such schemes should be included in a pension register able to provide each individual with a better overall picture of his/her pension rights. The ministry's conclusion, given in a White Paper entitled Report No. 12 (2004-2005) to the Storting: *Pension Reform - Safeguarding Our Pensions*, is that a pension register is not called for at the present time in view of the recent adoption of information requirements in the pensions legislation and the changes to the national insurance scheme heralded in the White Paper.

Implementation of the Insurance Mediation Directive

This Directive (2002/92/EC) was adopted on 9 December 2002, and must be implemented into national law by 15 January 2005. The Ministry of Finance asked Kredittilsynet to draft legislation and a consultative document to this end. A draft act on insurance mediation, accompanied by a consultative document, was duly forwarded to the Ministry of Finance and, following a round of submissions closing on 15 June 2004, is under consideration by the ministry. A Bill is expected to be introduced early in 2005.

CEIOPS has set up an insurance intermediaries working group to prepare a protocol of collaboration (MoU) in the field of insurance mediation. Kredittilsynet is represented in the working group.

Future solvency framework (Solvency II)

The EU/EEA countries' work on a new solvency framework in insurance (Solvency II), designed to reflect the various types of risk met by insurers, was intensified in 2004. One reason was CEIOPS' move to set up a number of working groups to address various aspects of the framework at the start of the year. These include requirements as to technical provisions and solvency capital in life insurance and non-life insurance (Pillar 1), various quantitative and qualitative methods for supervisory oversight of insurance markets (Pillar 2) and issues related to reporting requirements and market discipline, along with consequences of new accounting standards for insurance contracts (Pillar 3). CEIOPS has also set up a group to look into cross-sectoral issues.

CEIOPS' work on Solvency II will be based on various calls for advice (mandates) drawn up by the EU Commission. The mandates will guide CEIOPS' work in 2005 and probably some way into 2006. CEIOPS will regularly report back to the EU Commission on the position reached in following up mandates related to Solvency II.

Less progress has been made on Solvency II than was planned at project start-up. However, the EU Commission has indicated that a draft framework Directive will be available at end-2005/start-2006. A number of implementing measures and binding guidelines (based on CEIOPS' recommendations) must also be in place before the new framework can be adopted - in 2007/2008 at the earliest.

Guarantee schemes

The Ministry of Finance asked Kredittilsynet to look into issues related to the provisions of the Insurance Activity Act chapter 9 on guarantee schemes for insurance companies and associated regulations, specifically with a view to the limiting the coverage provided by the existing guarantee scheme. In its reply of 22 October 2004 Kredittilsynet stated that in today's market no purpose is served by a guarantee scheme for credit insurance companies. Kredittilsynet also highlighted the need for rules clarifying the issue of membership of the guarantee scheme for branches of foreign companies. In this connection Kredittilsynet recommended removing the guarantee scheme's ability to provide support to a company whose financial position was under threat, thereby limiting its coverage to directly insured parties.

In its assessment of what direct insurance claims should be covered by the Non-Life Insurance Companies' Guarantee Scheme, Kredittilsynet referred to the Bill that it had drafted and circulated for comment. Under this Bill, energy insurances, civil aviation insurances, marine insurances (except in the case of small vessels), and business insurances for large enterprises, will not be covered by the guarantee scheme. Moreover, the recommendation caps disbursements under the scheme at NOK 20 million per insured event, and calls for payment of excess in respect of damage other than damage to residential property and compulsory liability insurance.





SEcurities market

The overarching aim of regulation and supervision is to ensure that the securities market functions properly as a source of capital for business and industry and for investment activities. Alongside licensed institutions, supervision also covers compliance with general regulations of codes of conduct.

Supervision encompasses companies authorised to carry on activity under the Securities Trading Act, the Securities Funds Act, the Securities Register Act and the Stock Exchange Act. Important areas of supervision are market players' financial position and operations and their compliance with the regulations governing their activities.

Kredittilsynet is also assigned legislative and administrative tasks, including information tasks.

Investment firms

Supervision

The vigorous upward trend in the prices and turnover of shares quoted on Oslo Børs laid the basis for increased earnings by investment firms in 2004. Concurrently the volume of issues from companies listed on Oslo Børs showed a moderate trend, and investment firms' broking revenues were negatively affected by squeezed margins. The main revenue sources for non-bank investment firms are stockbroking, active management of investors' portfolios and issuing and counselling activity. Banks licensed to provide investment services derive their revenues primarily from trading in fixed income securities and currencies, as well as derivatives of the same.

By the end of 2004 licences had been granted to 78 investment firms. Kredittilsynet conducted 14 inspections at investment firms in 2004. An additional four inspections focused on investment firms' ICT systems.

The firms vary widely in terms of size, organisational set-up and the investment services provided. Risk-based criteria are used to select firms for on-site inspection. The criteria include liquidity, capital adequacy, changes in revenues, earnings, customer complaints and suspected breaches of good business practice. Firms' periodic reporting to Kredittilsynet and information gained in dealing with administrative tasks provide a valuable basis for selecting firms for inspection. Priority is also given to large firms, firms that have recently received a licence, firms that have undergone substantial changes and firms that have not been inspected for some time.

Supervision of firms engaged in broking of equity capital instruments, i.a. internet brokers, was the main focus in 2004. Breaches of laws and regulations, and in some cases significant deficiencies and weaknesses in some firms' oversight of compliance with codes of conduct were brought to light.

In connection with an inspection at ABG Sundal Collier Norge ASA, Kredittilsynet conducted a routine examination of selected transactions, some of which appeared to contravene laws and regulations. The firm's control systems were found to be so deficient that it was not possible to verify whether contraventions had actually taken place.

Stocknet Securities ASA was shown to have established an arrangement whereby client assets were used to fund lending in connection with clients' share purchases. Kredittilsynet ordered the firm to terminate this arrangement and to immediately separate client assets in compliance with the act. In view of his predominant position, the majority owner was instructed to sell his stake in the firm. Kredittilsynet has reported this individual to ØKOKRIM.

It was brought to the attention of Kredittilsynet that Delta Management AS, which was not licensed by Kredittilsynet, was engaged in misleading marketing. Kredittilsynet asked the firm to cease this activity. After scrutinising the firm, Kredittilsynet concluded that it had engaged in licensable activity and ordered it to cease its illegal operations. Before issuing the order, Kredittilsynet alerted the police by means of a written report drawing attention to criminal offences in addition to the violation of the Securities Funds Act. In light of this, the police seized the firm's bank accounts and charged its CEO with gross fraud.

Orders to rectify circumstances were issued in five cases. In one of the cases an order was issued to halt illegal activity.

Investment firms are required to file their quarterly reports electronically. Electronic reporting of capital adequacy was introduced in 2004, and in the course of the year a system was drawn up for electronic reporting of large exposures. The reporting was introduced as of the third quarter of 2004.

Table 12: Investment firms

	2002	2003	2004
Firms with licence	92	87	78
New firms with licence	5	6	5
Firms with licence handed in	6	11	14
Firms with licence revoked	0	0	0
Firms licensed only to market financial instruments	13	10	10
Firms licensed only for active asset management	9	10	9

Legislation and administration

The new Directive on Markets in Financial Instruments - MiFID (2004/39/EC), replacing the earlier Investment Services Directive, was adopted on 21 April 2004. The deadline for implementing the directive is 30 April 2006. The directive entails a comprehensive revision and enlargement of existing regulation of investment firms' activity, market places etc. The Committee of European Securities Regulators (CESR) has been asked by the European Commission to draft technical implementing measures to a number of articles in the draft directive. Kredittilsynet is represented in three expert groups charged with drawing up such provisions on issues such as business conduct, organisation requirements, market transparency and exchange of information between public authorities. A Securities Markets Law Commission has been set up to implement the MiFID Directive together with the Takeover Directive and the Transparency Directive. The Law Commission has until 20 August 2005 to present its report.

Regulations on investment firms' obligation to make sound recordings of incoming assignments took effect on 1 January 2004. The regulations are designed to ensure that investment firms establish satisfactory routines for taping all orders received by telephone. Firms are also required to establish satisfactory routines for keeping documentation of received orders as well as indications of orders received via other communication channels.

The Ministry of Finance proposed amendments to the Securities Funds Act's provision requiring security to be furnished for investment firms (Proposition no. 12 (2004-2005) to the Odelsting). The proposal, presented in January 2005, builds on a consultative paper prepared by Kredittilsynet. The background to the proposal was the conclusion of the EFTA Surveillance Authority that the Norwegian arrangement of individual guarantee agreements, which up to 1 January 2004 allowed an upward cap to be placed on the guarantee, was counter to Directive 97/9/EC. The establishment of a guarantee fund for investment firms is recommended. The fund will be a collective guarantee scheme in which investment firms - including credit institutions licensed to offer investment services and management companies licensed to engage in active asset management - will be mandatory members. The objective of the guarantee fund will be to guarantee a minimum coverage of clients of investment firms in cases where such firms no longer have the financial ability to honour their obligations in relation to client assets. The fund will be financed by its members. Kredittilsynet has drawn up a consultative paper containing further rules to be included in new regulations.

In 2004, as previously, Kredittilsynet arranged two information seminars for investment firms in cooperation with Oslo Børs. Participants were updated on current processes in the EU and topical issues of general interest.

Management companies for securities funds

Supervision

Share prices rose on a broad international front in 2004, with the Norwegian equity market performing particularly well. Norwegian equity funds achieved steady growth over the year thanks to rising share values and net new subscriptions. Management companies also saw improved earnings.

At the end of 2004 21 management companies were licensed to manage securities funds. Six of these were also licensed to carry on business described in the Securities Trading Act section 1-2 first paragraph no. 3: "*active management of investors' portfolios of financial instruments on a client-by-client basis and in accordance with investors' mandates*". The number of securities funds rose by nine to a total of 423 in 2004.

Due to extensive regulatory tasks, only three ordinary on-site inspections were conducted at management companies in 2004. One on-site IT inspection was also carried out. Risk-based criteria are used to select companies for on-site inspection. The criteria include return on and risk in the portfolio, size, client complaints or suspected breaches of codes of conduct. Companies' periodic reporting to Kredittilsynet also provides a valuable basis for selecting companies for inspection.

Off-site supervision of management companies and securities funds is on a quarterly basis. Since management companies can

now also offer active management, quarterly reporting has been extended to include this area of business, thus providing a better statistical basis for off-site analysis. Since 2002 it has been possible to file quarterly reports electronically. Capital adequacy returns and reporting of major exposures by management companies licensed to engage in active management can also now be reported electronically. The stage is thus set for electronic submission of all regulatory reporting by management companies, and has been adopted by all such companies. Moreover, a formal agreement on reporting of mutual fund statistics has been signed with the Norwegian Mutual Fund Association, thereby reducing the burden of reporting for management companies.

As regards securities funds, the companies report whether or not investments have been in keeping with law, regulations and articles of association. A small number of such breaches were noted in 2004. In some cases the companies were asked to give an account of the breaches. Kredittilsynet also utilises data from Oslo Børs Informasjon AS, and regularly reviews the funds' investments to verify their conformity with stated investment strategy and risk. Marked divergence from expected return and wide variations in relation to benchmarks were scrutinised in some cases.

Twelve off-site, ad hoc reviews focused on companies' practice in connection with fund-unit subscription and redemption.

Although issues related to subscription and redemption of units in Norwegian securities funds are a regular aspect of on-site inspections at management companies, the mutual fund scandal that emerged in the USA in the autumn of 2003 prompted Kredittilsynet to take a closer look at practices in the industry.

In order to gain an overview of the situation, 12 management companies were selected for off-site review. Data were obtained on all subscriptions and redemptions for 20 mutual funds in the period 1 January to 31 October 2003. The funds represented 25 per cent of aggregate total assets invested in Norwegian-registered securities funds as of 31 October 2003.

Certain flaws were brought to light in internal subscription and redemption routines at some management companies, in some cases involving departures from the routines. It was not proven that departures from internal routines were designed to give individual customers less than their fair share. As a result of the survey, some companies were asked to change their routines. In cases where a company was responsible for errors inflicting loss on the unit-holder in question, the company was asked to compensate the unit-holder. The survey will be followed up with ordinary on-site inspections at the management companies. Kredittilsynet communicated the results of the survey to CESR which published a report on surveys of malpractices in the European mutual fund industry on 4 November 2004.

Legislation and administration

Extensive amendments were made to the Securities Funds Act in June 2003 as a result of the implementation of amendments to the UCITS Directive (85/611/EEC). The amendments have introduced new framework regulator for management companies and new provisions for the products they offer.

Management companies licensed to carry out active asset management

An amendment to the Securities Funds Act enables management companies to be licensed for active asset management, i.e. to manage individual portfolios as defined in the Securities Funds Act. The amendment permits collective and individual management business to be carried out within one and the same company. As a result of the amendment, six management companies had received licences to carry out active management as of 31 December 2004, while twelve securities funds had handed in their licences to carry out active management.

New standardised articles of association

The new provisions of the Securities Funds Act governing the products offered have necessitated new standardised articles of association for mutual funds. Articles of association based on the new standard have to be prepared for all new securities funds. Funds already in existence when the new standard came into being will be able to make their adjustments by applying for permission to revise their original articles. The new standardised articles have prompted numerous inquiries regarding interpretation of articles of association for mutual funds.

Structural changes in securities funds, including mergers

Securities fund mergers took up much resources in 2004. The merger of the two groups DnB and Gjensidige NOR in particular

involved substantial follow-up in terms of processing the merger application, taking a position on the merger of securities funds and reviewing the substantial reworking of the new group's mutual fund structure. This has at times resulted in long case processing times for amendments to securities fund statutes. Case processing times were however reduced in the second half of the year.

Simplified prospectuses

The amendments to the UCITS Directive require management companies to prepare a simplified prospectus for each securities fund. Requisite provisions have been incorporated in Regulations no. 750 of 28 July 1994 on prospectuses for securities funds. As for existing funds, this requirement applied only as from 31 December 2004. Detailed requirements for the content of simplified prospectuses are set out in the European Commission's Recommendations 2004/384/EC of 27 April 2004. Kredittilsynet has initiated a process to consider necessary changes to Norwegian rules required by the Recommendations. Draft amendments will be forwarded to the Ministry of Finance in the first quarter of 2005.

Amendments to regulations

Kredittilsynet views it as imperative that purchasers of securities fund units receive the requisite information on their investments. Regulations no. 1045 of 13 August 2003 require management companies to ensure that unit-holders receive reports on a systematic basis. The regulations have come into force, but will only apply to information on unit-holders' holdings as from the second half of 2004.

Regulations no. 428 of 18 February 2004 governing requirements on and calculation of start-up capital and own funds for management companies for securities funds came into force on 1 July 2004. The minimum required start-up capital for management companies remains the Norwegian krone equivalent of 125,000 euro. The regulations also state that the own funds requirement will rise should total assets exceed a certain level.

The Securities Funds Act section 6-4 provides for the registration of nominees in securities funds' unit-holder registers. Further rules are set out in Regulations no. 1638 of 18 December 2003 which entered into force on 1 January 2004. If a nominee is to figure in a unit-holder register instead of the actual owner of the unit, the nominee must be authorised to do so under the regulations. Where securities fund units are registered in the Central Securities Depository, the nominee requires authorisation under the Securities Funds Act section 6-4 and the appurtenant regulations and under the Securities Register Act section 6-3. The ministry has circulated for comment draft regulations on the registration of nominees in registers of financial instruments with the closing date for comments set at 5 March 2004. The consultative document was prepared by Kredittilsynet.

New regulatory framework proposed

The Securities Funds Act with associated regulations specifies financial instruments that securities funds can invest in, and sets requirements as to investment liquidity and risk diversification. The act imposes strict constraints on how much a fund may borrow and for what purpose, and prohibits the sale of financial instruments not owned by the fund.

Exposure to derivatives cannot exceed the exposure resulting from the fund's other investments, and currency derivatives can only be employed for the purpose of hedging. The rules give little scope for dispensation and preclude heavily mortgaged portfolios, open currency positions and direct investment in property and commodities. Short sales are also heavily restricted.

At the request of the Ministry of Finance, Kredittilsynet prepared in 2004 a proposal for changes in the regulation of securities funds to allow such funds do offer new products. Kredittilsynet forwarded to the ministry draft amendments to Regulations no. 800 of 8 July 2002 on securities funds' trade in derivatives (Derivatives Regulations). The proposal lays down rules on UCITS funds' right to engage in covered short sales with respect to certain derivatives.

In November 2004 Kredittilsynet sent the Ministry of Finance a wide-ranging report on special funds accompanied by proposed changes to the Securities Funds Act and associated regulations.

The proposal opens the way for Norwegian management companies to offer funds entailing higher risk than currently permitted. It also permits management companies to offer professional investors funds conferring a right to engage in short sales, borrowing and extended use of derivatives. It further recommends that the Act's investment rules, and by the same token the requirement as to diversification and risk limitation, should not as a rule be applied. These rules are replaced by a requirement that the individual special fund's articles of association should specify strategy, risk limits and guidelines for risk management. According to the proposal, the trustee shall check that the special fund's strategy, risk limits and guidelines for risk management are complied with, and ensure that breaches are reported to unit-holders and Kredittilsynet. Special rules are proposed for venture funds. It is also proposed that foreign hedge funds established in countries with which Kredittilsynet has a supervisory cooperation should have an extended right to market their funds to professional investors in Norway.

Market infrastructure

Kredittilsynet oversees the Norwegian Central Securities Depository (VPS), Oslo Børs, NOS Clearing ASA (formerly the Norwegian Futures and Options Clearing House), Nord Pool ASA (formerly the Nordic Electric Clearing House ASA) and Imarex (International Maritime Exchange AS).

Trade in the freight derivatives market grew markedly in 2004, leading to a substantial increase in trade on Imarex and in clearing via NOS. In the summer of 2004 NOS closed the position of a member that was unable to furnish the clearing house with adequate security for its clearing obligations. The closure left NOS with a substantial loss of about NOK 55 million, equivalent to some 50 per cent of its equity. Kredittilsynet instructed NOS to increase its capital to a satisfactory level. In January 2005 NOS signed agreements with the Central Securities Depository and Imarex on a capital injection. The increase in traded and cleared volumes in the freight derivatives market, combined with substantial market price fluctuations, indicates that Kredittilsynet will need to pay close attention to this market in the period ahead.

Today NOS is a central clearing counterparty in the derivatives market on Oslo Børs. In contrast to most other European countries, Norway and the other Nordic countries have no corresponding clearing arrangement for shares. Together with central actors in the securities market, the Central Securities Depository has examined the merits of establishing a clearing system with a central counterparty in the Norwegian securities market. The report concludes that there is no pressing need for such a system. A similar report in Sweden comes to the same conclusion.

The Stockholm, Helsinki and Copenhagen stock exchanges have merged to form a single entity. The Finnish central securities depository has also initiated cooperation with its Swedish counterpart. These innovations have repercussions for the organisation of the infrastructure of the Nordic securities market.

High prices and sizeable price fluctuations are still in evidence in the electricity derivatives market. Kredittilsynet will therefore need to keep a close watch on developments in the electricity market ahead. Kredittilsynet is collaborating with the Competition Authority and the Norwegian Water Resources and Energy Directorate (NVE) on supervision of this market. The collaboration forum meets on a quarterly basis and addresses current supervisory issues.

Nord Pool Clearing has taken out credit insurance to cover possible losses should one or more clearing members default on their obligations towards the clearing house. The credit insurance agreement was signed in February 2004 for a period of three years. The agreement substantially mitigates the clearing house's risks.

Nord Pool launched green certificates trading as an ancillary activity in March 2004. Trade has been thin thus far, although individual trades have been substantial. Nord Pool has applied to alter its licence to enable it to buy and sell CO₂ quotas and to offer CO₂ derivatives from January 2005 onwards.

Kredittilsynet conducted IT inspections at Nord Pool Clearing, NOS and the Central Securities Depository in 2004.

Acting on Kredittilsynet's recommendation, the Ministry of Finance granted DnB NOR ASA dispensation until further notice from the ownership restriction rules of the Stock Exchange Act and the Securities Register Act, enabling it to own existing shareholdings in Oslo Børs Holding ASA and Verdipapirsentralen Holding ASA. Kredittilsynet also advised the Ministry of Finance to extend the dispensation granted to Statnett and the Swedish Affärsverket Svenska Kraftnät to own 50 per cent each of the shares of Nord Pool ASA. Kredittilsynet similarly recommended the extension of Nord Pool's dispensation to wholly own Nord Pool Clearing ASA.

Supervision of compliance with the general rules of conduct of the Securities Trading Act

Supervision in this field is designed to ensure adherence to the general rules of conduct contained in the Securities Trading Act. At centre-stage are the rules on unlawful insider trading and price manipulation and appropriate handling of information. Kredittilsynet also oversees compliance with notification rules and rules requiring disclosure of sizeable share acquisitions. Hence a wide circle of supervised entities is involved: investors, issuers and their partners, including investment firms. The object is to bring to light and prosecute unlawful conduct in the securities market and, insofar as the conduct provisions are applicable, in the markets for freight and electricity derivatives. Kredittilsynet aims to show potential lawbreakers that contravention incurs risk, and it also applies other measures designed to discourage criminal acts.

Supervisory tasks

The majority of cases dealt with in 2004 were referred to Kredittilsynet by Oslo Børs. Under the agreement between Oslo Børs and Kredittilsynet only a low level of suspicion is required to justify referral to Kredittilsynet. In 2004 Kredittilsynet investigated a number of cases where breaches of the insider provisions were suspected. Some of these investigations were time-consuming, especially where investigations involved other countries.

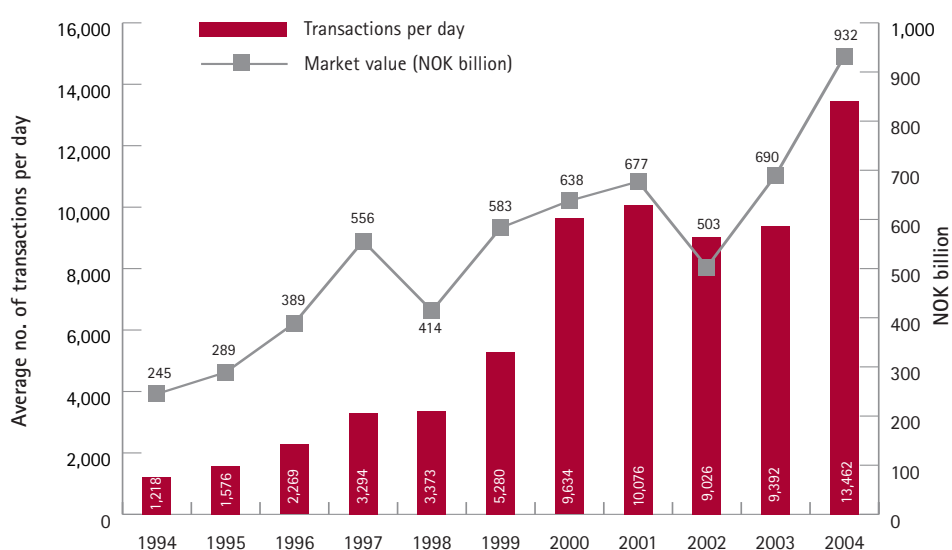
Kredittilsynet availed itself on several occasions in 2004 of co-operation agreements with foreign supervisory authorities when conducting investigations. Kredittilsynet similarly assisted foreign supervisory authorities in their investigations in a number of

cases. This assistance primarily consisted in obtaining information and arranging interviews with persons domiciled in Norway.

Kredittilsynet investigated several cases of suspected price manipulation in 2004. One such case involved suspected price manipulation in the electricity derivatives market. Morgan Stanley Capital Group Inc. was reported to ØKOKRIM, but the case was returned to Kredittilsynet since ØKOKRIM lacked sufficient capacity to handle it. The case culminated in a public letter in which Kredittilsynet censured the company for selling substantial volumes in a short space of time and for placing sell orders in the final seconds of the trading session.

In 2004 one case of suspected unlawful insider trading and/or breaches of confidentiality was referred to the prosecuting authority, as were two cases of price manipulation. Eight breaches of the securities-trading notification requirement were reported to the police over the year. A total of 93 notification cases were forwarded by Oslo Børs compared with 161 cases in 2003 and 326 in 2002. Even allowing for the change in procedure for registration of cases towards the end of 2002, there was a real decrease in the number of cases forwarded by Oslo Børs. The reduction in the number of violations is probably due to greater awareness among market participants which is in turn related to Oslo Børs's and Kredittilsynet's active follow-up of possible breaches of the rules. Six cases against issuing companies and individuals concerning notifiable securities trading resulted in fines.

Chart 3: Turnover and number of trades at Oslo Børs



Source: Oslo Børs

Four convictions were handed down for unlawful insider trading in 2004. All are unappealable. One (unappealable) conviction and one fine were handed down for breach of the prohibition against price manipulation. Kredittilsynet also issued several warnings to institutions for inappropriate handling of inside information.

Kredittilsynet investigated several breaches of the rules on notifiable securities trading in 2004. Since the breaches were not of a serious nature Kredittilsynet confined itself to issuing warnings.

In November 2004 Kredittilsynet applied, for the first time, its right to order the relinquishing of unlawful gain. The order was addressed to a limited company which had obtained an unwarranted gain as a result of insider trading.

In March 2004 Kredittilsynet forwarded to the Ministry of Finance a draft consultative document recommending how the Market Abuse Directive (2003/6/EC) might be implemented into Norwegian law. After a round of consultation, the ministry proposed amendments to the Securities Trading Act. The proposal (Proposition no. 12 (2004–2005) to the Odelsting), based largely on Kredittilsynet's submission, was enacted in January 2005.

In June 2004 Kredittilsynet forwarded to the Ministry of Finance a draft consultative document recommending how the Prospectus Directive (2003/71/EC) might be implemented into Norwegian law. The recommendation was prepared by a working group set up by Kredittilsynet. The Directive includes requirements as to the design, content, approval and publication of prospectuses. The Ministry of Finance is expected to introduce a Bill early in 2005.

Kredittilsynet has provided information on the legislation and on the work done on implementing the Prospectus and Market Abuse Directives, i.a. at a press seminar held in June 2004. In December 2004 Kredittilsynet organised a seminar in cooperation with Oslo Børs on the directives and their implementation. The seminar targeted market participants such as issuers and investment firms along with journalists.

In 2004, as previously, work progressed on further developing the collaboration between Kredittilsynet, Oslo Børs and ØKOKRIM. Kredittilsynet also collaborated fruitfully with Nord Pool in the period. The aim of the collaboration is to improve the overall efficiency of market surveillance. Routines, priorities and legal issues were among the topics discussed.

2001 2002 2003 2004

2005 2006 2007 2008 2009

2001 2002 2003 2004

FI

Financial reporting supervision – listed companies

As from 2005 listed companies are required to apply international financial reporting standards (IFRS) when preparing and presenting consolidated accounts. National enforcement bodies are being established to oversee that companies apply IFRS accounting rules in a satisfactory manner and to strengthen confidence in companies' financial reporting. The Norwegian parliament has resolved that Kredittilsynet shall perform this oversight role in Norway.

Oversight of listed companies' financial reporting

An important aim of the EU's Financial Services Action Plan for a smoothly functioning market for investment and capital services in the European Economic Area is to protect investors' interests and thereby promote deep and liquid capital markets in Europe. The International Accounting Standards (IAS) Regulation is a part of this plan, requiring all listed companies to apply international financial reporting standards (IFRS) from 2005 onwards. The aim, over time, is to ensure that financial statements are more easily comparable and give a better presentation of a company and its financial position than is the case under present rules. Norway has implemented the IAS Regulation with effect from 1 January 2005 by way of amendments to the Accounting Act and the Securities Trading Act. The amendments bring significant changes to current accountancy principles and imply substantial challenges for listed companies and for their auditors.

National enforcement bodies are being established to oversee companies' application of IFRS accounting rules and thereby underpin confidence in company accounts. In Norway, the responsibility for overseeing financial reporting is assigned to Kredittilsynet. This substantially widens Kredittilsynet's mandate and field of influence since it creates a direct relationship with all Norwegian listed companies as well as an indirect relationship with their investors. It also brings challenges in terms of competence, working methods, and information to and communication with these groups. Another consequence, in strategic terms, is that Kredittilsynet's remit becomes more clearly two-pronged, with the financial industry on one side and the securities market on the other.

Accounting supervision will be carried out based on the same standards across the entire EEA. One objective is to give investors greater assurance that financial statements can be trusted. The Committee of European Securities Regulators (CESR) has been asked by the EU Commission to prepare standards in this field. Kredittilsynet will base itself on the standards prepared by CESR, and will place substantial emphasis on international collaboration in this area.

In 2004 Kredittilsynet prepared to address its new tasks. It did so chiefly through a project drawing participants from several of the agency's departments and specialist units, and it was in regular contact with Oslo Børs. Advisory services were provided by a consultancy firm.

The new tasks will be incorporated in the current accounting team, and a separate section for financial reporting supervision will be set up within the accounting and auditing supervision department. The section will initially be reinforced by four advisers/senior advisers with IFRS competence, an experienced lawyer, and a head of section. An important complement to Kredittilsynet's resources will be an IFRS expert committee whose mandate was determined by the Parliament's Standing Committee on Finance and Economic Affairs in Recommendation No. 17 (2004-2005) to the Odelsting. This committee, charged with assisting Kredittilsynet, will be appointed by the Ministry of Finance, and guidelines will be drawn up for its work.

Regulations governing Kredittilsynet's activity in this area are due to be issued pursuant to the Securities Trading Act. The regulations were circulated for comment at year-end.

Scope of the oversight

The oversight includes all Norwegian issuers, i.e. companies which are Norwegian-registered, listed on a stock exchange or authorised marketplace in Norway or on a regulated market in another EEA country. Listed issuers as well as issuers which have applied for listing are included. Foreign companies listed on Oslo Børs are not subject to oversight by Kredittilsynet, neither are municipalities or county municipalities; cf. the object of the oversight. The same applies to municipal and inter-municipal enterprises/companies. State-owned enterprises will, however, be included.

Oversight will in principle focus on companies' periodic reporting, i.e. annual accounts (at both group and company level), the directors' report and interim reports. Companies' ongoing reporting to the market on price-sensitive conditions is not included in the oversight arrangement. Kredittilsynet's key role here derives from other EU rules, among them the Market Abuse Directive.

Design and establishment of financial reporting oversight

The primary objective of introducing IFRS is to ensure a more effective and efficient securities market. To that end, Kredittilsynet will give priority to major issues deemed to be of significance to investors and the market. In practical terms this means focusing attention on indications of significant errors in the evaluation of assets or liabilities, and materiality considerations for such errors will be at a relatively high level. Once errors are identified, steps will be taken after a specific assessment at far lower levels of materiality.

A combination of techniques will be applied to select companies for oversight. A three-pronged model is envisaged:

- selection of some companies based on reactions from other market players and submitted reports
- selection of some companies based on a systematic risk analysis conducted on an annual basis
- all companies must expect to be selected at some point based on a rotation principle within a given period of time

Kredittilsynet has experience in applying these techniques in all areas of supervision.

Information to and communication with the market

Information to and communication with the market and important user groups is of major importance, not least with a view to instilling confidence in the capital market. Kredittilsynet will provide information through a combination of its website, circulars, press releases, seminars on specific themes and oral presentations, as well as annual reporting. It will also be in direct contact with all listed companies.



Auditing

Kredittilsynet's tasks in relation to auditors comprise approval or licensing of individuals and firms in accordance with the legal requirements applying to this profession, as well as registration and supervision. Supervision encompasses entities listed in the register of auditors, and includes checking that they maintain their independence, and that their activity complies with law and regulations and is conducted in a satisfactory manner.

The auditing profession features a bipartite structure: a small number of international auditing companies that audit the majority of listed companies and other institutions of public interest, and a large number of smaller auditing companies which mainly audit small and medium-size clients.

Administrative activity in 2004

Under the Auditors Act, auditor authorisation requires approved theoretical training and three years of varied experience. Practising auditors are required to furnish security of NOK 5 million and to comply at all times with the requirement of 105 hours of post-qualifying training in the preceding three calendar years. To achieve authorisation, auditing firms need to be more than 50 per cent owned by state authorised auditors, and the

majority of the members of firms' boards of directors must be state authorised auditors. Requirements laid down in articles of association, and requirements as to financial probity, also apply. Authorisation of auditors is a key responsibility of Kredittilsynet in this supervisory field.

Table 13: Number of approved auditors and auditing firms

Auditors	31.12.2002	31.12.2003	31.12.2004	Approved in 2004
State authorised	2,107	2,177	2,325	169
Registered	2,899	2,977	3,033	151
Auditing firms	507	514	518	50

Auditors' obligation to report to the police has been extended by their inclusion as from 1 January 2004 in the money laundering legislation. Auditors are now obliged to report to ØKOKRIM any suspicion of money laundering of any proceeds of a criminal offence. There are some delimitation issues related to the reporting obligation which have yet to be clarified. According to ØKOKRIM, auditors reported 18 cases related to money laundering in 2004.

In 2004 Kredittilsynet sent a proposal to the Ministry of Finance recommending the introduction of an obligation for auditors to report to the police any suspicion of specific serious criminal offences. In the autumn of 2003 the Ministry of Finance had asked Kredittilsynet to review and comment on ØKOKRIM's proposal to amend the Auditors Act section 6-1 fourth paragraph on auditors' right to report, and to introduce a general obligation to report suspected criminal offences to the police. Kredittilsynet's proposal recommends a more delimited and precise wording of the reporting obligation than that recommended by ØKOKRIM. Kredittilsynet's proposal will restrict auditors' reporting obligation to suspicion of more serious criminal offences committed by a client or by individuals figuring in the client's

management/board or substantial shareholders. In cases where the client itself is the aggrieved party, for example as a result of embezzlement committed by an employee, the client itself will, as previously, decide whether a report should be made to the police.

Kredittilsynet also proposes retaining the current right to report cases not coming under the proposed reporting obligation. If endorsed, it will enable auditors to report suspicion of other criminal offences to the police without compromising their duty of confidentiality.

Supervisory activity in 2004

Supervision entails checking compliance with laws and regulations and with generally accepted auditing standards. This requires a thorough assessment of the following:

- the appropriateness of the auditor's auditing methods
- whether the audit evidence obtained (audit procedures) is sufficient
- whether the auditor's assessments and conclusions accord with the result of the audit procedures
- whether satisfactory supporting documentation for the audit is available

In 2002 an arrangement was established to coordinate Kredittilsynet's supervisory activity with the Norwegian Institute of Public Accountants' (DnR) quality control of auditors. Under the guidelines for the arrangement all auditors with auditing responsibilities who are members of DnR will, as from 2003, be checked on a five-year cycle. Experience gained with this collaboration has been fruitful. If the Institute's quality control of an individual auditor prompts withdrawal of his/her auditor's licence, the Institute refers the matter to Kredittilsynet for further consideration. Four cases were referred to Kredittilsynet in 2004, resulting in revocation of one auditor's licence and voluntary surrender of the three others.

The Institute of Public Accountants conducted quality checks at 293 auditors in 2004. 268 auditors were approved, 22 received critical comments and were informed that a follow-up check would be conducted, while two cases were referred to Kredittilsynet for further action. One auditor resigned from the Institute before the reports were finalised.

Under the guidelines, the Institute of Public Accountants is required to publish a report on its quality control activity. The report for 2004 is reproduced on page 53.

Kredittilsynet bases its supervisory priorities on reports received – mainly from the tax authorities, liquidators and audit clients – and signals emerging, for example, in the media. The number of such cases has risen substantially in recent years. Much importance is also attached to supervision of the largest audit companies which mainly comprises thematic inspections in selected areas.

Supervisory cases handled in 2004 totalled 138, of which 65 were on the basis of on-site inspections. Eighty-four auditors were reported to Kredittilsynet in 2004 compared with 65 in 2003. The number of reports has risen substantially in recent years, with 2004 showing an increase of 30 per cent over the 2003 figure.

Off-site supervision carried out in the autumn of 2003 revealed that 212 auditors were not in compliance with the requirement as to post-qualifying training. Some cases of failure to provide sufficient security were brought to light. Kredittilsynet warned many auditors that their licence would be withdrawn and that they would have to step down as statutory auditors.

As a result of Kredittilsynet's follow-up, one auditor lost his licence, 14 were ordered to step down as statutory auditors, six were sternly censured and three received critical remarks. Kredittilsynet further accepted six auditors' decision to voluntarily surrender their licence or to voluntarily step down as statutory auditors.

The widespread lack of post-qualifying training prompted Kredittilsynet in the autumn of 2004 to draw up a separate circular on such training which was circulated to all approved auditors.

With effect from 1 January 2002 the state took over all hospitals previously run by the county municipalities. The passage of the Health Institutions Act provided a legal basis for the establishment of five health regions based on a conglomerate model in which a state-owned company ("regional health enterprise") was set up in each region. These regional health enterprises took over ownership interests in the publicly owned health enterprises in the five regions. The auditing of each of these five regions was put out to tender in the private audit market.

Kredittilsynet conducted thematic inspections of the audits carried out at the health enterprises. The supervisory process started in the summer of 2004. The on-site inspections, which included the accounting years 2002 and 2003 for all five regional health enterprises and a selection of subordinate health enterprises, were conducted in the autumn of 2004. The final conclusions will be presented in 2005. No flaws were brought to light suggesting that there was an inadequate basis for the audit reports issued.

Table 14: Auditor's licence withdrawn

Auditors	31.12.2001	31.12.2002	31.12.2003	31.12.2004
State authorised	0	1	0	0
Registered auditors	7	5	3	4
Approved auditing firms	2	8	1	0

DnR Quality Control – Annual Report 2004

With reference to the guidelines for collaboration between Kredittilsynet and the Norwegian Institute of Public Accountants regarding quality control of statutory auditors, the Executive Board of the Norwegian Institute of Public Accountants hereby presents an overview of the results of the quality control conducted in 2004.

Organisation of quality control in 2004

The control set-up is described in "Details of the quality control set-up 2004" as posted at www.revisornett.no. It is designed with a view to checking compliance with audit standards, and focuses on provisions of the Auditors Act concerning auditors' finances, independence, provision of security and post-qualifying training.

The controller team comprised thirty state-authorized and registered auditors, all with a broad professional background.

Selection of auditors for quality control

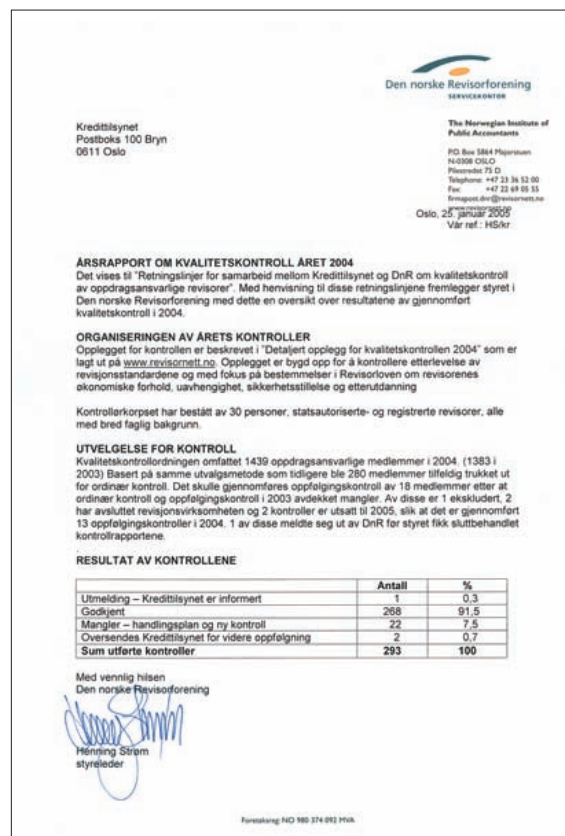
The quality control scheme encompassed 1,439 statutory auditors in 2004 (1,383 in 2003). Based on the same selection method as previously, 280 statutory auditors were selected for control on a random basis. A further 18 statutory auditors were subject to follow-up control as a result of deficiencies brought to light by ordinary and follow-up control conducted in 2003. Of these 18, one has been excluded, two have terminated their audit activities while in two cases control was postponed until 2005, leaving 13 instances of follow-up control conducted in 2004. One of these 13 statutory auditors resigned from the Institute before the Executive Board finalised its review of the control reports.

Result of the quality control process

	Number	%
Resigned - Kredittilsynet informed	1	0.3
Approved	268	91.5
Deficiencies noted - action plan and new control	22	7.5
Referrals to Kredittilsynet for further action	2	0.7
Total controls conducted	293	100

Yours sincerely
(sign)

Henning Strøm
Chairman
Norwegian Institute of Public Accountants



(facsimile of original letter)



External accounting services

Kredittilsynet's tasks in relation to external accounting services comprise authorisation of individuals and firms in accordance with the legal requirements applying to this profession as well as registration and supervision. Supervision includes checking that their activities comply with laws and regulations and are conducted in an appropriate and satisfactory manner.

Administrative activity in 2004

The Authorisation of External Accountants Act regulates firms that provide accounting services for other parties on a commercial basis. Licensed external accountants need a higher qualification in business economics equivalent to at least two years' full-time higher education and the equivalent of two years' relevant experience. Running the authorisation scheme is a major administrative task. As of 31 December 2004 the register of external accountants comprised 9,266 entities, of which 6,724 were individuals and 2,542 were firms.

Based on assessments from a number of bodies, among them Kredittilsynet, and amendments proposed to the External Accountants Act in 2002, the Government introduced a Bill (Proposition No. 63 (2003-2004) to the Storting) proposing that responsibility for authorising accountants should be transferred from Kredittilsynet to the Tax Administration. However, the

Storting responded by asking the Government (in a resolution dated 18 June 2004) to retain the authorisation arrangement unchanged.

In the wake of the above resolution, Kredittilsynet gave renewed consideration to the original alternative Bill. After this Bill was tabled, Kredittilsynet gained further experience with administering the Authorisation of External Accountants Act, prompting it to draft new amendments. The adjusted draft Bill was forwarded to the Ministry of Finance on 22 September 2004, and circulated for comment on 16 December 2004.

The amending Bill provides a clearer basis for external accountants' activities and for the obligations resting on state authorised accountants.

Table 15: Number of authorised external accountants and external accountancy firms

	31.12.2002	31.12.2003	31.12.2004	Authorised in 2004
Individuals	6,201	6,598	6,724	496
Firms	2,415	2,566	2,542	227

Unlawful external accounting activity

The number of reports of unlawful practice of external accounting activity has risen by as much as 94 per cent since 2003. Kredittilsynet notes the appreciable number of accountants still engaged in external accounting activity without the requisite government authorisation.

Unlawful external accounting activity is brought to light by reports to Kredittilsynet, by Kredittilsynet's processing of licence applications from individuals and by other investigations carried out by Kredittilsynet. Reports of unlawful activity in 2004 numbered 74, most of them filed by the tax authorities. In cases where Kredittilsynet believes there are grounds for suspicion of unlawful external accounting activity, the accountants in question are ordered to explain their activities. If the suspicion is

confirmed, Kredittilsynet orders the business to be terminated. Serious cases may be reported to the police. One firm was reported to the police in 2004. Two reports filed in 2003 are still under investigation, while one case in 2004 resulted in the confiscation of NOK 100,000. Nine firms were ordered to halt unlawful external accounting activities in 2004 under the provisions of the Financial Supervision Act.

Investigations in 2004 gave priority to earlier cases in which orders were issued to cease business.

Supervisory activity in 2004

The primary aim of supervision is to ensure that providers of external accounting services observe a minimum standard of professional conduct. Where law and regulations are not complied with, or professional conduct is regarded as unsatisfactory in other respects, Kredittilsynet may revoke the external accountant's licence.

Kredittilsynet's on-site inspections examined authorised accountants' business set-up in relation to Kredittilsynet's guideline circular no. 12/2000, in relation to good accounting practice and in relation to their conformance with central aspects of accounting legislation and of tax legislation in general. Based on the inspections carried out, the operations set-up of the external accountants in question was in general found to be flawed.

However, this finding is not representative for the profession as a whole. Kredittilsynet's checks are based not on a random sample but on complaints and reports from the Tax Administration, among other bodies. Based on its supervisory experience, Kredittilsynet's impression is that quality varies widely across the external accountancy profession.

A focal area of supervision in 2003 was external accounting services provided by the large nationwide external accounting firms/chains and mergers. Kredittilsynet had no comments of note on these firms' accounting procedures. Follow-up meetings were held with the various actors in 2004, and Kredittilsynet noted their compliance with the comments issued after the on-site inspections conducted the previous year.

Kredittilsynet handled 51 supervisory cases involving authorised external accountants in 2004, 28 of these on the basis of on-site inspections. As in previous years it was largely a matter of following up external accountants who had previously been censured by Kredittilsynet or reported to Kredittilsynet by the tax authorities or other public agencies. An appreciable increase has been noted in reports regarding external accountants. Seventy such reports were received in 2004 compared with 41 in 2003.

The uncertainty surrounding the authorisation scheme affected the supervisory effort. Kredittilsynet maintained a low level of activity in the first half of 2004, giving priority to serious cases. Kredittilsynet intensified its supervisory activity in the second half-year once it became clear that responsibility for the authorisation scheme was to remain with Kredittilsynet.

In the autumn of 2004 Kredittilsynet conducted an off-site examination targeting the external accountancy profession. All authorised external accountants and external accounting firms were asked to complete an examination designed to provide Kredittilsynet with an overview of the profession's structure and composition. The survey was conducted over the internet. This was the first time that such a large survey has been handled electronically. The results of this off-site process will become available in the first half of 2005.

Table 16: Revocation of authorised external accountants' licences

	31.12.2001	31.12.2002	31.12.2003	31.12.2004
Licence revoked - individuals	6	10	3	4
Warning issued	14	7	2	2
Licence revoked - firms	-	1	-	-





Estate agency

Supervision of estate agents encompasses the activities of firms licensed to practise estate agency and lawyers who have put up security for estate agency, as well as housing cooperatives that are licensed to provide estate agency services and ordinary housing cooperatives' brokerage of cooperative flats. Firms, lawyers and housing cooperatives are checked for compliance with the requirements of law and regulations, including observance of good estate agency practice. Supervision of estate agents takes the form of on-site inspection and off-site supervision. Kredittilsynet is also assigned administrative and consultative tasks, and responsibility for drafting regulations.

2004 – a good year for the estate agency industry as a whole

Whereas some stagnation was in evidence in the industry in 2003, particularly as a result of a weak first half-year, 2004 brought increased activity levels. There was marked growth in estate agencies' turnover and incomes in the first half of 2004 compared with the same period in 2003, the biggest contributor being higher property sale values. Property sale values in the first half-year totalled NOK 94 billion, i.e. an increase of 38 per cent or NOK 26 billion compared with the first half of 2003. Estate agency fees also rose steeply in this period, from NOK 1,494 million in the first half of 2003 to NOK 1,900 million in the first half of 2004.

At end-2004 578 licensed estate agency firms were in operation. Sixty-eight new licences were issued over the year, while 31 firms ceased their estate agency business. At year-end 41 ordinary housing cooperatives provided estate agency services, and 1,178 lawyers had furnished security to engage in estate agency.

A substantial annual net increase – 37 in 2004 – is still being seen in the number of estate agencies, indicating that estate agency is regarded as an attractive commercial proposition. The growth is largely attributable to branching whereby existing agencies, especially chains, extend their business by setting up new operations. However, a number of housing cooperatives, which – unless they hold a special licence – are only permitted to broker cooperative flats, are also switching to full-fledged estate agency and applying for the requisite licence.

Running an estate agency normally involves substantial start-up costs, and it often takes a while for a new agency to gain a foothold in the market. Beyond the minimum requirements set out in the companies legislation, no specific equity capital requirements apply to new entrants. This, combined with intense competition among estate agents – particularly in areas with a heavy concentration of agencies – means that a fairly large number of estate agents are running a deficit. Indeed, some agencies find themselves in a negative equity capital position, risking loss of their right to carry on estate agency.

The recovery of the estate agency market in 2004 naturally had a positive impact on estate agents' operating profits. Whereas about one third of the agencies reported negative operating profits for the first half of 2003, the figure for the first half of 2004 was down to 23 per cent.

Kredittilsynet rarely revokes estate agency licences on the basis of negative equity, and licences rarely terminate as a result of bankruptcy. Agencies that fail to operate profitably usually opt for voluntary, controlled liquidation before the supervisory authority has to step in.

On-site inspection

Kredittilsynet carried out 18 inspections of estate agency firms and lawyers in 2004. One IT inspection was also carried out. Due to extensive work on drafting regulations, inspection activity in 2004 was again lower than desired. No serious violations of the law were noted, although it was in some cases questioned

whether the estate agent in charge had exercised sufficient control over the agents employed by the agency. Some flaws were pointed out in the routines employed to account for clients' money and in brokerage routines.

New approaches to estate agency

The cost of estate agencies services is generally viewed as high, particularly in cases where the agent is responsible for both sale and settlement. Some actors within and outside the industry see a potential business opportunity in offering do-it-yourself packages whereby the seller attends to aspects of the sale process

him/herself: usually the marketing (advertising) aspect, showing the property, along with receiving and accepting bids. The contract and settlement are in such cases handled by an estate agency, or by a lawyer who has furnished the security needed to engage in estate agency. Agencies offering such packages

provide a detailed plan which the seller can follow up to and including acceptance of a bid, including advice and guidance on matters which the seller needs to be particularly aware of.

Variations on the above theme are launched from time to time, although such services are currently offered by only a very small number of licensed agencies. Kredittilsynet's impression so far is that the new approach is gaining little ground, and has probably not been a financial success for its providers. The reason why so few vendors are keen to utilise these services could be a combination of several factors. Selling a property often requires technical, financial and legal insight; without professional assistance

the seller may fear incurring liability if mistakes are made during the sale process. Nor can it be taken for granted that the seller will get the best possible price by completing the sale him/herself as opposed to engaging a skilled estate agent with a good knowledge of the market and the ability to sell the property in the market. Since the agent takes the interests of both parties into account during the sale process, he/she is required both to furnish information about the property and to investigate the property. This accords with the law and good estate agency practice.

Amendments to the estate agency regulations – tighter requirements on estate agency activities

The estate agency industry has expanded substantially in recent years, and the number of estate agents has risen correspondingly. Since the Estate Agency Act's qualification requirements are confined to the qualifications of the estate agent in charge (this person must either be a state authorised estate agent or a lawyer), most agents are untrained and their experience in the industry varies. Kredittilsynet has recommended a law amendment enabling the supervisory authority to issue further rules on the responsibilities and duties of the estate agent in charge and on the time he/she is expected to spend on the premises. The amendment was designed to highlight this person's responsibility for ensuring that estate agency services are of a good professional standard. The estate agent in charge accordingly has a manifest responsibility for monitoring the agents employed and for ensuring that they are qualified to perform their estate agency tasks.

A number of new provisions were added to the Estate Agency Act in 2002, enabling Kredittilsynet to issue provisions in the above and several other areas. New regulations issued in 2004 contain the following key provisions:

- an obligation for the estate agent in charge to be present at the agency on a daily basis and to check the work done by the estate agents employed there
- one person cannot as a rule be effectively in charge of two estate agencies
- an obligation for the estate agent in charge to ensure that the agents have the competence needed to perform their tasks
- an obligation for the estate agent to check that estate agency assignments are completed without undue delay, and that no agent has responsibility for more assignments than he/she can actively attend to

- bidders' and buyers' access to bids made
- an obligation for estate agencies to establish an internal control system ensuring satisfactory estate agency routines
- an obligation for estate agencies to notify the identity of their owners to Kredittilsynet. Kredittilsynet may refuse to approve as owners persons who have previously committed, or who have assisted in the commission of, serious violations of the Estate Agency Act or of other legislation.
- a doubling of the security to be furnished for estate agency activity from the current NOK 10 million to NOK 20 million

Some of these provisions, including those applying to the furnishing of security, the estate agent's presence on the premises and internal control become effective on 1 June 2005.

Appointment of a new law commission to revise the Estate Agency Act

The current Estate Agency Act entered into force on 1 April 1990, superseding the estate agency act of 1938. Shortly after it went into force, the new act proved unsuited to resolving all the issues that arose during the dynamic development of the industry witnessed since the start of the 1990s. These issues include significant structural changes, continual evolution of new approaches to estate agency, the general public's increasing expectations of and requirements on the estate agency product. Furthermore, new statutes have been passed impacting directly or indirectly on estate agents' duties. Moreover, the Estate Agency Act takes little account of conditions emerging in the professional segment of the commercial market. A further factor is Norwegians' increasing purchases of (holiday) property abroad, and that statutory requirements on estate agents also apply in regard to their broking of foreign property. This poses a supervisory problem.

Kredittilsynet has previously called for a new law commission to draw up and recommend rules that will turn the Estate Agency Act into a better tool for resolving the above issues. In 2004 the Ministry of Finance appointed a law commission to revise the act. The commission will draft rules designed to set the stage for a well-organised, orderly and overviewable industry in which consumers' interests are properly attended to. Kredittilsynet has one representative and two secretaries on the commission, which is due to present its report by 9 May 2005.

The commission will review the following:

- the scope of the act
- the licensing system and its organisation
- the merits of introducing qualification and competence requirements for all estate agents employed at estate agencies
- the duties and responsibilities of estate agents vis-à-vis the parties to a transaction
- whether the current act's requirement as to estate agents' independence serves its purpose, and possible changes resulting from this assessment
- estate agents' right to carry on other business activity
- the issue of own-account trading
- rules governing the bidding process



DEbt collection

Supervision of the debt collection industry encompasses agencies' financial position and their treatment of client funds. It encompasses agencies that collect overdue debt on behalf of other businesses and organisations as well as agencies that purchase overdue debt and collect it themselves. Collection of own claims and lawyers' debt collection activities lie outside the scope of Kredittilsynet's supervision. At on-site inspections Kredittilsynet checks in particular that recovered funds are properly handled and that the business is conducted in accordance with generally accepted debt collection standards.

Non-payment – a significant social problem

In recent years claims in process of recovery by debt collection agencies supervised by Kredittilsynet have amounted to about NOK 40 billion. At the end of the first half of 2004 the figure was NOK 39.2 billion distributed on 2.5 million cases.

In the five-year period 1999–2004 the number of debt collection cases rose by about 50 per cent. In the same period the value of claims for recovery rose by 30 per cent.

In the past five years debt collection agencies have recovered just under 20 per cent of claims for recovery. For 2003, the last year for which figures are available, the amount recovered came to almost NOK 8 billion.

The growth of the debt collection market is not exclusively due to an increase in non-payments, but also to the fact that debt collection agencies have taken over claims for recovery that were previously recovered by the creditors themselves. Both private and public enterprises have increasingly found it expedient

to cease collecting their own claims and to outsource this activity to professional debt collectors.

Enterprises' awareness of the substantial costs represented by outstanding claims has been significantly sharpened in recent years. As a result, the collection process has in general been initiated at an earlier stage than was previously the norm. In many cases debt collection agencies are asked to handle all-encompassing assignments. This involves following up the entire customer ledger vis-à-vis the enterprise's debtors as well as taking care of the pre-due date process, including invoicing and invoice reminder services. This type of assignment enables more efficient recovery of outstanding claims. Many debtors react to what they regard as unreasonably hurried reminders and, in the event, to the ensuing collection process when payment is not made when due. A quicker recovery process does not, however, represent a breach of fair debt collection practice so long as the statutory time-limits are adhered to.

Stable industry structure

At the end of 2004, 114 ordinary debt collection agencies were registered, compared with 123 at the start of the year. Of those removed from the register, four had their licences revoked while the remainder closed down due to trading deficits.

A small number of agencies continue to dominate the industry, with seven agencies accounting for more than 75 per cent of claims for recovery. It is these agencies that generally compete for the major clients. Agencies often need to offer prospective clients extremely favourable terms in order to win large portfolios. Kredittilsynet's impression is that debt collection agencies' margins can be on the low side as a result.

Debt purchase and collection

The number of agencies which purchase overdue debt and collect it themselves remained unchanged through 2004. Ten such agencies exist, only four of which operate on a large scale. Aktiv Kapitaladministrasjon AS is the largest. Another major actor in this field is Tenea AS, part of Olympiagruppen. Aktiv Kapital signed an agreement in 2004 to take over Tenea. The takeover has been approved by the Competition Authority.

Debt purchase and collection is also carried out by licensed financial institutions.

On-site inspection

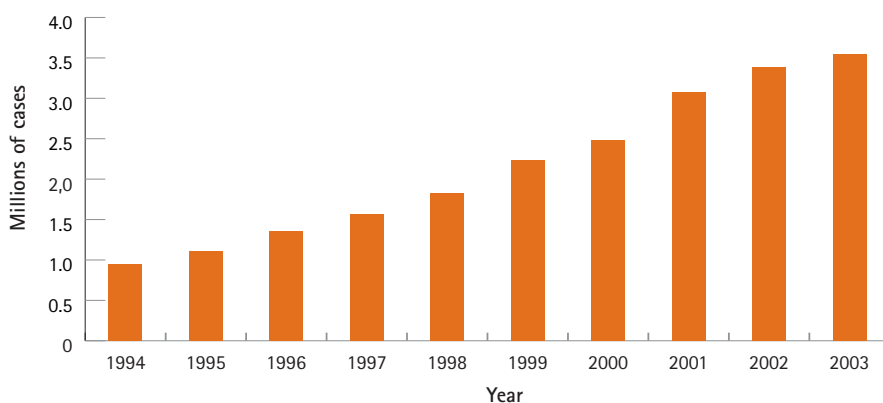
Kredittilsynet conducted 25 on-site inspections at ordinary debt collection agencies in 2004, and one IT inspection. Since earlier routine inspections have in some cases revealed serious flaws in accounting for and handling of client assets, most of the inspections were carried out at agencies in this category. Few serious violations were noted, however. Four agency licences and three personal debt collection licences were revoked in 2004. These were cases brought to light at an earlier stage and closed in 2004.

Breaches of fair debt collection practice

Inflicting unreasonable harm, inconvenience or pressure on someone represents a breach of fair debt collection practice under the Debt Collection Act. The Debt Collection Services Complaints Board went into operation on 1 April 2003, as a result of which Kredittilsynet now receives fewer written complaints against debt collection agencies. Although Kredittilsynet's remit does not include dealing with complaints of a routine nature, it continues to receive a number of complaints from businesses. These are dealt with in a supervisory context. The great majority of complaints concern the claim itself. A pertinent example is where a complainant states that the claim is not valid and that debt recovery proceedings should therefore not have been initiated, or that proceedings should have been stopped once the debt collection agency became aware that objections had been raised against the claim. In some cases information has been sent by the debt collection agency to credit rating agencies despite the objections raised, resulting in wrongful registration with debt rating agencies. This is a serious matter, and contravenes fair debt collection practice.

A significant number of complaints that were referred to the Debt Collection Services Complaints Board also concern disputed claims. As required by the statutes underlying the Complaints Board's activity, Kredittilsynet receives a copy of all decisions made by the Board, as well as other information coming to the Board's attention suggesting possible irregularities at debt collection agencies. Based on the information received, Kredittilsynet looked into some cases involving debt collection agencies in 2004. These cases concerned agencies' treatment of disputed claims, with some agencies apparently employing deficient routines. Kredittilsynet's investigation of these cases showed that although agencies may employ sound routines, which include the issuing of instructions to case-processing officers, they are not immune to human error. Debt collection agencies need to take human error seriously since it may inflict substantial harm and inconvenience on individuals and businesses. Kredittilsynet will give close attention to these agencies to ensure satisfactory debt collection procedures in this regard.

Chart 4: Number of debt collection cases received per year



Source: Kredittilsynet





money laundering and other issues

Money laundering

The Act relating to measures to combat money laundering of proceeds of crime etc. (Money Laundering Act) went into force on 1 January 2004. Revised regulations on identity control and measures against the laundering of proceeds of crime (Money Laundering Regulations) were concurrently enacted. The above legislation replaces the money laundering provisions of the Financial Institutions Act and associated regulations. The new body of rules essentially implements the EU's second money laundering directive (Council Directive 2001/97/EC), along with international standards in this field, notably the FATF's special recommendations including measures against terrorist financing. In June 2004 the Government presented its action plan for increased efforts against financial crime, and wants to see Norway play an active international role in this work. The new action plan will be implemented over a three-year period.

Enterprises outside the financial sector are being used for money laundering purposes to greater degree than previously. The new rules require auditors, external accountants, estate agents, lawyers and dealers in valuable objects (e.g. cars and antiques) to report to ØKOKRIM any suspicion that a client or customer is engaged in money laundering. Banks and other financial institutions were already required to do so. In April 2004 Kredittilsynet sent all supervised entities a circular (no. 9/2004) containing a guide to the new legislation.

2004 brought a positive trend in terms of the frequency of reports filed by the new categories of reporting entities included in the legislation. By the start of December, auditors had filed 18 reports, external accountants six reports and estate agencies one report. See also the chapters on *Banking and finance*, *Auditing*, *External accounting services* and *Estate agency*.

Safeguards and contingency

Maintaining a preparedness to deal with problems that may arise in the financial sector is defined as one of Kredittilsynet's objectives. The aim is to respond to possible crises in enterprises, infrastructure and markets with measures that limit harmful impacts and consequences for users, enterprises and owners to the greatest possible extent. This includes monitoring compliance with relevant statutory requirements. Priority is given to crisis preparedness focusing on activities etc., which could threaten financial stability. Contingency plans have been drawn up in all areas where such a threat could arise.

Importance is attached to safeguards and contingency facilities in the annual plan drawn up for the agency's activity. A new overarching contingency plan was drawn up in 2003 for dealing with any crisis arising within Kredittilsynet's own organisation. This work continued in 2004. A number of internal plans addressing safeguards in the broad sense already exist. These are also reviewed annually in connection with the review of activity planning. In 2004 Kredittilsynet's data servers were moved to securer premises, and a new back-up system was installed. An ICT security plan was also prepared.

IT supervision

Kredittilsynet conducted more than 20 IT inspections in 2004 at banks, insurance companies, finance companies, securities institutions, estate agencies, debt collection agencies and external accountants. IT inspections were also carried out at IT service providers and data processing centres under the ICT Regulations

section 12 on the outsourcing of ICT operations. The IT inspections were conducted in conjunction with the department responsible for IT supervision at Kredittilsynet. The inspections showed a continued need for measures in the areas of catastrophe planning, back-up solutions and testing, as well as a need for adequate risk and vulnerability analyses. Change management remains a key focus for supervision along with major change processes in connection with platform replacement, coordination following mergers and relocation of IT operations to other countries. The experience gained in applying the ICT Regulations as a tool for IT inspections has been positive. Even so, many enterprises still need to implement measures to bring them into line with the regulations. A new risk and vulnerability analysis was conducted again in 2004. This brought to light a new threat area in which banks' use of the internet as a service-distribution channel is particularly vulnerable to organised crime. As one of several preventive measures, a new obligation to report to Kredittilsynet was introduced in December 2004 with regard to payment systems. Efforts are also under way to further develop IT supervision arrangements and to adapt methods and tools to the new capital adequacy framework for banks (see the account of Basel II on page 29-30). The system for institutional reporting to Kredittilsynet is also being further developed.

Better information to retail customers in the financial market

A working group drawing participants from the Consumer Council, the Office of the Consumer Ombudsman and Kredittilsynet delivered a report entitled *Measures to improve the information available to end-users in the financial market* (strategic project no. 5) in the autumn of 2004. The project was rooted in a need to take a closer look at this information since many consumers find it difficult to gain an overview of products and services offered by banks and other actors in the financial market. Sound, properly presented information is essential to enable consumers to find their bearings among the various products and to make the right choice.

The working group recommended measures designed to make it easier to compare prices of loans, credit, savings instruments and non-life insurance. The establishment of an internet-based information database/portal for the financial sector with a view to enabling a better overview of various products is a key recommendation of the report. The Consumer Council will head the further effort to organise an information portal. The working group also recommends legislative changes. These include following up industry-stipulated guidelines on financial advice, harmonising disclosure rules in respect of loans and credit, and ensuring that changes in non-life insurance premiums are more clearly visible. The report is available in Norwegian on the websites of the above three agencies.

Appeals handling – Register of Company Accounts in the Brønnøysund Register Centre

Kredittilsynet is the appeals body in respect of penalties imposed by the Register of Company Accounts for late filing of company accounts. In 2004 562 appeals were received compared with 361 in 2003. The penalty was waived entirely or in part in 242 cases (i.e. 43 per cent) compared with 47 per cent in 2003. Kredittilsynet notes an increase in the number of cases handled in this area. Further increases can be expected as a result of a change recommended in the Accounting Act whereby all entities required to keep accounting records will be obliged to file their financial statements with the Register of Company Accounts. More resources will need to be allocated to this supervisory area.



International activities

Kredittilsynet played an active part in international forums in 2004. A key event was the decision of the International Monetary Fund and the World Bank to review Norway's financial legislation and financial supervision as part of their Financial Sector Assessment Program. Kredittilsynet has been actively involved in coordinating rules and supervisory practice on a global basis and in developing international standards. The work of the EU supervisory committees continued at a brisk pace, above all on the new capital adequacy framework (Basel II) and in the securities sector.

Integrated supervision model – development and collaboration

The integrated supervision model – entailing joint supervision of banks, insurance companies and in general the securities sector – continues to gain ground internationally. Since 1999 a number of integrated financial supervisory authorities have met informally each year to discuss administrative and technical matters of common interest. In 2004 the Conference of Integrated Financial Supervisors was hosted by the Monetary Authority of Singapore, which was the first authority in the world to establish integrated financial supervision. The 2004 meeting was attended by 16 countries¹. Topics discussed at this meeting

included supervisory authorities' adjustment to new tasks derived from new legislation, and comparison of staffing and resource use. Kredittilsynet, with its long experience as an integrated supervisor, is often asked to make its experience and expertise available to international courses and seminars for supervisory authorities in emerging markets. Moreover, Kredittilsynet regularly receives visits from foreign authorities wishing to share in Kredittilsynet's experience with integrated supervision.

Global collaboration

Securities market

Kredittilsynet is a member of the International Organization of Securities Commissions (IOSCO), which held its annual conference in Amman, Jordan, in May 2004. Kredittilsynet also attends the semi-annual meetings of IOSCO's European Regional Committee, and participates in a working group under the Technical Committee which deals with enforcement of IOSCO resolutions and collaborates on issues related to surveillance, enquiries, investigation and prosecution of criminal offences. Under an international Memorandum of Understanding (MoU) drawn up by IOSCO, supervisors have to meet certain criteria to accede to the MoU. Kredittilsynet is about to consider applying for membership. Kredittilsynet is also a member of the Enlarged Contact Group for Supervisors of Collective Investment Funds (ECG) which meets once a year.

Insurance

Kredittilsynet participates in the development of international principles for supervision of insurance by virtue of its membership of the International Association of Insurance Supervisors (IAIS), and in 2004 hosted quarterly meetings of the IAIS committees and subcommittees. The meetings, held on 22-25 June 2004, drew more than 120 representatives from 36 countries, more than any previous quarterly IAIS meeting. A joint meeting between the IAIS Accounting Subcommittee and the Executive Committee of the International Accounting Standards Board (IASB) was held in conjunction with the IAIS meetings. The Financial Stability Institute organised a seminar on risk management and risk transfer mechanisms ahead of the IAIS meetings, drawing participants from many countries.

The IAIS organised its eleventh annual conference in Amman in Jordan in October 2004, where the General Meeting of the IAIS adopted new principles on the supervision of insurance activities on the internet, standards for reporting non-life insurers' and reinsurers' technical results and risk, guidelines for investment risk management, guidelines related to anti-money laundering and terrorist financing measures, along with new IAIS by-laws. Themes presented during the conference proper included corporate governance, a panel discussion headed by Kredittilsynet's Director General, Bjørn Skogstad Aamo, accounting standards, risk-based supervision, disclosure obligations etc. Bjørn Skogstad Aamo has been a member of the IAIS Executive Committee for two years. Kredittilsynet is represented on several IAIS subcommittees as well as on the Technical Committee, which has overarching responsibility for standard setting.

Kredittilsynet attends meetings of the OECD Insurance Committee, and other meetings under OECD auspices, on a regular basis.

Occupational pensions

No international collaborative body existed for the supervision of pension insurance prior to 2004. For a number of years meetings of pension supervisors were organised by the OECD in conjunction with the meetings of the OECD Insurance Committee. In the summer of 2004 the OECD took the initiative to set up a new international body, the International Organisation of Pension Supervisors (IOPS), which Kredittilsynet has joined. The organisation counted about 24 members upon its foundation. The OECD secretariat acts as secretariat to the IOPS.

¹ The group now comprises the supervisory authorities of Australia, Austria, Belgium, Canada, Denmark, Germany, Hungary, Iceland, Ireland, Japan, Korea, the Netherlands, Norway, Singapore, Sweden and the United Kingdom. (Several of the new EU members have also integrated their supervisory authorities, among them Latvia, Malta and Estonia. The Netherlands formally established integrated supervision, under the central bank, on 1 January 2005. Liechtenstein is in the process of merging its supervisory authorities.)

Banks and financial institutions

No global forum on a par with IOSCO and IAIS exists for banking supervision.² The Basel Committee on Banking Supervision under the Bank for International Settlements (BIS) coordinates global cooperation on banking supervision. Kredittilsynet receives relevant documents from the Committee and is invited to comment on them, and to take part in some of the Committee's activities. The Basel Committee has worked for some time on revising the international rules for calculating banks' capital adequacy, which were finally adopted in 2004 (see page 29-30 in the chapter entitled *Banking and finance*). Every second year the Basel Committee organises the International Conference of Banking Supervisors (ICBS). The 2004 conference was held in Madrid, and was hosted by the Spanish monarch. Banking supervisors from 120 countries, including Kredittilsynet, attended. Kredittilsynet also attends meetings of the OECD Capital Markets Committee on a regular basis.

Cooperation on financial stability and macroeconomic surveillance

Developments in financial markets have led to closer international collaboration on financial stability and macroeconomic surveillance. Kredittilsynet and Norges Bank attend semi-annual contact meetings with the European Central Bank (ECB). Kredittilsynet has also attended meetings of a working group

under ECB auspices focusing on crisis management. Furthermore, Kredittilsynet sends a representative to meetings of the UN-coordinated Project Link, a macroeconomic analysis centre. Financial stability and crisis management were central themes at EU forums and a number of other international forums in 2004. Kredittilsynet is not a member of the Financial Stability Forum or Joint Forum, but keeps abreast of the work done under the auspices of these forums, particularly through its participation in the European supervisory committees.

Money laundering and terrorist financing

Kredittilsynet plays a part in developing national and international measures against money laundering and terrorist financing, and attends the meetings of the Financial Action Task Force on Money Laundering (FATF). FATF develops international standards against money laundering and has also in recent years worked on international guidelines to combat terrorist financing. Kredittilsynet is currently participating in the FATF Terrorist Financing Working Group and collaborates with the United Nations in this field. Kredittilsynet is currently participating in the European Council's evaluation of the Ukraine's money laundering measures. As part of this effort, Kredittilsynet is in touch with foreign embassies and attends international seminars. In 2004 Kredittilsynet attended a money laundering seminar in Nairobi as well as seminars under EU Commission auspices.

Cooperation within the EEA

New EU committee structure

New EU supervisory committees for banking and insurance (level 3) were established and went into operation in 2004 (see Kredittilsynet's 2003 annual report). A number of subcommittees and working groups have been set up under these committees, and aspirations are high.

The Directive formally establishing the new legislative procedures and committees on level 2 (ministerial level) was adopted on 22 December 2004. The Ministry of Finance and Kredittilsynet previously alternated in representing Norway at meetings of the EU Banking Advisory Committee (BAC) and Insurance Committee (IC). These committees will now be formally converted to new level 2 bodies known as the European Banking Committee (EBC) and the European Insurance and Occupational Pensions Committee (EIOPC). Meeting formats have been informally adapted to the new committee structure since the summer of 2004, and the Ministry of Finance has attended BAC and IC meetings in an observer capacity, while Kredittilsynet has attended as adviser to the Ministry of Finance. Where the European Securities Committee (ESC) is concerned, it was not considered necessary to have a representative from Kredittilsynet attend meetings of this body in 2004.

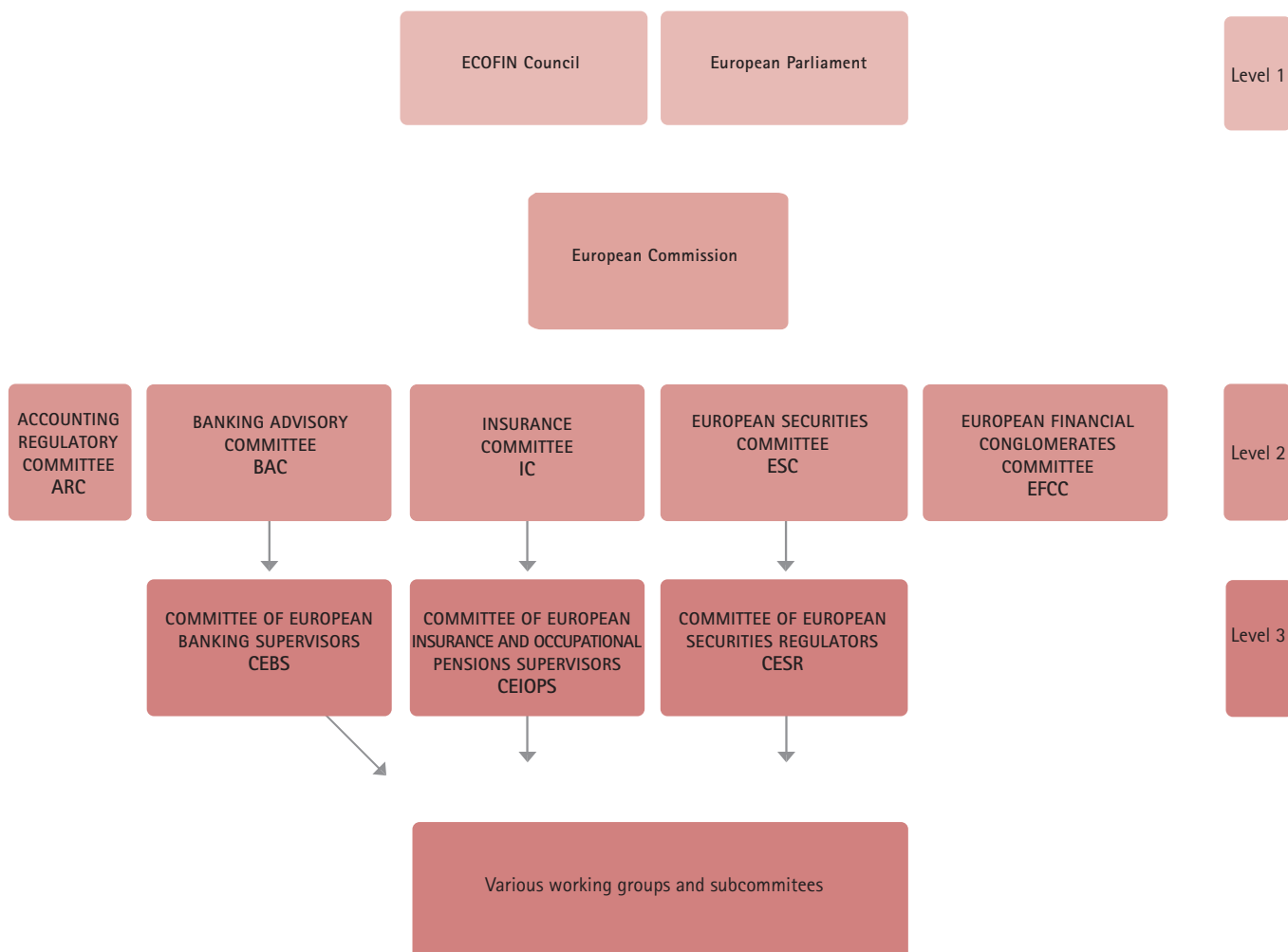
EEA securities market

Kredittilsynet attends meetings of the Committee of European Securities Regulators (CESR). CESR acts as an advisory committee to ESC and the European Commission, and works for consistent implementation of community law in member countries. Kredittilsynet plays an active part in CESR working groups. New working groups were set up in 2004, primarily in connection with the new Directive on Markets in Financial Instruments (2004/39/EC) (the previous Investment Services Directive). These working groups draft rules on market abuse and investment services, prospectuses, information requirements and asset management. One such group is looking into the possibility of harmonising clearing and settlement procedures. There were also several meetings of CESR's forum for information exchange on market surveillance (CESR-Pol), and for coordination of accounting and reporting rules (CESR-Fin).

Several legislative acts were adopted by the Commission under the Lamfalussy procedures in 2004. Two directives and a regulation pertaining to the Market Abuse Directive were adopted in December 2003. Further legislation pertaining to the Market Abuse Directive and the Prospectus Directive was adopted in 2004. See page 46.

² The Basel Committee comprises representatives from the banking supervisors and central banks of the following countries: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States.

Chart 5: EU financial architecture in 2004



Banks and financial institutions

The new banking supervisory committee, the Committee of European Banking Supervisors (CEBS), was established on 1 January 2004. Kredittilsynet attended all CEBS meetings in 2004 together with representatives from Norges Bank. CEBS established a secretariat in London in the summer of 2004, and most of its meetings will be held in London. CEBS has set up several working groups focusing, among other issues, on accounting and auditing, supervisory review and implementation of the new capital adequacy framework. One such group is looking into the merits of coordinating supervisors' procedures and routines for publishing information related to capital adequacy. In conjunction with the establishment of CEBS, it was decided that Groupe de Contact, the former liaison body for banking supervision, should continue as a separate group under CEBS and perform assignments for CEBS. Kredittilsynet has attended meetings of Groupe de Contact for several years, and hosted a Groupe de Contact meeting in Oslo in 2004. Within this forum, banking supervisors exchange information on a number of supervisory issues and

gain an overview of supervisory methods in member countries. Groupe de Contact has also set up a number of ad hoc working groups, and delivered several reports to CEBS in 2004.

Insurance

Kredittilsynet attended meetings of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). CEIOPS established a secretariat in Frankfurt in the summer of 2004. Kredittilsynet played an active part in establishing this new supervisory committee, and participates in all CEIOPS working groups and committees. Kredittilsynet chairs a working group charged with coordinating the supervision of insurance groups engaged in cross-border activities, based on a multilateral MoU. The Financial Stability Committee is working on a system to monitor financial stability in the insurance sector. A working group has also been set up to deal with supervisors' preparations for implementation of the Pension Fund Directive and to coordinate the cooperation between pension supervisors. Another working group has been assigned the same tasks in relation to

the new Insurance Mediation Directive. Given the extensive process expected ahead on reforming the EU solvency framework (the Solvency II project), a number of working groups have been established to put forward proposals for regulation related to insurers' solvency. These working groups are:

- Pillar I Life, focusing on solvency legislation for life insurers (technical provisions, capital requirements and internal models)
- Pillar I Non-Life, focusing on solvency legislation for non-life insurers (technical provisions, capital requirements and internal models)
- Pillar II, focusing on the supervisory review and internal control
- Pillar III/Accounting, which is to recommend rules on reporting and accounting
- Conglomerates and cross-sectoral issues, focusing on issues related to financial groups and consolidated supervision

The EU Commission still has a number of expert groups under the Insurance Committee in which Kredittilsynet participates although, strictly speaking, this should be the task of the Ministry of Finance under the new committee structure. The EU

Commission has extended invitations to attend a number of implementation meetings to discuss the interpretation of new directives and the practical implementation of Directive texts. In 2004 such meetings were organised in the context of the new Pension Fund Directive (Directive on Institutions for Occupational Retirement Provision, IORP) and the Insurance Mediation Directive.

Accounting and auditing

Kredittilsynet participates in the EU's elaboration of accounting rules and standards for auditors within the EEA, and attends meetings of the EU Accounting Contact Committee and the EU Committee on Auditing. In 2003 the EU adopted a regulation requiring EU states to introduce international accounting standards based on certain principles.

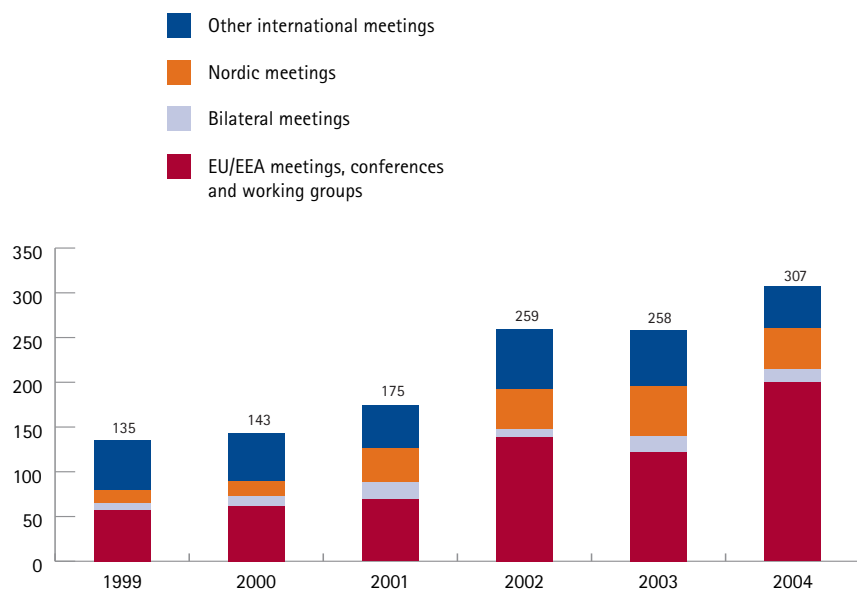
The regulation is incorporated in the EEA agreement (see the account in the chapter *Financial reporting supervision - listed companies* on page 48). A new body, the Accounting Regulatory Committee (ARC), responsible for assessing the new accounting standards, has been established in accordance with the regulation. Kredittilsynet and the Ministry of Finance attend ARC meetings.

EFTA cooperation

Kredittilsynet participates in EFTA's Working Group on Financial Services and EFTA's Working Group on Company Law. The remit of these working groups - which operate under EFTA's Subcommittee II in the EFTA pillar within the EEA structure - is to coordinate viewpoints and to incorporate legislative acts in the financial sector and in the area of company law (including accounting and auditing) into the EEA agreement. The working groups meet three or four times each year, and are also useful forums for obtaining updates on legislative developments in the

EU. EU Commission representatives are invited to each meeting to give presentations on a variety of measures and to give updates on the decision-making process in the European Council and the European Parliament. Together with the Ministry of Finance and Norges Bank, Kredittilsynet hosted a meeting of EFTA's Working Group on Financial Services in June 2004. A seminar was also held on the new Directive on Markets in Financial Instruments which was also attended by participants from the Norwegian financial sector.

Chart 6: International meetings attended by Kredittilsynet 1999-2004



Nordic cooperation

Nordic cooperation remains a priority despite the increasing cooperation both within the EU and EEA framework and on the global level. In addition to joint annual meetings of Nordic financial supervisors at director general and deputy director general level, Kredittilsynet's representatives attended several meetings with their Nordic counterparts focusing on supervision of Nordic financial conglomerates. The Nordea Group's plans to

convert its Norwegian subsidiary to branch status have prompted increased collaboration between the supervisory authorities, particularly with an eye to future supervision of the Nordea Group and distribution of supervisory responsibilities. Kredittilsynet hosted a meeting of Nordic insurance supervisors and a meeting of Nordic banking supervisors in 2004.

Bilateral cooperation and visits from abroad

The need for bilateral cooperation has diminished as a result of increasing cooperation on the global level, within the EU and EEA framework and in the Nordic region. Moreover, multilateral MoUs are employed in the insurance and securities field. Since no such multilateral cooperation agreement exists for the banking sector, Kredittilsynet has concluded bilateral agreements with banking supervisors in several countries. In 2004 Kredittilsynet visited Germany's financial supervisory authority BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) as part of its review of its own organisation.

Each year Kredittilsynet receives representatives of the Federal Reserve Bank of Chicago, the US banking supervisor responsible for Norwegian banks in the USA. Kredittilsynet received delegations from China, Korea and the Ukraine, among other countries, in 2004. Kredittilsynet was also host to several working groups and major events in 2004, including a meeting of the CEIOPS Helsinki Protocol Working Group (now the Insurance Groups Supervision Committee) in January, a Groupe de Contact meeting in May, an EFTA seminar and working group meeting, IAIS Committee meetings, the CEIOPS Working Group on Financial Stability, as well as Nordic meetings on banking and insurance. What required most attention and resources, however, was the visit by a delegation from the International Monetary Fund in October 2004 in connection with the Financial Sector Assessment Program (FSAP) review of Norway.

Table 17: International organisations and EU/EEA-related committees in which Kredittilsynet participates as a member or observer

Banking/finance

- ICBS (International Conference of Banking Supervisors)
- OECD's Financial Markets Committee
- BAC (EU's Banking Advisory Committee)
- CEBS (Committee of European Banking Supervisors) - www.c-ebis.org
- GdC (Groupe de Contact) (EEA banking supervisors - now under CEBS)
- Nordic supervisory meetings

Insurance

- IAIS (International Association of Insurance Supervisors) - www.iaisweb.org
- IOPS (International Organisation of Pension Supervisors)
- OECD's Insurance Committee
- EU's Insurance Committee
- CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) and working groups under CEIOPS - www.ceiops.org
- Conference of European Insurance Supervisory Services
- Nordic supervisory meetings
- Nordic-Baltic supervisory meetings

Securities

- IOSCO (International Organization of Securities Commissions) - www.iosco.org
- ECG (Enlarged Contact Group on Supervision of Collective Investment Funds)
- ESC (European Securities Committee)
- CESR (Committee of European Securities Regulators) and working groups under CESR - www.cesr-eu.org
- Nordic meetings

Accounting and auditing

- ARC (Accounting Regulatory Committee)
- EU's Accounting Contact Committee
- European Committee on Auditing
- Nordic meetings

Money laundering

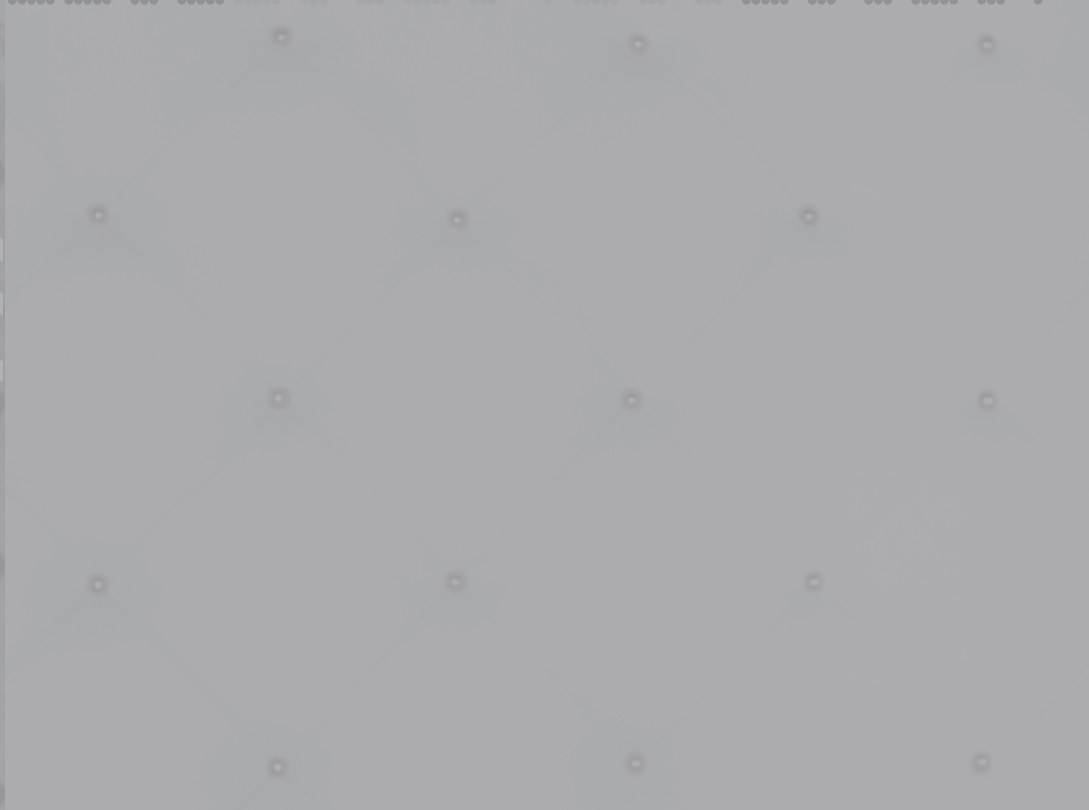
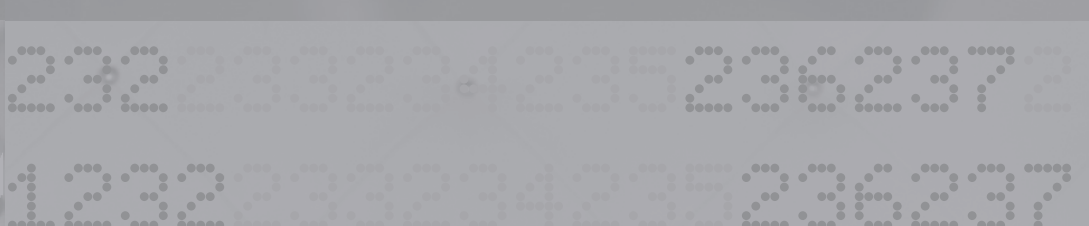
- FATF (Financial Action Task Force on Money Laundering) - www.fatf-gafi.org
- EU's Contact Committee on Money Laundering
- Nordic meetings

EFTA

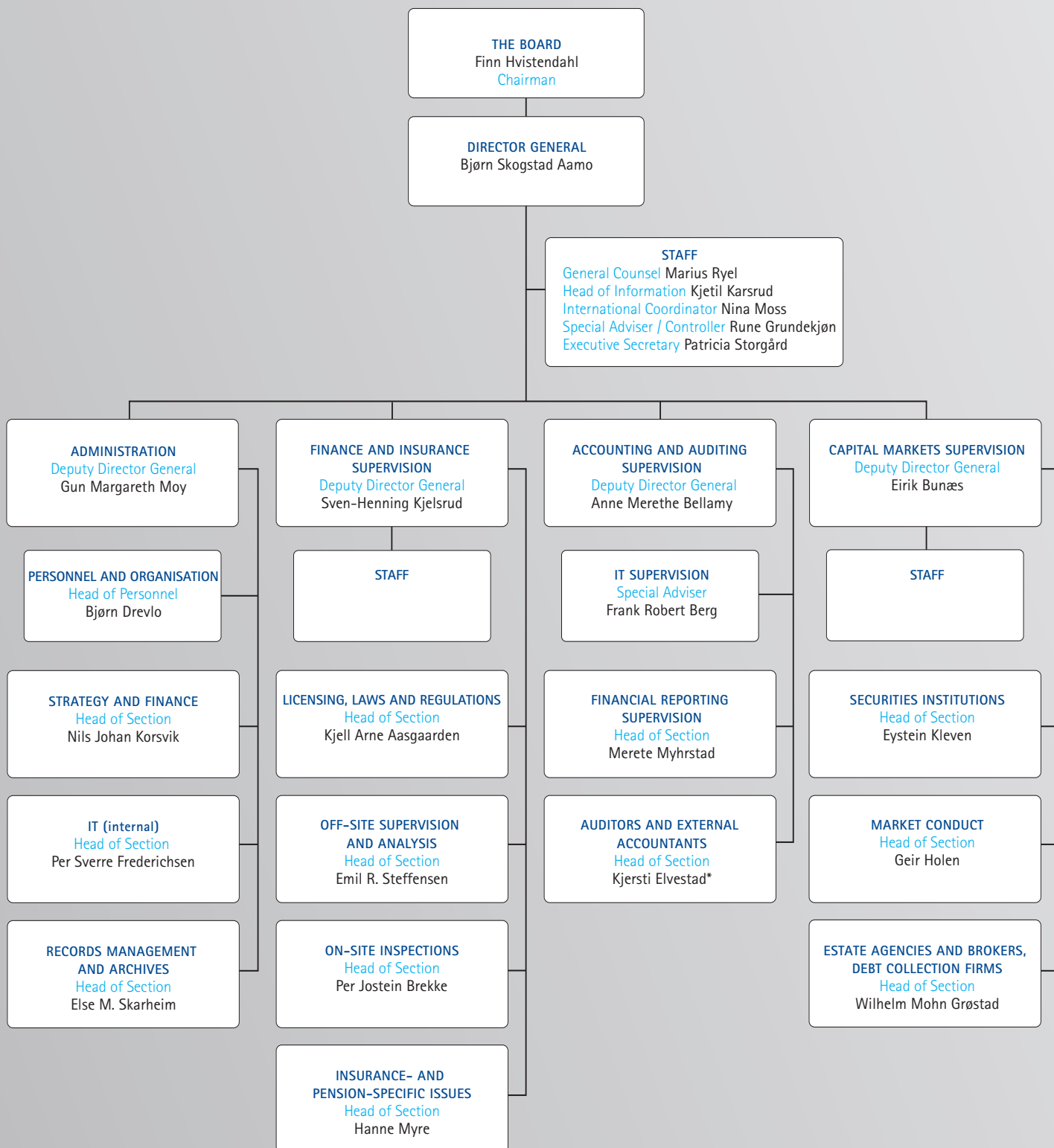
- EFTA Working Group on Financial Services
- EFTA Working Group on Company Law



12 9/18 - 10
13 JR. 5.5
1.59 JR. 28



Kredittilsynet's organisation



* From 18.07.2005
Organisation chart per 01.05.2005

The Financial Market in Norway 2004

Since 1994 Kredittilsynet has systematically analysed and assessed potential stability problems in the Norwegian financial market against the background of developments in the Norwegian and international economy. This is a necessary supplement to Kredittilsynet's ongoing supervision of individual institutions. Much of the assessment of individual institutions' profitability and financial strength needs to be carried out in light of the general state of the financial market. As from 2003 Kredittilsynet has given its view of the state of the financial market in a separate report. The report summarises financial institutions' results for the previous year in the light of general developments in the international and Norwegian economy, and assesses risks facing banks and other institutions in the financial market.

This year's report is available on paper from Kredittilsynet, and in electronic form at www.kredittilsynet.no.

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